

*Walt*

*Page 6 missing*

**NOTE TO READER:**

This stenographic transcript was typed at great speed and under considerable pressure to meet requests of newspapermen for copies of Mr. Eccles' address as soon after delivery as possible. It has not been edited. We ask your indulgence in overlooking errors of grammar and grammatical construction.

**NEW YORK STATE BANKERS ASSOCIATION**

From:

News Bureau  
New York State Bankers Association  
33 Liberty Street, New York, N. Y.  
H. H. Clarke, Director  
January 19, 1942

Address of Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, at the opening session of the Association's 14th Annual Mid-Winter Meeting in the auditorium of the Federal Reserve Bank of New York, Monday morning, January 19.

Mr. Donovan, My friends, Members of the New York State Bankers Association: It is a privilege and a pleasure for me to be invited to speak to this group. I have been in public office now for eight years, and this is the first time that I have met with the New York State Bankers Association. My colleague, Mr. Sproul, stated that he and you did not always agree with me. Possibly, and I might say that I haven't always agreed with the point of view of many of the bankers. That does not mean that you are right and I am wrong, neither does it mean that I am right and you are wrong.

I think that we are living in a world that requires a good deal of imagination, and I think likewise that it is very difficult to be entirely sure of just what may be right and what may be wrong. It depends a good deal on one's point of view.

I was asked to speak to you prior to Pearl Harbor. Since that time I have had much less heart to speak than I had prior to that time, feeling that it was more important to be ~~possibly~~ doing something, to be working, than to be speaking. It seems to me that we ~~possibly~~ have had too much talking, and I should like to see us in the future, all those in public office, do a little less talking, and a little more thinking and working.

I was impressed recently when I read an editorial in the Life Magazine by Henry Luce. I am ~~just~~ going to read a quotation from it, because it seems to me to ~~rather~~ set the stage for the kind of an attitude that ~~seems it is~~ ~~to me to be~~ necessary for all of us to have. It impressed me very forcefully and vividly with the realization of the situation that we are confronted with. He said, "There is terrible fighting to be done. Every true American will rise to take military arms or civilian action to seize conclusive victory. There is terrible fighting to be done. All of us will be in the fight, men, women and children, for this is total war, but let us never forget that the hardest fighting is done at the front by our soldiers and sailors. We have fighting men in the field and on the high seas. Thousands of soldiers and sailors in the Pacific are at this very hour facing death. We tell ourselves how young they are, how gallant, how brave. We salute with our hearts in our throat, with tears in our eyes, we pray for them, too, but also, day

after day we must be asking ourselves how good a chance we ~~have~~ here at home are giving them to fight and to live on. Are we straining every last nerve to see that help, arms, material, reach them as soon as possible. If they die, are thousands more like them in the long hard days to come? Will they die through any fault of ours?"

As bankers, we are only engaged indirectly in the field of the production of the munitions of war, but our job is just as important, it is just as essential, it is as necessary and as useful as if we were producing ships, and planes, and guns, and tanks. We occupy the position of leadership in our community. There is no group of men in this country who can exercise greater influence toward the problems of defense if they so will it than ~~do~~ the bankers.

I know that you are primarily interested in getting down to some of the practical aspects of the fiscal and the monetary job that is ahead. I agree, however, important as that may be, with what the President had to say in his budget message. He said there need be no fiscal barriers to our war effort and to victory. I should like to add this: that we do not propose to fall into the error of setting up the avoidance of inflation rather than the maximization of defense output as the supreme aim. The financing of this great effort is and should be made secondary. By that I don't want to minimize its importance. I do, however, want us to get the financing of the job in its proper perspective. I don't think that the effort of trying to avoid inflation should be the primary thing in our thoughts. In that effort we would not want to lose sight of the supreme aim of getting the manpower and the materials in the place where they can do the most good.

We have been gradually, and not so gradually, either, over the last year or so, adjusting ourselves to huge government expenditures, in comparison with what we thought in the past were huge expenditures. But what we have done in the past, when measured by the recent budget requirements, fades into insignificance.

To give you a comparable picture, in June of 1940, we were spending for our entire defense effort about \$150,000,000 a month. At the present time we are spending \$150,000,000 every three days. By the time we are carrying out the present program called for by the budget we will be spending \$150,000,000 a day. We must step up our present expenditures three times. We are called upon to spend for defense more than half of our entire national income, more than \$50,000,000,000. Up to the present time, we have had but little inflationary development. The reason for that is due largely to the fact that we had a great slack of both manpower and productive facilities that were not ~~work~~ being utilized to their capacity. Thus, during the past two years we have been in the process of building up our national income from around \$70,000,000,000 to around \$100,000,000,000, through the more complete and full utilization of our manpower and our productive facilities.

In that process, the people of the country as a whole made no sacrifice. As a matter of fact, the people generally have been better off, business included, than they have ever been. The standard of living, in spite of the diversion of a substantial portion of our production to defense purposes has risen. This, of course, cannot continue. When we reach a medium, or an ~~approx~~ approximate maximum of the utilization of our productive facilities and manpower, merely the expenditure of more money does not mean further prosperity or further increased production. It merely means inflation unless there is a diversion of private spending of all kinds, and private investment to that of

public expenditure.

No matter what the income in dollars of our people may be, labor, agriculture, and business, there is only going to be so much left over after the requirements of our war effort have been met. What is going to be left over is going to be increasingly less as the war requirements increase. It is therefore important that the funds available for the purchase of a diminishing supply of goods and services likewise be less, or that they be diverted into public financing.

The idea of increasing wages, income, agricultural income included, as the cost of living index goes up is a fallacious approach to the problem of inflation. It should be obvious to all of us that the standard of living cannot be maintained, and when an effort is made to increase wages, salaries and income to meet increased living costs, all we are doing is feeding an inflation cycle. You are increasing ~~the~~ purchasing power without increasing the supply of goods available, because that is something <sup>for which</sup> there is a limit.

I have heard -- and I know many of you have -- that the incomes of people should be adjusted in relation to their increased living costs. If that could be done, there would be no need of sacrifice on the part of anyone. Sacrifice means a reduction in your living standards, a surrender of the things that <sup>you</sup> have enjoyed in the past, ~~to the defense program.~~

The sheer size of <sup>the</sup> ~~the~~ program at first frightens us, ~~and~~ <sup>the danger</sup> and there are many who say that an inflation is unavoidable, that no such program can be undertaken and carried out without ~~dangerous~~ dangerous inflationary development. The problem of course isn't so much getting the money. Any government that is sovereign can get all the money that it wants. The problem is getting the money in such a way that the inflationary dangers are minimized, that the greatest amount of stability that it is possible to create under these conditions should be created. It is essential, it is necessary for the maintenance of morale. It is necessary in order to hold down so far as possible the cost of defense and hence the public debt.

There are two ways of getting the money to finance the defense program. One is through taxes, and the other is through borrowing. Both of these methods, of course, will have to be used in increasing amounts. \$100,000,000,000 national ~~income~~ <sup>income</sup> about the amount of our present national income, and that income will likely go to ~~possibly~~ \$110,000,000,000, maybe as high as \$125,000,000,000, depending upon the success of holding the price structure in line.

Any such ~~income~~ <sup>income</sup> as that normally gives to the people of the country a ~~great amount~~ <sup>great</sup> great volume of funds for new investment, ~~that would be after providing for a very great volume of consumers' durable goods, and that would be after paying very substantial taxes.~~ <sup>added for purchase</sup> It would seem to me that out of that national income we could collect \$25,000,000,000 to \$30,000,000,000 of taxes. Say the national income is \$110,000,000,000., which it may well be in the fiscal year '43, from next July to July '43, the period covered by the budget. That would leave from \$80,000,000,000 to \$85,000,000,000 after Federal taxes were paid. Any such national income as that certainly would make available \$15,000,000,000 to \$20,000,000,000 of savings that would normally be used for ~~good~~ investment. Due to the lack of raw materials, new investment by private industry, except for defense purposes, is almost out of the picture. ~~New housing except for defense housing, none defense housing,~~ is likewise

Capital funds

out of the picture. The funds that would normally go into ~~that type of expendi-~~  
~~ture~~ ~~on~~ ~~into~~ those types of expenditures, are available for the financing of the  
 defense program. Such a conversion would not be at all inflationary. There is  
 likewise the ~~at~~ large amount of funds that are spent by consumers for what we  
 speak of as consumer durable goods -- automobiles, the biggest item, frigidaires,  
 radios, vacuum cleaners, and the thousand and one items that are not going to  
 be available. The funds that would normally ~~out of such a national income as~~  
~~I have referred to~~ go into consumer durable goods should likewise be diverted.  
 If people, instead of diverting that part of their income that would normally  
 be spent for consumer durable goods, such as I have mentioned, undertake to  
 hoard those funds, or undertake to spend them in other ways for more clothing,  
 or food, than would normally be the case, then you may get an inflationary  
 development in that field of consumer goods.

However, if people generally would get along with the consumers  
 non-durable goods in about the amount that they normally get along with, and  
 would divert that portion of their income that would go into housing, into  
~~farm~~ furnishings, and not the consumer durable goods of various kinds, into  
 the Government bonds, Defense Savings Banks primarily, and if industry, in-  
 stead of diverting its revenue into plant expansion and improvement, were not  
 engaged in necessary defense activity, if investors who ~~have accumulated~~ are accumu-  
 lating savings of substantial amounts would invest what normally is available  
 for investment purposes in government securities, we can see that so long as  
 the Government is spending any such sum as they propose, industry and the people  
 of the country as a whole get those funds, and all that ~~it~~ is neces is for them  
 to make that sacrifice that we have talked so much, of making far less than is  
 being made by the soldiers and the sailors, and diverting those funds into  
 Government securities. And that, mind you, ~~is~~ after very high taxes are paid,  
 because we are not accustomed to having a national income of \$110,000,000,000,  
 and we fail to realize that the type of expenditure that the Government pro-  
 poses to make is going to maintain a national income at a point in excess of  
 anything we have every known, far in excess of anything we have ever known,  
 and therefore we can, the economy as a whole, pay perfectly huge taxes and  
 still have left over perfectly huge amounts available for investment, and still  
 have enough to get along with in so far as the basic necessities of life are  
 concerned.

I just wanted to give you that general picture so that you would  
 see that it is possible for us to pay perfectly huge taxes, and I am speaking  
 of the economy as a whole, and save billions and billions of dollars for defense  
 purposes without any real individual suffering.

The present budget picture calls for receipts in the next fiscal  
 year of approximately \$28,000,000,000, and this means under the present tax  
 law, it is estimated about \$19,000,000,000 will be collected by the Federal  
 Government in taxes. It means that we must collect in accordance with the  
 President's program approximately ~~\$1~~ \$9,000,000,000 of additional funds. The  
 proposal is to collect \$2,000,000,000 of that from Social Security, and to col-  
 lect \$7,000,000,000 from new additional taxes. That means that corporation  
 taxes, excess profit taxes, will have to be substantially higher than at the  
 present time. It would seem to me to indicate that excess profits will be al-  
 most a thing of the past, but I don't know why that shouldn't be the case. It  
 means that surtaxes on individuals will have to be increased.

If we would look at the Canadian and the British picture 79

we will get some idea of the amount of increase in taxes that will be necessary if we are going to collect one-half of our public expenditures in taxes. If we are spending over half of our national income and are going to collect one-half of that in taxes, then you can see about the kind of rates that are going to be necessary. It means there will be less exemption for inheritance and gift taxes. It means there must be higher rates in both of these categories. It means -- it would be my view, at least, that it should be done -- that the exemptions which are now \$1500 and \$750 should be further reduced, possibly to \$1200 and \$600. The exemption for dependents of \$400 will likewise have to be reduced. It will be my view that it would be more equitable, and would be more sound, to reduce those exemptions than it would to put in a general sales tax. I am unalterably opposed to a general sales tax. It is a regressive tax and not a progressive tax. It is based upon no principle of equity, no relationship whatever to ability to pay. There is a subsistence wage that is absolutely essential for the maintenance of health and morale in this country, and certainly an exemption of \$1200 for a married couple, or \$600 for a single person is not excessive, and that amount certainly is about ~~minimum~~ the minimum that is essential for food, shelter and clothing, even in a war economy.

The practical job of collecting income taxes seems to me to call for a withholding tax. Certainly where so many people will be subject to income tax as is now the case, and as would be the case even to a greater extent if the exemption is reduced as I have indicated, a withholding tax at the source would greatly lessen not only the expense of collecting the tax, but it would collect the tax at the time the income was received and would avoid the recipient of that income spending the funds only to find a year later, when the tax was due they didn't have the funds. It is essential, it seems to me, to have a withholding tax in order that the inflationary effect of the government expenditures would be reduced, by avoiding the lag between the expenditure and the time the taxes are paid.

If other taxes could be paid on a quarterly basis, even beyond the withholding tax, based upon estimates, it seems to me that that might likewise help to avoid the inflationary effect by the Government recovering as rapidly as possible some of the expenditures that it would be making.

I have always had in mind that the withholding tax would be deducted from the income tax that would be due in the following year. For instance, whatever revenue bill is passed in 1942, the income tax under that revenue bill would fall due in 1943. If the exemptions, as I have indicated, are reduced, and if the income tax rates are increased, then whatever revenue, or whatever tax ~~was~~ that would call for in '43 would be lessened by the amount of any withholding tax that had been collected in the year 1942. ~~That~~ ~~seems to me~~ If we are going to avoid a sales tax, such a proposal as that would seem to me to be one of the practical and equitable ways of meeting the problem. I think that there has got to be an increasing amount of what I call excise taxes, rather than a general sales tax. The excise tax should be applicable to those goods in particular that are needed for defense purposes. On those goods where the amount available for civilian supply is very restricted, an excise tax would dampen the demand for those goods. But to put an excise tax on essential foods, on rents, on essential clothing, on drugs and medicines that are essential, it would seem to me to be unwise and inequitable.

I know the fooling of business generally has been in favor of a

that they are not spending that income and hence the demand for a reduced supply of consumer goods, as well as capital goods, will be available for the defense program.

We have at the present time in the banking system already created what I speak of as deposit currency, as well as actual currency in circulation, very close to \$50,000,000,000. That is almost double the amount of funds that we had in 1929. Those funds, of course, are owned by our depositors. The bank does not loan those funds. The banks loan their excess reserves, or they loan funds that they may borrow from the Federal. The owners of those funds -- and I am not speaking of the savings funds.; I am speaking of the demand deposits which at the present time have a very low, or what we term a slow velocity. I am speaking of the great amount of currency that is not being utilized, a lot of it is hoarded. I would like to see those idle funds and idle currency, so far as possible invested in Government securities. It is true that they do not create inflation so long as they are lying idle, but they are a potential inflationary threat, and if they are not utilized, it will become necessary for the banks to do more and more of the Government financing and to the extent that they do, they increase the total supply of deposit currency. It is that process that is fraught with danger. An increasing supply of the means of payment with a diminishing supply of consumer goods made available on the market, means the problem of inflationary control becomes more and more difficult, and a point may well be reached where the potential deposits and currency that are now idle may get into circulation, get into use, and the people who are the owners of the funds might well begin to lose confidence in the purchasing power of their money and start to run from money into goods. That, of course, is a danger that we must avoid, and the way, as I say, to avoid that danger is to avoid increasing the total volume of funds and devise ways and means of utilizing the existing funds over and over and over again, as you turn them to the Government, and the Government puts them back into circulation, and they go into the banks, and as the owners of the funds invest them again in Governments.

That is what we term the velocity of funds, and with our present volume of funds, given that kind of a velocity, a very much larger portion of the public debt can be financed outside of the banks than I think is generally believed. We must devise securities that are going to meet the requirements of the owners of these funds. Our three types of Baby Bonds have gone a long way to meeting the demand of a certain group ~~of investors~~ or type of investor. I think that we have to devise further tap issues to meet the demands of very large investors, and particularly institutional investors and corporations aside from the banks. So long as we ~~mainly~~ rely almost entirely, outside of our Defense Bonds, on market issues, the banks are going to be large purchasers and holders of Government securities. That ~~method~~ ~~it~~ seems to me to be more inflationary than if we can divert the financing directly into the hands of the investor who is going to hold the securities as a permanent investment.

It is with the cities, counties and states collecting possibly more taxes than they have ever collected before, because they are collecting delinquent taxes, and their current tax collections are high. They should curtail to the fullest possible extent the expenditures for new capital expenditures and also maintenance expenditures, and you bankers in every community can encourage your public officials to maintain their taxes, not reduce taxes, because to the extent that they do, they are working directly against the Government program of increasing taxes. They should maintain their taxes, and they

should use their revenue for paying off their public debt at a time when the Government can't pay off but must expand. That would be deflationary and would tend to offset the increase in the government debt if every city and county within the country would pay off some of their debts; if they likewise would take their surplus funds in case they have a debt and use those funds to purchase Government securities, that would likewise be of great assistance.

There are many of them with surplus funds that can't buy in their own bonds, because they are selling at a premium, and many of them can't buy those bonds at a premium. Therefore, they need some sort of tap issue that is available to meet their investment requirements. There are a great many corporations who are not engaged in ~~any~~ dense activity, and they are talking depreciation and depletion, and they can't reinvest their funds in rehabilitation and maintenance of their properties, because the allocations and priorities make it difficult to get materials. Those reserve funds should likewise be invested in some form of tap issue designed to meet their requirements. Many of the corporations at the present time have large unused balances, representing profit, and likewise representing uninvested reserves of many kinds. Those funds should be invested in a ~~tax~~ short term tap issue that would be readily available so the funds would be readily available to them.

We likewise have many concerns that are going to have to either close up, or many of them will have to operate on a very restricted basis. In that case, their inventories will greatly decline, and their accounts receivable will greatly decline, and they will have working capital from those sources.

We have estates that are waiting to be liquidated. There are trust accounts of various kinds. There are funds in the hands of universities and churches, and numerous organizations that are not willing to go into a long term market issue which they feel is subject to a fluctuation in value. They don't want to speculate on ~~what~~ market issues. They want a place to put their funds that will give them some return, and where they can get those funds in reasonable time if they need the funds.

I have suggested that a short term tap issue be put out, that might run two years, three years, four years, five years, that would have, say, a coupon on it of one rate for the first six months, a little higher rate for the second, a little higher rate for ~~the~~ the third, higher rate for the fourth, and so on, with an average rate depending upon the period in which the tap issue was permitted to run, such an issue to be a non-negotiable issue, to be available not to the banks but to other investors, that it be issued in amounts of, say, not less than \$1000, and that at any interest payment date, upon 30 days' notice, it could be cashed in. That would give the holder of a security of that sort a six months' investment, or a three or five year investment, depending on how long they wanted to carry it, and there would be no loss in principle, there would be no depreciation. They would get an interest return based upon the time in which the Government was permitted to use the funds.

It has seemed to me that there are possibly \$7,000,000,000 or \$8,000,000,000 available in funds in the banks for that sort of an issue. You may say, "Well, we don't want to lose these funds." The point is, you don't lose the funds, because the funds will be coming ~~back~~ right back to you as fast as they are going out. The funds that the depositors in your bank invest in Government securities, the Government immediately spends those funds. They



never have a balance of more than \$2,000,000,000 on hand, and they are spending the funds as fast as they are getting the funds in, and the banking system as a whole is really not losing funds. So that it would seem to me that that sort of an issue, added on to the existing defense savings bonds, would go a long way to meeting another type of investment demand.

Then we could have a long term tap issue, say a 15-year,  $2\frac{1}{2}$ , which would merely be an extension of the 12-year series G without the limitation of \$50,000, which would be available to the institutional type of investor, such as our insurance companies, savings institutions, savings departments of commercial banks, on some limited basis. In other words, I am not wedded to any particular type of issue, but it does seem to me that we must design our financing to meet the requirements of the investor, every type of investor, that we must try to bring in all of the funds from every possible source that we can, and then ~~keep the market~~ if ~~like~~ with the type of Government financing that has been indicated, with the kind of a tax system that has been indicated, the Government is not getting sufficient funds to take care of its current outgo, the banks should be used, and an offering should be made to dealers and the banks of short term securities, up to 8 and 10 year bonds. Those would be market issues, the banks to be favored in the allocation. We would depend entirely on the banks to take that issue largely, because that would only be the last resort. That would be the type of issue that would be given to the banks. That doesn't mean that it would necessarily exclude other investors, financial institutions, who preferred a short market issue. But if the requirements of the investor are met as I have indicated, there would be less demand for heavy oversubscriptions and padding and so forth of market issues, and the effort would be to put the market issues into the hands that were going to hold them, into the hands of those where you expected them to go.

I have talked on here for rather an extended period, and I don't know ~~am~~ whether I have made my point clear to you or not. I think, in summing up, however, that it should be obvious that, first, we have an unprecedented program of financing; secondly, that the financing can be done, and the importance of it is the way in which it is done, in order to avoid the inflationary effects of it.

I have tried to indicate to you the way in which I think it can be done, by a proper system of taxation, and a devising of our financing so as to utilize the banks to a minimum and to tap existing funds or savings funds as they are created through various forms of tap issues.

There are just two <sup>other</sup> things that occur to me that I want to mention. One is, there seems to be abroad the idea that the Government is going to force people with funds to invest in Government securities, and there has been some currency hoarding, I think, as a result of some people feeling that their funds might be forced into Government securities. There never was a more fallacious rumor. There is not the remotest indication or desire, I am sure, on the part of the Government to force those with deposits in banks to invest those funds in Government securities. What the Government is primarily interested in is to induce people to save currently. It is more important that the current income be invested in the Defense Bonds than it is that existing funds be drawn out of institutions that already have those funds invested in bonds. People have not done their duty merely by drawing out their funds from insurance companies, or drawing funds out of a mutual savings bank, and investing them in bonds, and continuing to go on living just as they have always lived.

They have done nothing, because the institution has those funds largely invested and they served no useful purpose whatever. What the Government really wants is for people to take the current income that normally would be spent and put these funds into Government securities, and do without the goods that they normally would spend their income on. That is a very important point to be made, and it is up to the bankers, it seems to me, to do more of an educational job in that field than has been done. If the people are made to realize that factor, there possibly will be less of a feeling that the Government is going to force them to invest the funds that they already have in an institution.

In closing, I am going to refer again to this article by Mr. Luce, the editorial he wrote, because I think it is, of course, easy in the workaday world in which we all live to see the romance, the glamor, but we are not conscious of the immediate fighting, and it is so easy to get back into our habits of thought which we have had under which we term normal times. We would like to go back in our thinking to orthodoxy. We would like to go back to the days of the 20's, or the days prior to the first war, and I think we have got to constantly jar ourselves to get out of that habit of thought, and to try to realize the new world that we are living in, and to think primarily of the kind of world that we want to live in, that we expect we might live in when this great effort that we must all undertake is over. This was an inspiration that Mr. Luce at least gave me, and I think it might give it to you. He says, "For this our America was made. Uniquely among the nations America was created out of the hopes of mankind and dedicated to the fulfilment of those hopes. It is for this reason that we accept only two alternatives, either to die in smoking ruins of a totally destroyed America, or else to justify forever the faith of our fathers and the hopes of mankind. Years ago, Woodrow Wilson begged us not to break the great heart of the world. We go forth now from a half beleaguered continent to join hands with all men everywhere, and by our character and our deeds to write with them the happy and triumphant songs of a new world."