Address of Marriner S. Eccles, Member of the Board
of Governors of the Federal Reserve System,
at a Luncheon of The Executives' Club of Chicago,
Grand Ballroom, Morrison Hotel,
Chicago, Illinois, March 2, 1951.

For release upon delivery,
Friday, March 2, 1951.

Adequate defense against Communist aggression calls for more than powerful military forces and strong allies. It also calls for sound domestic economic policies that will assure the preservation of our free democratic institutions. More specifically, it calls for the prevention of further inflation which erodes the savings of the people, impoverishes all recipients of fixed incomes, destroys incentives to productive effort, corrupts the moral fibre of the nation, and in the end destroys the very system which the defense effort is designed to protect. Defense of the free nations of the world and defense of the dollar are equally compelling.

The dollar cannot be defended for long, if at all, with a harness of direct controls - we all know what happened to its purchasing power during and after the last war. We should have no illusions about the effectiveness of such direct controls. They attack the symptoms, not the basic causes, of inflation. In the absence of adequate fiscal and monetary measures to curtail buying power in the hands of the public, imposition of direct controls for the prevention of further price increases merely postpones and delays inflation, but does not prevent it. If demands of businesses and individuals supported by money and credit had not exceeded the available supplies of goods and services, prices could not have advanced so rapidly since Korea. You cannot divert labor and material from civilian to defense production and avoid inflation unless you divert a corresponding amount of financial resources from the civilian economy.

The only way that the purchasing power of the dollar can be preserved is through a tax program that will keep the Federal cash budget in balance as long as inflationary pressures exist, and through monetary and debt management policies that will effectively regulate the expansions of bank credit in relation to the total output of goods and services. Adoption of such policies, together with the maintenance of an adequate amount of savings by the public, will bring about the necessary balance between civilian demands for, and the available supply of, goods and services. A pay-as-you-go tax program by itself is not enough to defend the purchasing power of the dollar. During 1950 the Government operated on a cash budgetary surplus; despite this, wholesale prices advanced roughly 16 per cent during the year. The inflation is due, therefore, not to Government spending more than its income, but to excessive spending by the public, a substantial part of which resulted from new money created by bank credit.

To a great extent, this expansion in bank credit was made possible by the Federal Reserve's purchase of Government securities in the market at fixed prices. Such purchases provided the commercial banking system with reserves that formed the basis for a multiple expansion of loans and deposits. Despite the rapid increase in bank loans since Korea, and the inflationary impact of this credit on the economy, the policy of purchasing Government securities at the will of the holders at fixed prices has been continued. Such action by the Federal Reserve does not assure confidence in the credit of the Government. The credit of the Government is determined by the willingness of the public to buy and hold Government securities. A policy that results in continued monetization of the public debt in time of inflationary pressures leads to destruction of the Government's credit by depreciating the value of the dollar.

Continued support of Government securities at fixed prices, some above par, makes call money, or interest bearing currency, out of the marketable public debt. If these conditions are to prevail, there is no justification for the various issues of marketable Government securities, with their wide variation of maturities and interest rates. Why should the Government discriminate against holders of savings bonds by paying them less interest if they cash them prior to maturity, when it requires that the holders of marketable bonds be protected against any loss of principal or interest if they sell them before maturity? Why should they be called marketable when their prices are not permitted in any degree to reflect market demand?

The Federal Reserve System has been accused of seeking higher interest rates, which primarily enrich the banks and other corporate holders. The Federal Reserve is not interested in higher interest rates as such, but only as they help in curbing the sales of Government securities which add to the reserves and deposits of the banking system. In order to curb such sales of Governments, it is necessary that the market for them become more self-supporting and less dependent on Federal Reserve purchases. The incidental result of such a development, under current conditions, will be somewhat higher interest rates.

This does not mean, as has sometimes been suggested, that the Federal Reserve favors a completely free market for Government securities. The responsibility for maintaining an orderly market that will assure the continued success of Treasury financing has long been recognized and publicly proclaimed by the Federal Reserve System. Let us not confuse the issue - an orderly market, in which the demand for and supply of Government securities are permitted some freedom of action in order to determine what the real public market is, is not the same thing as maintaining a fixed pattern of rates irrespective of inflationary conditions.

If the Federal Reserve became a more reluctant buyer of Government securities, the market for such securities would in no sense get out of hand. These securities are held mainly by large institutional investors who need the income from them. I strongly believe that if the marketable securities eligible for purchase by non-bank investors bore a somewhat higher yield, such investors would be less willing to sell the securities they now own and more willing to take new or refunding issues.

While the maintenance of an orderly, as contrasted with a pegged, market may result in some increase in the interest cost to the Government, such increase would be nominal as compared with the effects of a further depreciation of the dollar. Only that portion of the debt which is refunded or converted each year would bear the higher interest rate. The additional interest cost on that portion of the public debt which may be refunded or converted during the next few years would be very small indeed compared with the added cost of inflation to the Government, if monetization of the public debt is allowed to continue. As a matter of fact, the increased interest cost on the marketable debt would be less than claimed, since the Government will collect in taxes more than half of any additional interest which it pays to holders of its securities.

We must, above all, be realistic in formulating and assessing the effectiveness of debt management policies at the present time. We are not starting with a clean slate. We must recognize the size, structure, and distribution of the public debt. There are a great many different types of Government obligations outstanding which are held by various classes of investors. Consequently, increases in yields on market bonds must not be permitted to adversely influence the very large number of savings-bond holders.

While the establishment of a freer but orderly market for Government securities is essential to curb further sales by banks and other institutional holders, the moderate changes in interest rates permissible in view of the debt structure may not prove to be a sufficient deterrent, especially in the case of banks, which largely hold short-term securities yielding from 1-1/2 to 1-3/4 per cent. In that event, Congress will have to authorize supplementary authority to increase reserve requirements or some other form of controlling reserves of commercial banks so as to limit their sales of Government securities to the Federal Reserve for the purpose of expanding their loans and investments.

So far as the disagreement between the Treasury and the Federal Reserve System is concerned, it is not a matter of personalities, but what appears to be a conflict of responsibilities. The Treasury's primary responsibility is that of financing the operations of the Government at the lowest possible cost at which it can induce the public to buy and hold its securities. The Federal Reserve System, as an independent agent responsible to Congress, is charged with the responsibility for regulating money and credit in such a way as to contribute to the maintenance of economic stability. Ordinarily there should be no conflict between the objectives of these two agencies of the Federal Government. However, a conflict has arisen during the postwar period, and particularly since Korea, over continuance of the cheap money policy of the wartime period of heavy deficit financing, despite the existence of budget surpluses and inflationary pressures since the war. These inflationary pressures have been due in large measure to credit expansion by the banks, based upon reserves obtained through the sale of Government securities to the Federal Reserve System because of its support of the Treasury's cheap money policy.

It is not the responsibility of the Federal Reserve System at a time like this to underwrite the public debt at fixed prices, but rather to do everything in its power to curb further expansion of the money supply and further depreciation in the purchasing power of the dollar. Therefore, the Federal Reserve System should not continue to support the market for all Government securities at present prices. If the Congress does not want the Federal Reserve System to carry out its present statutory responsibilities it should repeal or redefine its powers. Until such time as it does, the System has no choice under the present impact of inflationary pressures but to use its powers in a manner consistent with its responsibilities to the public as well as to the Treasury. To do otherwise, would be to fail in its public duty and would not be in the real interest of the Government. A greater degree of independence on the part of the Federal Reserve System is long overdue.

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March 2, 1951

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EXECUTIVES' CLUB NEWS

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Marriner Eccles Urges a Balanced Budget and Foreign Policy the Nation Can Support

Marriner S. Eccles speaks at luncheon meeting Friday noon, March 2

Mr. Eccles is photographed at the speaker's table with (left to right) A. W. Peake, Clifford S. Young, Frank G. Anger and President Coulter.

PRESIDENT COULTER: It is now my privilege to turn the meeting over to our Director and Program Chairman, Mr. Frank G. Anger, who will introduce our guest speaker. (Applause)

MR. FRANK G. ANGER: Back in the nineteen thirties, when the economic pulse of the nation was low, the monetary doctors prescribed sizeable doses of a stimulating fiscal liquor called "inflation". Successive doses of the medicine seemed to quicken the blood stream of commerce and induce an aura of well being in the patient.

Here at last, it was thought, is a painless cure for all economic ills and increasing amounts of inflation accompanied our preparedness program—the hot war and the cold war which followed.

Unfortunately, it turned out to be habit forming, so even in the past few years, when we needed it the least, we have continued to imbibe to the point where many are genuinely concerned about the ability of the country to survive this seventeen year monetary binge.

For all these seventeen years, Marriner Eccles has been a member of the Board of Governors of the Federal Reserve System. He has spoken out clearly and vigorously at the time of every crisis, recommending adoption of the correct fiscal medicine. His advice was taken all too infrequently.

He came to Washington as Assistant to the Secretary of the Treasury in 1934 from Utah, where he had organized and headed a holding company owning and operating 28 banks in Utah, Idaho and Wyoming.

His wide business experience includes directing companies in such diversified lines as lumber, sugar, milk products, implements and hotels.

Within a year he was appointed a member of the Federal Reserve Board and was designated as its Chairman in 1936.

Mr. Eccles' outspoken criticism of monetary policies resulted in Mr. Truman appointing another as Chairman in 1948. Instead of returning to his extensive interests in Utah, Mr. Eccles decided to remain as a member of the Board to continue his fight in defense of the dollar. One of the skirmishes in this continuing fight currently in the headlines is his disagreement with the Secretary of the Treasury over the Treasury's easy money policy.

Had we followed the suggestions of Mr. Eccles over the years we would have a dollar worth more than its current value of 58 cents, and would have prevented the injustice that has been perpetrated on the saver, the bond buyer, the life insurance purchaser, and the person on fixed incomes.

He is convinced that we should make a determined stand at this late date to prevent a further needless decline in the value of the dollar and avoid the greatest internal threat to our free economy —more inflation.

Our Next Program

FRANCIS P. MATTHEWS

Secretary of the Navy

March 16, 1951 — Grand Ballroom, Hotel Sherman

EXECUTIVES' CLUB NEWS

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We are glad to again welcome you to our forum, Mr. Governor, and hope that you will continue your valiant efforts until the battle for fiscal sobriety is won.

Gentlemen—The Senior member of the Board of Governors of the Federal Reserve System . . . Mr. Marriner S. Eccles. (The audience arose and applauded)

MR. MARRINER S. ECCLES: President Coulter, Mr. Anger, Members of the Executives' Club of Chicago, and Distinguished Guests: After listening to that, I would say, eloquent introduction, I think maybe anyone staying in Washington seventeen years is entitled to that kind of an introduction. (Laughter)

But I was reminded of the Italian who was driving a calf along the highway and an automobile came along and honked the horn. There happened to be a bridge. The calf jumped off the highway and into a stream and was drowned. The Italian shrugged his shoulders, and he said, "Too biga de horn for so smalla de calf." (Laughter)

HIGH SCHOOL SENIORS HEAR ABOUT INFLATION

Representing high school seniors at the Club luncheon last Friday, were ten boys and their District Superintendent, Mr. Peter B. Ritzma. The boys attended a reception for the guest speaker, Mr. Marriner Eccles prior to the meeting and there they were able to ask questions informally of Mr. Eccles.

Richard Hunt	Austin
Roy Batista	Austin
Richard Koebetz	Crane Technical
Steve Maychszak	Crane Technical
Rony Brodnicki	Farragut
Eugene Stunard	Carter H. Harrison
Carl Kramp	Carter H. Harrison
Warren Liebman	Marshall
Leon Cohen	Marshall
Clifton Jordon	McKinley

When I was here nearly three years ago, we were confronted with problems—we thought. But by comparison with the problems we are confronted with today, they seem somewhat insignificant.

At that time, if you will recall, we were very much concerned about the problems of the increased cost of living or the decreased purchasing power of the dollar or what we call inflation. We were also very much concerned about the world situation which I think most students of the economic situation considered primarily responsible for our inability to deal more adequately with the domestic situation.

I remember at that time that I quoted to you people—and I am going to quote it to you at this time—a statement from General Dean who had headed the military mission to Moscow during the entire period of our alliance with the Soviets.

This is what he said, and I quote: "If the record up until the end of the war was not sufficient to clarify the Soviet intentions, certainly all doubt should have been dispelled by February, 1946, when Stalin reaffirmed the doctrine of Marx and Lenin in exhorting his people to extraordinary efforts in the preparation for the inevitable wars which must be expected so long as capitalism exists.

"In a sense, we are fortunate that the issue is so clearly drawn. Never before in our history have we had so much advance warning of the peril which confronts us. Never has it been more important to take preventive measures to avoid the dangers which lie ahead and to prepare to overcome them if they prove to be unavoidable. This is going to require American leadership which is crystal clear as to our own objectives and which is supported in pursuit of them by a unified public opinion. Most important, we must not adopt a program which is designed to defend our American way of life passively, but offensively, to counteract constructively those forces which threaten us."

The psychiatrists say that one should never regret the past nor fear the future, but live usefully, happily and effectively in the present.

I think it is extremely difficult for any thoughtful or enlightened person not to regret our failures of the past, particularly in the international field when today we are confronted as a result of those failures with the very problems of life and death.

As to not having some fear for the future, that is also difficult to ask of every one in the light of the situation that we are confronted with, not only domestically but internationally.

I do not want to appear before you and deliver a speech of recrimination, nor do I want to appear before you and not try to offer something, at least, that I consider constructive; something helpful to business and professional men, such as you are, leaders in this great city, in this great area of the United States.

I do not pose as an expert on foreign policy, nor as a military expert, nor for that matter, as an expert on anything. However, as I review the situation that the experts have led us into, I must say that I would not be too venturesome if I at least offered some ideas and suggestions.

There are other leaders I have in mind—President Hoover, Mr. Taft and others—who are certainly not military experts, who yet, I think, have offered some views that make, to my way of thinking, a lot of sense. (Applause)

Program to Prevent War

I was one of those, when I came before you three years ago, who advocated an enforcement of the conditions of peace upon the Russians at the risk of war while we had a monopoly over the atomic bomb, a great strategic air force, and

GUESTS AND MEMBERS AT SPEAKER'S TABLE, MARCH 2, 1951

Mr. Graham Trippe, *President,* Trippe Manufacturing Company

Mr. David H. Reimers, *Chairman of the Board and President,* The Live Stock National Bank of Chicago

Mr. Jack C. Luhn, *President,* The Easterling Company, and *Director,* The Executives' Club of Chicago

Mr. E. C. Harris, *First Vice President,* Federal Reserve Bank of Chicago

Mr. Lyle R. Allen, *Vice President and Controller,* Horder's, Inc.

Mr. A. Fletcher Marsh, *President,* Marsh and Truman Lumber Company

Mr. Oliver O. Smaha, *District Chairman of the Chicago-Central District,* The Borden Company

Mr. Robert L. Scott, Jr., *Vice President,* Carson Pirie Scott and Co.

Mr. John W. Severs, *Vice President, Finance and Accounting,* Chicago, Milwaukee, St. Paul and Pacific Railroad Company

Mr. J. Vincent O'Neill, *President,* Mercantile National Bank of Chicago

Mr. Paul C. Clovis, *President,* The Twentieth Century Press

Mr. Bertram J. Cahn, *Chairman of the Board,* B. Kuppenheimer and Company, Inc.

Mr. John D. Allen, *President,* Brinks, *Inc.*

Mr. H. V. McNamara, *President,* National Tea Company

Mr. Philip R. Clarke, *President,* City National Bank and Trust Company of Chicago

Mr. Thomas H. Coulter, *President,* The Executives' Club of Chicago

Mr. Marriner S. Eccles, *Guest Speaker*

Mr. Frank G. Anger, *Vice President,* Chicago National Bank, and *Director,* The Executives' Club of Chicago

Mr. Clifford S. Young, *President,* Federal Reserve Bank of Chicago

Mr. A. W. Peake, *President,* Standard Oil Company (Indiana)

Mr. Mark A. Brown, *President,* Harris Trust and Savings Bank, and *Former Director,* The Executives' Club of Chicago

Mr. S. L. Hypes, *President,* Wieboldt Stores, Inc.

Mr. A. L. Bruckner, *Treasurer,* Swift and Company

Mr. James F. Donovan, *Trustee,* Central Manufacturing District

Mr. Robert C. Borwell, *Vice President,* Marsh and McLennan, Inc.

Mr. Edward Byron Smith, *Executive Vice President,* The Northern Trust Company

Dr. Willard J. Graham, *Professor of Accounting,* School of Business, The University of Chicago, and *Director of Executive Program,* University College

Mr. Robert C. Munnecke, *President,* The P. Brennan Company, and *Former Director,* The Executives' Club of Chicago

Mr. P. E. Tillman, *Vice President and Treasurer,* G. D. Searle and Co.

Mr. Robert P. Vanderpoel, *Financial Columnist,* Chicago Sun-Times control of the seas, at a time when I did not consider that war was inevitable.

We did nothing. In the light of the situation which now exists, I have somewhat altered my views on attempting to force a condition of peace upon the Soviets at the risk of war because I think that war under those conditions certainly at this time, might well be inevitable. I am not inconsistent, having a different view today than I had three years ago, because we have rapidly lost our position of strength and leadership in the world, as compared with what it was three years ago.

I had occasion recently to appear before the Joint Committee on the Economic Report of the Congress. Mr. Taft and Mr. O'Mahoney are the Republican and Democratic leaders of that committee. What I said upon that occasion—and the reason I bring this in now is because I feel that it is impossible to discuss the domestic economic situation with which we are now confronted, without considering the reasons for the jeopardy of the dollar and the foreign situation—was:

Our defense preparedness program must be designed to prevent war and to prevent inflation, while at the same time preserving the essential freedoms of our democratic institutions. Now, that is quite an order, but it must be our objective, and I will proceed to try to show you why. The preparedness program must be sustainable for an indefinite period of time. If we fail to make these aims our major goals, the very system which we are trying to maintain will be destroyed. This means that, at this late date, we must adopt a realistic foreign policy, one which recognizes the strength of our enemies and the limitations of our resources and manpower, and one which we can pay for currently. How can we best, within the framework of a balanced budget protect ourselves, maintain our essential economic and democratic strength, and at the same time fulfill our commitments to help defend and protect the other free countries of the world? I believe to do this we must

limit our aggregate expenditures on our defense efforts and foreign aid program to a maximum of fifty billion dollars annually or about one-sixth of our total present production. This we can pay for currently, given a national product of some three hundred billion at present prices, the estimated amount for the next fiscal year. This money must be used in such a manner as to assure the maximum military effectiveness of ourselves and our allies, which means a program most likely to prevent war.

Control Air and Sea

We must recognize the fact that Russia occupies with her satellites the greater part of the tremendous land mass of Europe and Asia. This land mass has a population of nearly a billion people and great material resources, and is far removed from our shores. We can never expect to defeat Russia on the land. We would be bled white and destroyed economically as well as militarily by any attempt to do so. We cannot hope to be prepared to supply or to maintain ground forces at every strategic point around the twenty-thousand-mile periphery of the Communist Empire which it would take to contain Communism. We cannot be prepared on the ground to meet attacks at the time and the place selected by the Soviets.

There are, however, decisive things we can do with our superior technology and our scientific know-how, and within the limitations of the budget that we can pay for. We can and must, with the assistance of the British Empire and such cooperation as other free nations are willing and able to give us, rapidly establish overwhelming control of the air and the sea. From strategic air and naval bases throughout the world, protected by adequate ground forces, we can threaten swift retaliation with atomic and our other destructive weapons if Russia undertakes aggressive action.

We should recognize the facts that our unrivalled productive capacity is our strongest line of defense, that our ability to produce is largely determined by our available manpower, and that our country is the arsenal of the free nations of the world. It must not be weakened by a military program which we cannot maintain indefinitely without regimentation or inflation, or one which leads to war. We should keep our ground forces as small as possible so as to maintain our production at full strength, to meet our civilian and military needs and help the other free nations to arm their available manpower and build up their defenses. Our manpower can contribute far more to the defense of the free world in our production line, in our navy and our air force, than in the front lines of the land armies in Asia or Europe.

We should quickly arrange a peace treaty with Japan and with Western Germany, bringing them into the United Nations and helping them and other friendly countries, including Spain, to rearm as quickly as possible, so as to be able to deter or resist, if necessary, aggression by China, Eastern Germany or other Russian satellites. Our present military forces should be maintained in Germany and Japan until they have fully rearmed for the defense of themselves. Neither they nor the other free countries can be expected to resist successfully direct attacks by Russia. Such additional land forces as we furnish would be at the expense of maintaining our supremacy on the production line, in the air, and on the sea, and cannot be expected to provide the balance of power necessary to deter, contain, or defeat the Soviets.

Deterrent

Russia should know that direct attack by her means war with the rest of the free world—war in the air and on the sea and on the land so far as possible, involving atomic and all other weapons of destruction. This threat of world-wide total war will, I believe, deter the Soviet Union because it will mean her destruction as well as that of her enemies. A world war would be an atomic war or worse, a war that could not be won by any nation or group of nations, a war that might mean the total destruction of civilization, and for that reason, we should not think or talk of war now as being inevitable. We can, I believe, by the plan that I have indicated, make it so costly for Russia to start war, that she will not dare to attempt it.

Under the protection of American and British air and sea power, the free nations on the periphery of the Soviet Empire can rapidly rearm with the great help we can give them from our production lines if we do not undertake to build too large an army.

We should not attempt to build great military strength in either Germany or Japan for possible war with Russia. The logistics of such a distance would be so destructive to our economy that we would likely be destroyed on the rocks of domestic inflation. I do not believe that Russia will be willing to tolerate the reconstruction of great military forces of Western Powers on her borders, any more than we would if our positions were reversed. I do not believe Germany or Japan will be parties to such a program. It would seem that they do not propose to be the battleground for the defense of the Western World. I believe we must plan on Germany and Japan developing as defensively armed neutral areas, between the Communistic and the Western World.

War can be avoided, I believe, if we do not attempt to build up international competitive and threatening military forces in Japan or on the continent of Europe. I am thinking of a land army. Any attempt to do so is likely to provoke aggression—great standing armies cannot be mobilized facing each other for long periods of time without bringing about war. In any case, what is the stopping point in building up standing armies, and how do we ever demobilize them?

We should not make any commitment not to use the atomic bomb unless it is used against us first. Such a commitment offers us no protection. We must retain the initiative for use of all our weapons, including atomic bombs. Any defense preparedness program may mean or will mean at this late date an uneasy peace, at least for some time, but it will be as uneasy for Russia as it is for us.

How to Avoid Inflation

If we maintain a program such as I have indicated, at least so far as expenditures are concerned, how are we then to avoid inflation, and why should we avoid inflation?

We must avoid inflation by preventing deficit financing by the Federal Government at a time when we have full employment and full production and a lack of excess capacity or idle facilities.

It is essential that the transfer of goods and services from the civilian economy to the Government must be accompanied by a transfer of the money with which to pay for them. The financial must watch the physical. Otherwise, the Government's operation would be inflationary because new money would likely have to be created to finance the deficit, when the labor supply and the supply of goods were not adequate, or could not be increased, to match the new creation of funds.

We saw what happened during World War II in that regard when we borrowed to pay for all but 44 per cent of its cost. If we have idle capacity and idle men—in other words deflationary conditions—deficit financing is not inflationary. It tends to utilize and put to work what otherwise would be idle. But under the conditions that confront us today, you have great inflationary pressures, at a time when the Government defense program has not added a dollar to the inflationary pressures. Up to the present time—or at least during the past calendar year—the Government had a substantial budgetary surplus. In other words, it took more money out of the economy than it put into the economy. That is not likely to be true for long without further increases in taxes. That is why a tax program, that will meet the expenditure program, is basic.

It is impossible to prevent an inflation under these conditions for very long with an unbalanced budget. You might undertake to prevent, and think that you are preventing it, by dealing with the effects and not the causes, by applying the harness of onerous, direct, controls of various kinds, which in themselves is a regimentation of the economy. However, they only postpone and delay and cover up and sugar-coat the ultimate effects of inflation; and particularly when there is no apparent terminal point to the defense program, we should not depend upon direct controls and regimentation in order to prevent inflation.

To prevent it, we must first maintain a balanced budget, but that in itself is not the sole answer. You can have, as we have had during the past year, a large expansion of bank credit for the civilian economy, even when the Government's operation is neutral or deflationary, and still add greatly to the inflationary situation.

Credit Expansion

Bank credit has expanded more than it ever has expanded in the history of this country, except for carrying government deficits during the war. Bank loans have grown since Korea approximately 20 per cent, or about ten billion dollars. That is a greater expansion of the money supply—than we had in the banking system during the entire period of the twenties.

How were the banks able to expand this credit? The expansion of this credit was possible because the banks were able to get Federal Reserve funds, and on the basis of these reserves, to increase loans; when they increase reserves they have the basis for increasing loans by about six times.

How were the banks able to get those reserves? They came from two sources. They came from the sale of Government securities which the Federal Reserve was required to purchase, because of pressures by the Treasury and the Administration, from non-bank investors, including insurance companies and others. When the Federal Reserve purchased these Government securities, it provided the basis for the creation of more money. The Federal Reserve is the source of the supply, and as it creates that money, the non-bank investors put it into circulation.

They loan it or they spend it, and when they do so it goes into the banks, and the banks have a deposit. The banks don't know where it came from. They didn't have it before, but now they have an excess reserve. They loan that reserve—85 per cent of it. The remainder is kept as a reserve against the deposit. As that 85 per cent is loaned, it goes into another bank. That bank doesn't know where it came from, but it loans 85 per cent. That goes into another bank and so on, until you get a six-fold expansion. On the basis of that millon dollars worth of bonds that the Federal Reserve bought from an insurance company, you finally get six million dollars in new deposits.

If the banks don't get it that way, they sell their own Government securities. By selling their own securities, they obtain reserves; those reserves are the basis for a multiple expansion of loans and deposits, exactly the same way as the reserves they got from non-bank investors. The Federal Reserve purchased about three and a half billion dollars worth of government securities from last May up until the end of the year. Of that three and a half billion dollars, approximately one and a half billion was required to offset gold which was transferred out of the banks. Despite the deflationary effect of this gold movement, amounting to one and a half billion dollars, we still had a terrific growth in bank credit.

The only way that you can stop that is to not make Federal Reserve funds available to the market. There are limitations because of the size and the structure of the public debt, as to how far you can go in refusing to make such funds available.

I wrote a release for the press that covers this whole field. I didn't want to spend too much time going into the detail, but the press release is available for any one who wants to study the operation of the Federal Reserve System.

Editor's note: Following is quoted verbatim from Mr. Eccles' press release referred to above.

"To a great extent, this expansion in bank credit was made possible by the Federal Reserve's purchase of Government securities in the market at fixed prices. Such purchases provided the commercial banking system with reserves that formed the basis for a multiple expansion of loans and deposits. Despite the rapid increase in bank loans since Korea, and the inflationary impact of this credit on the economy, the policy of purchasing Government securities at the will of the holders at fixed prices has been continued. Such action by the Federal Reserve does not assure confidence in the credit of the Government. The credit of the Government is determined by the willingness of the public to buy and hold Government securities. A policy that results in continued monetization of the public debt in time of inflationary pressures leads to destruction of the Government's credit by depreciating the value of the dollar.

Continued support of Government securities at fixed prices, some above par, makes call money, or interest bearing currency, out of the marketable public debt. If these conditions are to prevail, there is no justification for the various issues of marketable Government securities, with their wide variation of maturities and interest rates. Why should the Government discriminate against holders of savings bonds by paying them less interest if they cash them prior to maturity, when it requires that the holders of marketable bonds be protected against any loss of principal or interest if they sell them before maturity? Why should they be called marketable when their prices are not permitted in any degree to reflect market demand?

The Federal Reserve System has been accused of seeking higher interest rates, which primarily enrich the banks and other corporate holders. The Federal Reserve is not interested in higher interest rates as such, but only as they help in curbing the sales of Government securities which add to the reserves and deposits of the banking system. In order to curb such sales of Governments, it is necessary that the market for them become more self-supporting and less dependent on Federal Reserve purchases. The incidental result of such a development, under current conditions, will be somewhat higher interest rates.

This does not mean, as has sometimes been suggested, that the Federal Reserve favors a completely free market for Government securities. The responsibility for maintaining an orderly market that will assure the continued success of Treasury financing has long been recognized and publicly proclaimed by the Federal Reserve System. Let us not confuse the issue—an orderly market, in which the demand for and supply of Government securities are permitted some freedom of action in order to determine what the real public market is, is not the same thing as maintaining a fixed pattern of rates irrespective of inflationary conditions.

If the Federal Reserve became a more reluctant buyer of Government securities, the market for such securities would in no sense get out of hand. These securities are held mainly be large institutional investors who need the income from them. I strongly believe that if the marketable securities eligible for purchase by non-bank investors bore a somewhat higher yield, such investors would be less willing to sell the securities they now own and more willing to take new or refunding issues.

While the maintenance of an orderly, as contrasted with a pegged, market may result in some increase in the interest cost to the Government, such increase would be nominal as compared with the effects of a further depreciation of the dollar. Only that portion of the debt which is refunded or converted each year would bear the higher interest rate. The additional interest cost on that portion of the public debt which may be refunded or converted during the next few years would be very small indeed compared with the added cost of inflation to the Government, if monetization of the public debt is allowed to continue. As a matter of fact, the increased interest cost on the marketable debt would be less than claimed, since the Government will collect in taxes more than half of any additional interest which it pays to holders of its securities.

We must, above all, be realistic in formulating and assessing the effectiveness of debt management policies at the present time. We are not starting with a clean slate. We must recognize the size, structure, and distribution of the public debt. There are a great many different types of Government obligations outstanding which are held by various classes of investors. Consequently, increases in yields on market bonds must not be permitted to adversely influence the very large number of savings-bond holders.

While the establishment of a freer but orderly market for Government securities is essential to curb further sales by banks and other institutional holders, the moderate changes in interest rates permissible in view of the debt structure may not prove to be a sufficient deterrent, especially in the case of banks, which largely hold short-term securities yielding from $1\frac{1}{2}$ to $1\frac{3}{4}$ per cent. In that event, Congress will have to authorize supplementary authority to increase reserve requirements or some other form of controlling reserves of commercial banks so as to limit their sales of Government securities to the Federal Reserve for the purpose of expanding their loans and investments.

So far as the disagreement between the Treasury and the Federal Reserve System is concerned, it is not a matter of personalities, but what appears to be a conflict of responsibilities. The Treasury's primary responsibility is that of financing the operations of the Government at the lowest possible cost at which it can induce the public to buy and hold its securities. The Federal Reserve System, as an independent agent responsible to Congress, is charged with the responsibility for regulating money and credit in such a way as to contribute to the maintenance of economic stability. Ordinarily there should be no conflict between the objectives of these two agencies of the Federal Government. However, a conflict has arisen during the postwar period, and particularly since Korea, over continuance of the cheap money policy of the wartime period of heavy deficit financing, despite the existence of budget surpluses and inflationary pressures since the war. These inflationary pressures have been due in large measure to credit expansion by the banks, based upon reserves obtained through the sale of Government securities to the Federal Reserve System because of its support of the Treasury's cheap money policy.

It is not the responsibility of the Federal Reserve System at a time like this to underwrite the public debt at fixed prices, but rather to do everything in its power to curb further expansion of the money supply and further depreciation in the purchasing power of the dollar. Therefore, the Federal Reserve System should not continue to support the market for all Government securities at present prices. If the Congress does not want the Federal Reserve System to carry out its present statutory responsibilities it should repeal or redefine its powers. Until such time as it does, the System has no choice under the present impact of inflationary pressures but to use its powers in a manner consistent with its responsibilities to the public as well as to the Treasury. To do otherwise, would be to fail in its public duty and would not be in the real interest of the Government. A greater degree of independence on the part of the Federal Reserve System is long overdue."

The heart of the controversy that exists, is the Government's cheap money policy; a policy which requires that the Federal Reserve System stand ready to buy at the will of the market all of the government bonds, the marketable bonds, that are offered at fixed prices. That, of course, as I have said, does tend to create an engine of inflation. It is extremely important that at least that part of the monetary system be gotten under a greater degree of control than it is at the present time.

Successful Preparedness Program

To sum up, let me repeat that a successful preparedness defense program must prevent war, and must not lead to destructive inflation. Total war with atomic weapons would mean victory for none and destruction for all. Regimentation or further inflation, even if war is avoided, will ultimately lead to the destruction of our capitalistic democracy. Therefore, our foreign policy must be designed on the basis of what we can pay for currently, and our fiscal program must be supported by a restrictive monetary and credit policy, together with such limited direct controls as the situation may require. Those direct controls must be the minimum; and to the extent that fiscal and monetary restrictions are applied, the direct controls will be less necessary. To the extent that they are not applied, more and more direct controls will be needed, and your free economy will be destroyed. Ultimately we could get an inflationary system that would destroy us as it has destroyed other countries when it goes to extreme. Our very effort to defend our democracy may well prove its destruction unless we understand the issues that are at stake.

I thank you for the privilege of meeting with you.

(The audience arose and applauded.)

PRESIDENT COULTER: Thank you, Mr. Eccles, for your profund analysis of our confused financial situation.

In Memoriam

It is with deep regret that we announce that member Dayle G. Malone passed away on January 29, 1951.

SPEAKER'S TABLE GUESTS - MARCH 2, 1951

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The Executives' Club of Chicago

Mr. Marriner S. Eccles
Guest Speaker

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Federal Reserve Bank of Chicago

Mr. Robert P. Vanderpoel, Financial
Columnist, Chicago Sun-Times

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Marsh and Truman Lumber Company

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(See inside)

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Stanislaw Mikolajczyk
War-Time Polish Premier

Robert Friars
Travel Lecturer and Humorist

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Narration by O. S. U. Coach, Harry L. Strobel

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Dr. Hu-Shih
Former Chinese Ambassador to the U. S.

Dr. Edwin G. Nourse
Former Chairman of the Council of Economic Advisers to the President

Rocket Panel Discussion
Gen. Harry G. Armstrong, U. S. Air Force
Dr. Heinz Haber, Distinguished German Physicist
Dr. Andrew C. Ivy, Vice Pres. University of Illinois

John Foster Dulles
Member U. S. Delegation to U. N. and Former U. S. Senator (N. Y.)

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Chancellor, National Industrial Conference Board

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Former Chief of Naval Operations

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Chairman, Joint Chiefs of Staff

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Angler, Sportsman and Author

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Economist, Journalist and Commentator

Sir Basil Brooke
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Cmdr. Irving Johnson, U.S.N.R.
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Raymond Moley
Editor—Former Presidential Adviser

William (Bill) Alexander
Republican Candidate for the U. S. Senate from Oklahoma