JAMES C. OLIVER
FIRST DISTRICT MAINE
239 HOUSE OFFICE BUILDING

COMMITTEES:
MERCHANT MARINE AND FISHERIES
WORLD WAR VETERANS' LEGISLATION
IRRIGATION AND RECLAMATION

MARION LECLAIR
SECRETARY

# Congress of the United States
## House of Representatives
### Washington, D. C.

R 2/20

March 16th
1 9 3 9

Released 3/11/39 Ret 3/13/39

Hon. Marriner S. Eccles, Chairman
Board of Governors of the Federal Reserve System
Washington, D. C.

Dear Sir:

My attention has been called to a release of the Board of Governors of the Federal Reserve System of March 6, 1939, in which a sweeping reply is made to the proposals contained in various bills in Congress, such as that of Hon. M. M. Logan of Kentucky (S. 31); the bill introduced by Hon. Brent Spence of Kentucky in the House of like purport; the bill introduced by Hon. Wright Patman of Texas; the bill introduced by Hon. John E. Rankin of Mississippi, and probably others. Your release groups the substance of these bills as those favoring the control of the purchasing power of money by regulating the volume of money.

Your release says:

> "Those who favor such proposals believe that prices can be raised by increasing the supply of money, that prices can be lowered by reducing the supply of money, and that prices can be kept fairly steady by changing the supply of money in the right direction at the right time."

The substance of your release is a denial of the substantial truth of these views. You conclude your argument in the following words:

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"In view of all these considerations the Board does not favor the enactment of any bill based on the assumption that the Federal Reserve System or any other agency of the Government can control the volume of money and credit and thereby raise the price level to a prescribed point and maintain it there."

Since your release broadly denies the law of supply and demand, it seems unnecessary to go further than to examine the question as to whether you are right in your main premise; that the value of money does not depend upon the supply of money in circulation. Yet you are contradicted by our own experience under the Board of Governors. The index of the purchasing power of money was 145 in May, 1913. When money was expended in financing the World War, the index of the purchasing power of money fell to 60 in May, 1920, less than half what it had been before the expansion of the money supply took place. The country was able thru the Federal Reserve System to finance the World War and become highly prosperous doing so. John Skelton Williams said truly, as Comptroller of the Currency, "That one Act won the War." Under that Act the United States Government raised $40-billion of credits and liquidated a very large part of them. And if the foreign debts had been paid, would have almost completely liquidated the cost of the World War in bonds.

You are contradicted flatly by the experience of 1920-21,

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when the Federal Reserve Board, by the contraction of credit and currency (the money supply), caused the price level to fall from 167 in May, 1920, to 93 in June, 1921. This contraction of credit and currency was deliberate and intended to increase the purchasing power of money by contracting the supply of money. The details of how this was done is set forth in Senate document 310, published in February, 1923, in which the Federal Reserve banks under the influence of the Board caused the member banks to put on a drastic contraction of credit. Farm products fell to less than half of what they were. The price of farm and farm ranch lands suffered a loss in market value of over $20-billion, from which agriculture has never recovered.

The Federal Reserve Board fully understood and used their power to influence the purchasing power of money by contracting the money supply. The effect on the purchasing power of money was immediately represented by a rise in the dollar index from 60 in May, 1920, to 107 in June, 1921. The letter of Governor W. P. G. Harding of May 25, 1920, a copy of which is where is it? hereto attached, shows 11 different ways in which the Board explained its power to change the price level and to change the purchasing power of the dollar. It does not Since your Board of Governors denies the obvious and contradicts the self-evident, it is idle to follow the detail by which a justification is attempted for the conclusions which are obviously and demonstrably unsound.

Your Board's conclusions are not only contradicted by reason and by fact but by the experience of other nations. The Government of Great

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Britain now directs the credit operations of the Bank of England and the Government of Great Britain during the last six years has given comparative domestic stability to the pound sterling; has increased its index of industrial production fifty per cent; and has given its people an unbroken two per cent rate for the use of money employed in industry.

US incr. 70%

The unreasonable denial of the obvious in the release of March 6 is contradicted by the experience of every nation in Europe. Sweden has demonstrated how money can be regulated by regulating the supply. Germany for two years past has had no change in the domestic purchasing power of the mark. Under managed money it has expanded its index of industrial production 146 per cent since 1932.

During the World War when Italy expanded the lira four times, it diminished the purchasing power of the lira to one-fourth of what it had been.

When France expanded the franc from sixteen billions in number to eighty billions, or five times, it diminished the purchasing power of the franc to one-fifth of what it had been.

The Board of Governors of the Federal Reserve System in the astonishing release submitted not only contradicts the experience we have had in the United States and the experience in Europe but it flatly contradicts the opinion of the House of Representatives as declared on May 2, 1932, when the House, after a two days' debate and a unanimous report from the committee on Banking and Currency passed the Goldsborough bill directing the Secretary

Not a finding as to facts

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of the Treasury, the Federal Reserve Board and the Federal Reserve banks to make effective the policy of restoring the purchasing power of money to the predepression price level, or the average for the years 1921-29, inclusive, as found by the Department of Labor.

The Thomas amendment to the Agricultural Adjustment Act was an expression of opinion by the Congress of the U. S. thru an overwhelming vote contradicting the present declaration of the Board. The Thomas amendment recognized the principle that the value of money and the price of commodities would be directly affected by the volume of money. The Board of Governors has made itself responsible for refusing for about six years to use the means proposed by the Congress of the U. S. for relieving this country of depression.

The President of the U. S., himself, in his famous cable to the London Economic Conference declared the purpose of the United States to establish money whose debt-paying purchasing power should remain the same from one generation to another. And he declared his purpose to restore the pre-depression price level.

The arguments made by various monetary authorities and by various groups demanded the expansion of the money supply as a means of restoring prosperity in 1932. Five hundred pages of testimony was taken by the committee. Representatives of the National Grange, the National Farmers Union, the American Federation of Farm Bureaus, and the American Federation

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of Labor supported the contention. The farm organizations are now demanding the expansion of the money supply as a means of restoring prosperity and employment.

I have not failed to note the argument submitted by the Board in which it is contended that the banks are full of money. That they have more money now than they had in 1929. In your release you say that the demand deposits in 1929 were $23-billion and $26-billion in 1938 and that the price level was 95 in 1929 and 77 in 1938. You argue from that that the price level, upon which the purchasing power of money is based, is not affected by the volume of demand deposits. You fail to point out what money is in its relation to prices. You fail to point out that demand deposits which are hoarded, which are not in circulation, cannot be properly called "money" because money is " anything conventionally used as a medium of exchange and measure of value". Demand deposits not employed as a medium of exchange cannot properly be called "money", although it is potentially capable of quick conversion into money. But that is true of securities listed on the exchanges which are quickly convertible into money. But securities in locked boxes are not money because they do not function as a medium of exchange and measure of value. Neither are Government deposits in process of expenditure operating as a medium of exchange. Government demand deposits comprise the absorption of demand deposits from taxpayers, diminishing the amount of money used by the taxpayers as a medium of exchange and until the Government expends the money, it does not function again as a medium of exchange, nor until it is used as a medium of exchange by the depositor. In 1929 the

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Prices are 20% lower

demand deposits of June 30 for individuals and corporations, excluding inter-bank deposits and Governmental deposits, were $22.4-billion; and in 1938 were $22.8-billion as of June 30. It appears that in the figures you use in the release for 1938 for demand deposits there has been added over $3-billion dollars of Governmental accounts because the corporate and individual demand deposits were only $22.8-billion as of June 30.

This does not appear to be the only error. There is a far more important oversight made by the Board which does not appear in the statistics which you recite; and that is the extent to which in 1938 the demand deposits were hoarded.

The extent to which they are hoarded is relatively ascertainable by comparing the turnover of check money or checks debited against demand deposits in 1929 and 1938. The checks debited against demand deposits in 1929 were $1227-billion and $530-billion in 1938, showing that over half of the $22.8-billion of demand deposits of 1938 were hoarded. This is well known and is capable of demonstration by an examination of the books of the banks, which have been available to the Board all these years.

It is perfectly obvious that the Board of Governors has not taken into account demand deposits having zero circulation, or approximately zero circulation. It is perfectly obvious that they are entirely unconscious of the manner in which the circulating medium can be contracted by the hoarding of demand deposits. These demand deposits which are hoarded are the reserves of the great corporations and insurance companies, of investment

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companies, of those who are merchandising in money and stocks and who sold their stocks on a colossal scale in 1937-38 and are hoarding the money as demand deposits awaiting future investments. It is perfectly obvious that the Board of Governors is responsible for its failure to make a correct diagnosis of the causes which have resulted in the destruction of the value and market price of farms and ranches and town and city property, and has resulted in the destruction of the value of securities, and has resulted in the concentration in the few large cities of a great mass of unemployed money which is being loaned to the Government at negligible rates of interest. Everybody knows that the debtors of this country who are now compelled to pay their debts in dollars which have a purchasing power of 130 are being squeezed to death and being deprived of their property and their right to a living by a contraction process brought about by those who believe in increasing the purchasing power of money and decreasing the exchange value of the products and services of Labor.

Has been that & higher for 8 yrs.

I do not care to turn from the main point to discuss your observations on the price level because informed students understand that perfectly well. They know that monopolies can effect individual prices. They know that unfair trade practices can interfere with the normal prosperity of the country; and they also know that the remedies for these things lay in other departments of Government and that the Board of Governors has no occasion or justification to excuse itself from giving the country relief thru a proper monetary policy by pleading that other departments are not discharging their duty to the public.

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--9. M. E. S.

I have not failed to observe that your press release states your sympathy with the restoration of prosperity and the prevention of booms and depressions, but your release contains no constructive suggestions. On the contrary, they are obstructive in the highest degree and clearly intended to discourage those who have been studying this question and who are trying to bring about a public understanding and to establish the means thru which the Congress of the U. S. shall discharge its constitutional duty to regulate the value of money. Those who founded the Constitution and had had experience with unstable money put a direct mandate in the Constitution authorizing and directing Congress to regulate the value of money. And after 150 years we are confronted by A Board of Governors under the Federal Reserve Act declaring in effect that the value of money cannot be regulated by the Board or by anybody else. I wonder if the usefulness of the Board of Governors as at present organized has not ended.

Yours respectfully,

J. C. Oliver

JAMES C. OLIVER, M. C.

April 22, 1939

Honorable James C. Oliver,
House of Representatives,
Washington, D. C.

Dear Mr. Oliver:

This is in reply to your letter of March 16 in which you raise some questions about the Board's statement on proposals to maintain prices at fixed levels through monetary action. In the first place, I should like to call to your attention a more recent statement of the Board, issued on April 8, which may be taken as a supplement to the earlier statement. In this statement the Board proposes "that Congress through appropriate committees or a joint committee take steps to determine the objectives by which monetary and banking authorities shall be guided, the validity of different plans and views on monetary and credit matters proposed or held by agencies within or outside the Government, including the Board's own position, and the character of governmental machinery that would be best calculated to carry out the purposes of Congress in this important field." A copy of this statement is enclosed.

The Board has always recognized the important role that monetary action can play in influencing the course of business activity, employment, and national income, and since the beginning of the Reserve System has endeavored to pursue policies that would help to maintain economic stability. The recent statement, concerning which you have written, was for the purpose of pointing out some of the limitations on the effectiveness of monetary action and to raise the question whether price stability should be the sole or principal objective of such action. It is the Board's belief that the ultimate objective should be economic stability and that in order to achieve it cooperation between many agencies within and outside the Government is essential.

This view of the Board is illustrated by the developments to which you refer in your letter. Monetary action aided in financing the war, and policies pursued by the System in the 1920's aided in financing the reconstruction of the world after the war. In the recent depression period, monetary action has been much more vigorous than in those periods;

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an abundant supply of money has been maintained and interest rates have been reduced to the lowest levels in history. That, notwithstanding the abundance and cheapness of money, business has been less active in recent years than in earlier periods shows that there were retarding factors other than the supply and cost of money. During the war there was an active demand for money, for financing the production of needed materials, and during the post-war period it continued in active demand in various highly profitable private activities. During these periods, in fact, unsound uses of credit for speculation in commodities, real estate, and securities developed, which led to later difficulties.

The heart of the present problem is contained in the discussion of idle funds, beginning on page 6 of your letter. The failure of the public to make active use of the idle funds which it holds in the form of currency and deposits is the crux of the difficulties which we face in our current efforts to further business recovery by monetary means. As you state, deposits which are idle are not effective in influencing the course of business activity and the volume of national income, and the same is true of hoarded currency. Since 1930 there has been an increase of something like $1,000,000,000 in currency of large denominations reported as in circulation. Most of this is undoubtedly held idle in private hoards. In addition to the amount of currency in circulation and deposits in banks which are not being actively used, the banks have nearly $4,000,000,000 of excess reserves. These excess reserves are money on which banks would like to earn interest but for which they can find no satisfactory employment. The banks are offering these funds at rates of interest far below those charged in the 1920's. In short, both the banks and the public with more funds than ever before are finding it impossible to invest them all. Funds currently being made available through the inflow of gold are piling up as hoarded currency, unused deposits, and idle bank reserves. This is the problem to which you call attention in your letter and which the Board has frequently discussed in its official publications.

Although recent experience shows that sizable additions to bank reserves and deposits do not suffice alone to stimulate a vigorous and sound business expansion, it is, of course, impossible to forecast the ultimate effects of adopting a program involving tremendous additions to the supply of money and bank reserves. In my opinion, such a program would tend to create a condition of fear and uncertainty in business and financial circles that would rapidly spread to the general public. As the country was literally flooded with money, the confidence of the public in our monetary system might be shaken to such a degree that inflationary psychology would develop. In such circumstances, there might be a rush by the public to convert money into commodities and equities that would result in a speculative boom. Once a movement of this type gains headway, it is virtually impossible to regain

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control of the situation. Any attempt to do so runs the danger of precipitating a violent collapse in prices and business. Yet to permit the movement to run its course uncontrolled would be to invite an even more demoralizing collapse.

To my mind, therefore, it would be irresponsible public policy to adopt a program which contains such potential dangers. We cannot expect to convert a boom that is based upon fear and loss of confidence in our monetary system into a sound and lasting prosperity.

As I pointed out in my recent statement before the Silver Committee, I advocate as the most effective means of achieving our common objective a broad Government program of expenditures for non-competitive projects and social benefits along with every possible encouragement to private investment. Revival of private investment, which is essential for sustained recovery, depends upon an increase in current consumption to a level that will not only utilize existing plant and equipment but will provide profitable outlets for investment in new enterprise.

You imply in your letter that other countries have been able to accomplish by monetary policies that which the Board's statement denies can be accomplished. This view, which has often been stated, does not seem to be supported by the facts:

(1) Monetary authorities of no country have taken as vigorous action to increase the supply and reduce the cost of money as have the authorities in the United States. (2) Differences in behavior of prices in this country and in England and Sweden, the two countries most frequently cited as examples of advanced monetary policy, have not been striking. (3) Such variations in economic developments as have occurred in the different countries are attributable to other factors than monetary policies. (4) Monetary authorities of other countries themselves do not believe that monetary action alone can create and maintain any desired price level. I am informed that in Sweden the objectives of the Riksbank's policy are substantially those enunciated in the statement issued by the Board of Governors of the Federal Reserve System in August 1937.

Neither in England nor Sweden has central bank policy made money easier than it is in the United States. The Swedish Riksbank has disbursed comparatively little through purchases of securities since 1929; its discounts and advances have been sharply reduced; and its rediscount rate has been lowered to only 2 per cent as against 1 and 1 1/2 per cent for our Federal Reserve banks. The cash reserves of the Swedish commercial banks, which are the basis of the deposit currency of the country, have been greatly increased by the inflow of funds from abroad, as have reserves in the United States; but the rates charged by the leading commercial banks on loans are no lower than those charged by leading banks in the United States.

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The Bank of England has pursued a far less expansionist policy than that of the Federal Reserve banks. It has done little to expand commercial bank reserves through security operations. From time to time it has disbursed funds through the purchase of large amounts of gold, but the gold acquisitions of the British Exchange Equalization Account have been sterilized and prevented from increasing the amount of money available to the public, in sharp contrast to the way that the gold inflow has been handled in this country. In England the growth in the demand for currency and the needs of the banks for additional reserves against deposits have been met; but the supply of money has not been increased, as it has been here, to the point where the public and the banks have large amounts of unused funds. Both the discount rate of the Bank of England and market rates of interest remain higher in England than the corresponding rates in the United States. The Bank of England's discount rate is 2 per cent as compared with 1 per cent at the Federal Reserve Bank of New York, and the prevailing rate for industrial and commercial loans is around 4 1/2 per cent in England compared with an average of about 3 per cent for banks in leading cities in the United States.

The experience of the United States since 1932 so far as wholesale prices is concerned has not differed much from that of England and Sweden. Earlier in the depression prices fell further in the United States. Differences between developments in this country and those in England and Sweden, however, are not attributable to more stimulative policies pursued by the central banks of these countries, since their policies have in fact been less stimulative. The differences are the consequences of broadly differing economic situations. A comparison of price movements in the three countries is shown below:

WHOLESALE PRICE INDICES

(1929 = 100)

| | United States | United Kingdom | Sweden |
|---|---|---|---|
| 1932 | 68 | 75 | 78 |
| 1937 | 91 | 95 | 98 |
| 1938 | 83 | 89 | 93 |

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I should also like to explain the differences between the amount of demand deposits as shown in the Board's statement and in your letter. The differences arise in part from the exclusion from your figures of deposits of State and local governments which have increased by about $1,000,000,000 since 1929. Since these deposits are generally used as actively as deposits of individuals and corporations they are included in our total of demand deposits. Another difference is that the Board's figure is adjusted to exclude the amount of cash items held by banks in process of collection, which represent checks drawn on deposits but not yet debited and, therefore, funds not available for further use. These deductions were about $700,000,000 larger in June 1929, when deposits were active, than in December 1938. The principal difference, however, arises from the fact that your figure for 1938 refers to the end of June while the Board's figure refers to the end of December. In the six months from June to December 1938 there was an increase of $1,600,000,000 in demand deposits at banks. Whatever figures are used, however, it is clear that the amount of deposits was larger in 1938 than in 1929, while prices were 20 per cent lower.

Very truly yours,

M. S. Eccles,
Chairman.

Enclosure
WEG:WL:HE:WT:EAG:lw
WRG

M.G.