

ADDRESS BEFORE THE
SEVENTH NEW ENGLAND
BANK MANAGEMENT CONFERENCE
OF THE
NEW ENGLAND COUNCIL
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BY

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(Stenographic transcript)

ADDRESS by Hon. Marriner S. Eccles, Chairman of the Board of Governors
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Mr. Chairman, fellow bankers and friends of New England, it is very gracious of you to permit me to come before you today. I assure you that it is a privilege for me. Had I come to New England prior to November 3rd, during the period of a heated campaign, whatever I might have said might have been misconstrued. Anyone in public office would have found it very difficult to make a public address without being accused of making a political speech.

I am not a partisan. To me political questions resolve themselves, when you look through them, into economic and social questions, and if we could forget party labels and consider political problems from the economic or social aspect and in an unemotional manner, it seems to me that we would have a much clearer conception of our problems and be better able to arrive at practical solutions.

New England is looked upon, of course, as a conservative section of this country. I am a conservative, a believer in development of private initiative, private banking and business opportunity, but when I analyze just what it is that I want to conserve I come to the conclusion that it is, after all, property rights, the opportunity for expression of individualism. And then when I look a little further, I realize that the great majority of people in this country own very little property, and that what they want to conserve is the right to work, and the security of a reasonable standard of living for themselves, and their families, now and in the future. I realize that human rights must be

preserved if property rights are to be preserved, and property rights must be preserved if human rights are to be preserved.

The interests are not conflicting. They are a part of the same thing. As the owners of property and as leaders under a system of capitalism it seems to me that we cannot expect to conserve that which we are so desirous of conserving without attempting or being willing to conserve and assure that which the great majority of our people want to be assured of.

As I look back and consider what we have gone through from the time of the boom period of the '20's up to the present, I am impressed with this fact: That to have safety in banking we must have stability in our economy, that it isn't possible to have such great fluctuations in the national income as we have had, and at the same time devise any formula for sound credit and investment policy for banks.

Loans and investments which are perfectly good when the national income is \$80,000,000,000 become worthless or nearly so when the national income, through the process of deflation, is permitted to be cut in two. The same debt structure cannot be supported on a national income of \$40,000,000,000 that is supported on a national income of \$80,000,000,000.

It is just as important to bankers that deflation be prevented as it is that inflation be prevented. Why bankers recognize the necessity or desirability for government or for public bodies which are instruments of government preventing inflation on the one hand and object to the intervention by government to stop the processes of deflation on the

other hand is difficult for me to understand.

Deflation, if anything, is more destructive to bankers than inflation. They are twin evils and both should be prevented, if possible. The volume of money--that is, the means of payment including bank credit, as represented by deposits and currency--and the velocity or turnover of funds are a measure of our national income. We know in a money economy that the way we effect an exchange of all goods and services is through the mechanism of money. It stands to reason that when the total volume of money, which includes bank deposits, and the turnover of that money diminish, the volume of business has also diminished. If we expect to maintain stability or reasonable stability of business, we must find ways and means of maintaining a more uniform availability of money and of encouraging a more uniform flow or velocity than we have had in the past.

In looking at the record of the past, it seems to me that it should serve somewhat as a guide and that we should profit by its teaching. There is great disagreement as to what all of the causes of deflation were, just as there may be some disagreement as to the causes of reflation, but I would like to read here what seems to me to be a very brief and reasonable explanation of some of the primary causes of deflation.

The Brookings Institute, which is an endowed, non-partisan body, recently made a study, and in their report of income and economic progress, on page 37 they have this to say:

"The consumptive requirements or wants of the people were far from satisfied during the period of our

highest economic achievement. The value of the total national production of goods and services in 1929, if divided equally among the entire population, would have given to each person approximately \$665. There were nearly 6 million families with incomes less than \$1,000; 12 million with incomes under \$1,500; over 16 million with incomes under \$2,000; and over 19 million, or 71 per cent of the total, with incomes less than \$2,500. A family income of \$2,500, at 1929 prices, was a very moderate one, permitting few of the luxuries of life. Hence it was clear that the consumptive requirements, and especially the wants, of the masses of the people were far from satisfied."

Speaking of what appears to be at least one of the reasons for some of our difficulties, the same report (page 156) goes on to say:

"As to income distribution and its results, we found * * * * the proceeds of the nation's productive effort going in disproportionate and increasing measure to a small percentage of the population--in 1929 as much as 23 per cent of the national income to 1 per cent of the people. We found the unsatisfied wants--needs according to any good social standard--of the 92 per cent of all families who are now below the level of \$5,000 annual income sufficient to absorb the product of all our unused capacity under present conditions

of productivity and still demand much more from such unexplored potentialities as might hereafter be opened up.

"We found the incomes of the rich going in large proportion to savings and these savings strongly augmented by others impounded at the source by corporations through the practice of accumulating corporate surplus. These savings, after providing for such increase of capital goods as could be profitably employed, we found spilling over into less fruitful or positively harmful uses, ranging from foreign loans (bad as well as good) to the artificial bidding up of prices of domestic properties, notably corporate securities.

"Thus, we begin to discern the answer to our question whether the basic defect in our economic system, not discovered in the technical processes of production, is to be found in the way in which we conduct the distribution of income. The answer is affirmative: this is the place at which we do find basic maladjustment."

Now whether you agree with that statement or not, the fact remains that the system of production did not break down. The fact remains that the surplus income which corporations failed to pay out in dividends, in wages, or in reduced prices, together with the surplus income of individuals, that is, the income that they saved beyond what

they spent and which they either invested directly or through savings banks or insurance companies, made up the great volume of what we may term savings funds, and a very substantial part of those funds went into foreign loans and into stock market or brokers' loans.

Bank credit did not expand to a point which in itself would have caused the speculative inflation that we had in 1929. Between \$5,000,000,000 and \$6,000,000,000 went into the stock market through loans by others to brokers. The speculative inflation was outside of the control of the bankers.

Had a greater portion of these funds that went abroad and that went into the market gone to consumers through lower prices, or higher wages, or a wider distribution of dividends, or a combination of the three, thus maintaining a greater consumer buying power and an increased standard of living on current income, we would have had a very different situation. We would have had a far better opportunity to maintain stability. The people as a whole must receive sufficient buying power to enable them to buy what the productive facilities which we have created produce or otherwise the value of our investments and our savings, as we found out, shrinks or disappears entirely in many cases.

There was a maldistribution of the national income which resulted in getting consumer buying power out of relation to our productive capacity, and you couldn't maintain that consumer buying power forever on credit. I don't mean bank credit, because there was a great deal of other credit, in fact, most of the credit was outside of the banks.

And when this point of saturation was reached, when the people

as a whole could no longer buy out of current income what was being produced, when they could no longer get credit to keep on buying on the basis of credit what was being produced, and we were unwilling to take our surplus savings and continue to loan them abroad and thus give the foreigner buying power to buy what we produced, we found that the market for what we produced began to disappear. With its disappearance we saw prices tumble, and with the tumbling of prices and the disappearance or the reduction of the market for the sale of our goods, we saw unemployment increasing.

And we saw, therefore, a contraction of credit. This supply of money which is created by the banks began to disappear. Every time a bank loan is paid off that much money disappears. And the disappearance of that money created a downward spiral which was self-accelerating. Many bankers and business men had what I conceived to be the false philosophy of believing that there was a natural bottom where this thing would stop--that Government should not interfere with the operation of "natural law," and that deflation should be permitted to take its course. They felt that to have the Government unbalance its budget would destroy confidence, and that to fail to maintain the gold convertibility of our money would further destroy confidence. Therefore we continued to adhere to the fetish that the Government was like an individual, that it should contract its expenditures in times of deflation when everybody else was contracting expenditures--that we should adhere to the gold standard at all hazards, and that by so doing somehow in some way business people,

those with money and those with credit, would undertake to go out and to build new plants and to produce more goods and thus put people back to work. It was not reasonable, to my mind, to expect that individual investors or business concerns would make new investments at a time when everything they had was becoming less valuable and less profitable every day. The individual or corporation is not going to invest money and put people to work unless there is a reasonable expectation of profit.

And so we found what we call "confidence," what we depended upon to turn the tide of deflation, failed to turn it, and we kept on to a point where we had destroyed or extinguished one-third of our money supply through bank credit contraction and bank closings, and had reduced the turnover of money compared to what it was in the late twenties by more than 60 per cent.

The reduction in the supply of money times the reduction in its turnover was reflected in a reduction of the national income from \$83,000,000,000 to approximately \$40,000,000,000 from 1929 to 1932, and a complete collapse of the credit structure. No other country in the world even approached the degree of credit contraction and deflation that this country went through. In Britain the contraction during the depression was, as I recall it, about ten per cent. In Canada the contraction of the volume of bank money was less than half of what it was in this country. And even in France during the long period of time that they have attempted to adhere to the gold standard, while deflation

continued, their contraction does not approach what we had in this country.

The Government can do for all of us what we individually cannot do for ourselves. The Government can and should spend money for social purposes. It is not animated by the profit motive, as business concerns and business men must be. It can and did stop the process of deflation through providing funds first to shore up the credit structure; to stop foreclosures on homes and farms by taking over and refunding the defaulted securities, and then by a program of public works and relief. The size of that job was far greater than it should have been permitted to be. The cost of turning the tide of deflation would have been much less if the Government had intervened earlier on a sufficient scale to stop the destruction before it reached such vast proportions. When the Government finally interceded, it supplied the deficiency of the means of payment by borrowing money when no one else would, because no one else could borrow money and invest it profitably. It borrowed money from the banks and from those depositors of banks whose funds were idle in the banks, whose funds were not circulating, and put that money into circulation. The Government gave its bonds for the money, and used the money to give buying power to people who didn't have it. That money created a demand for goods which otherwise would not have been marketed or produced; it created business that otherwise would not have existed, and eventually the money came back into the banks in the form of deposits. In addition to putting existing but idle funds to work, the Government, by borrowing directly from the banks, created new money which it likewise

put into circulation. Thus, an increase both in the volume and in the velocity of the supply of money was created.

In other words, to the extent that they bought Government bonds-- on a large scale during the period of 1933 and 1934, less in 1935, and very few in 1936--the banks created money, just as they would have created it had they loaned the money instead to individuals or corporations. They credited the Treasury's account on the one side and they put in their investment portfolio Government bonds or bills or notes on the other side, and as the Treasury checked those funds out and put them into circulation, that money created business and finally came back into the banks in deposits to the account of various individuals and corporations. The funds went through the mill of production and distribution, produced goods and services, came back into the banks, and are there today.

Now that process increased employment. It made it profitable for business to employ people in order to fill orders for goods. You know what it did to many of the loans that you had which you charged off or which were considered slow or doubtful. You know what happened to your security portfolio. You know that some Government bonds which you owned in 1931, and in 1932, when the Government debt was far less than it is now, were selling at 83, 20 points less than their selling point today.

Why did this great change in conditions come about? Because the Government intervened to increase the supply of money by borrowing when nobody else was in a position to do it. The Government thereby

increased the velocity or the circulation of money; that in turn increased employment, and increased the volume of production until it is higher now than it was in the 1923-25 period. It has increased the national income until at the current time it is running more than \$20,000,000,000 above what it was three years ago, and that has increased the Federal income so that the Federal budget will be balanced in the near future.

I have said for three years that you cannot balance a Federal budget until you correct the causes for its being out of balance. A Federal budget can only be balanced out of national income, and the national income can only be increased by the increase in the volume and the flow of money, and private interests will not increase the volume or the flow of money except as it is profitable to do so, but a Government, acting collectively for all of us, can do for us under such circumstances what we cannot do for ourselves, acting individually.

That has been done, and the Federal budget will be balanced out of an increased national income. It is my belief that there will be very little more borrowing by the Federal Government. With the large Treasury balances, with the assets which are being liquidated bringing funds into the Treasury, together with tax revenue, it is my belief that the market will not be given an opportunity to take substantial additional issues of Government securities, even though the budget is not technically balanced.

I believe thoroughly that a technically balanced budget will be reached by 1939, and that a balanced budget, so far as having to go to the market for additional funds is concerned, will be reached by 1938.

Now we have experienced the influence of deflation on the banking system. We have seen an example of the influence of reflation on the banking system and on our economy as a whole. If we can determine the forces that make for deflation and deal with them, and again can determine the forces that make for inflation and deal with them, we have some chance of approaching successfully the problem of maintaining a greater degree of stability than we have been able to achieve in the past. I think it is much more necessary to deal with that problem now than ever before because of the complexity of our economy, because of the interdependency of its many parts, because of the fact that we are a creditor nation and because we no longer have the great frontiers that we once had in the West and South. Yet I firmly believe that with far-sighted leadership on the part of the bankers and the business men, it is possible to devise ways and means for a better, more orderly functioning of our economic system, with a minimum of government encroachment upon the field of private enterprise and initiative.

The Government's field, it seems to me, is broadly this: As deflation starts, as evidenced by unemployment, it is in the interests of all of us that the unemployment problem be met; when private business cannot profitably employ people, and therefore lays them off, it seems to me that we must be willing to have them employed on socially beneficial public work by a public body, and thus stop the process of deflation in its inception. The cost is relatively small. In fact, it is negligible if action is taken before the national income is permitted to diminish greatly.

In times of full business activity, Federal revenue, which is one of the greatest factors in stopping inflation, should greatly exceed Federal expenses. At such times, Federal revenue should be diverted to the reduction of the Federal debt. This in turn has the effect of offsetting private credit expansion by the banking system as recovery proceeds and thus of keeping the supply of money more or less constant.

If for any reason we get out of balance again and unemployment starts to develop, surplus Federal revenue should be promptly diverted into the spending stream and away from the stream of the reduction of Federal debt. If that isn't sufficient to meet the unemployment situation and stop credit contraction in its inception, we should be ready to incur a budgetary deficit. In other words, the Government must be looked upon as a compensatory agency in this economy to do just the opposite to what private business and individuals do. The latter are necessarily motivated by the desire for profit. The former must be motivated by social obligation.

I want to say just a word about what I suppose is uppermost in your minds. You are not worrying today, of course, about deflation. You are pretty well satisfied with recovery up to date. You have been worried about the Government debt and unbalanced budget, and you have had fear that it would create an inflation and destroy the value of your money, the value of your investments.

Now I have answered one of your questions, and that is the one with reference to a balanced budget. Inflation comes not only from a continued budgetary deficit, financed by the banks, but inflation can

come through an expansion of private credit. I believe that that can be met. It can be met first, as I stated a moment ago, by diverting surplus Federal revenue to retiring Federal debt as private debt expands. It can be met by the powers which have been given to the Federal Reserve Board, by extinguishing excess reserves, and even going so far, if need be, to force the banks to borrow. That, of course, would stop the process of private credit expansion.

There is a distinction between a speculative inflation and what we may term a general inflation of the entire price structure. There is little immediate danger of the latter. Prices have been maintained on the average for the past two years on one of the most stable bases that this country has had in years. However, we have less power to control a speculative inflation unless it is built upon bank credit. When stocks are bought out of funds already created, it is much more difficult for the Reserve authorities to stop that process. But, that is a far less dangerous speculative inflation than one which is built upon bank or broker credit. In 1929, you will recall, the credit extended to the market by banks to brokers, and by others to brokers, was around 9 billions, whereas today it is less than 1 billion.

The Board now has the power that it didn't have at that time to fix margin requirements on brokers' loans and bank collateral loans for the same purpose. The law also prohibits member banks from acting for others in making loans on securities as collateral to securities brokers or dealers.

I think that with the powers that are in the Federal Reserve Board, coupled with the right fiscal policy by the Government, first by balancing the budget, and then by using surplus income in times of prosperity to reduce the Federal debt, we can stop inflation. Foreign funds coming to this country are an undesirable development, and create a problem that I think can be met, but which must be carefully and closely watched. The excess reserves of our banks today are due almost entirely to foreign funds coming into this country. If it were not for the foreign capital that has been transferred into this market, because foreign investors had more confidence in America's future than in their own, we would have no excess reserves whatsoever. We would really have a deficiency, taking into account present reserve requirements which the Board prescribed recently. Those funds came in here in the form of gold, and that gold was perfectly worthless to us so far as our need for it is concerned. It only costs us money to store it. We gave to the foreigners dollar credit, which they invested in our stocks, bonds, and properties. And we are paying them interest and dividends and rents on those funds while they are so invested. And we will likely pay them a substantial profit if they choose to convert those funds into their own currencies and take them somewhere else.

With the \$2,000,000,000 stabilization fund, which is neither in the money market nor reflected in our excess reserves, and with the present excess reserves of more than \$2,000,000,000, together with the power of the Board to reduce reserve requirements back to where they were, which would restore a billion and a half of reserves, we have a

total of \$5,500,000,000 available that we could lose, theoretically in gold, without causing member banks to borrow from the Reserve System. I merely mention that to give you an idea of the resources available to meet any great out-movement of gold. And that, mind you, would be without decreasing further the gold value of the dollar, or increasing further the price of gold.

That gives to the Federal authorities broad powers, if intelligently used, affecting domestic stability as well as an international stability. What other countries might do that could upset the national equilibrium, of course, we cannot control. The Federal debt is about \$13,000,000,000 more than it was at the bottom of the depression, and if the entire amount of Treasury balances today, the entire amount of liquidation of assets were used for further government expenditures, the debt would not increase above \$13,000,000,000, which added to the \$21,000,000,000 debt at the time of the bank holiday would make the total debt \$34,000,000,000. Now, the cost of servicing that debt is not a serious problem. It is about one per cent of an 80 billion dollar national income. The cost of servicing the British debt is about 3 per cent of their present income which is the highest income they have ever enjoyed.

A \$13,000,000,000 increase in the debt for a nation with our wealth is a small cost to pay for recovery. A \$13,000,000,000 debt is less than two months of our pre-depression national income. It is equal to the Federal deficit during but one year of the World War. However, we have something to show for the \$13,000,000,000 now. Moreover, \$4,000,000,000 of it hasn't yet been spent, and we paid a bonus which

was a liability to be paid at some future date--at least, we put it in the form of a Government bond, and put it on the books--it was a liability before that wasn't on the books.

In other words, the \$13,000,000,000 hasn't left the country. It hasn't gone overseas. It is on deposit in the banks, and it is that increase in the means of payment and the increased velocity of that fund which has made it possible to bring about the increase in national income, which is yielding the revenue to balance the budget; to bring about the increased well-being of the people, and the increased safety and increased security of the banks.

Now, let me recapitulate for a moment. As I have indicated, our problem today is not the national debt, which is large but not oppressively burdensome for a nation of our wealth and resources. And we are rapidly reaching the point of a balanced budget when it will not be necessary to create new deposits by the sale of government securities to the banks. These causes for anxiety no longer exist.

As for the problem of excess reserves, which, as I have said, are almost entirely the result of the inflow of foreign funds, we are in a position to deal with the present volume of reserves, and to meet very heavy withdrawals of funds if there should be a reversal of the inward movement. Therefore, the present volume of reserves does not present an unmanageable problem.

However, we have reached the stage in recovery at which it is no longer desirable to have additions either to our banking reserves or substantially to the volume of deposits. We have adequate means at our

disposal to cope with the present volume of reserves and of deposits, but we have no way of preventing a further, continuous inflow of foreign capital which would superimpose another huge and possibly unmanageable volume both of deposits and of reserves upon our banking system. This is our most immediate problem from the standpoint of the Federal Reserve System as well as from the viewpoint of the Treasury. The President has called attention to this problem and has requested the Treasury, the Reserve System and the Securities Exchange Commission to study it thoroughly with a view to recommending such ways and means as may be appropriate for dealing with it.

It is manifestly unfair for our own people, for American investors, to be required to pay a capital gains tax and to pay income taxes, which range as high as 75 per cent in the highest income brackets, while foreigners are able to purchase our securities and to profit by our recovery without being subject to any taxation other than the nominal 10 per cent assessed against dividends under the so-called withholding tax. Foreigners are free to withdraw their funds and their profits at any time and to take them out of the United States without paying a fair share or a comparable share of taxes such as are imposed upon our own people. Now this is not an equitable situation.

But, beyond that, the speculative movement of foreign funds into and out of the principal money markets of the world has long been a seriously disturbing factor. It upsets the domestic economy of the country losing the capital and in our own case, as I have pointed out, it is the sole source of our present excess of reserves. Such action as the Reserve

System has taken and is now contemplating once more in order to prevent these foreign funds from becoming the base for an unhealthy, speculative expansion at home, is, after all, action dealing with effects and not with the fundamental cause. Furthermore, such action does not prevent inflowing foreign funds from swelling the bank deposits of the country.

That is not all. These speculative movements of foreign capital put a strain not only upon the domestic economies of the countries directly affected, but they impose a heavy load upon the stabilization funds set up to maintain an equilibrium among the principal currencies of the world and to facilitate normal trade and commerce. Why should the foreign speculator be permitted to throw monkey wrenches into this vitally necessary economic machinery? Why should the foreign speculator at the same time escape a fair share of taxation?

Neither government nor Federal Reserve policy in the interest of promoting and preserving full recovery can be effectively exercised when such conditions exist and threaten to get beyond the boundaries of control. Monetary management, under existing powers of the Reserve System; operations of the stabilization fund; Treasury financing policy in relation to the creation and maintenance of a necessary but not excessive level of bank deposits, and the problem of interest rates and the maintenance of easy but not excessively easy money conditions are all exposed to upset under the impact of large scale, speculative shuttling of funds among the principal capital markets of the world. Stability of currencies and of external trade conditions as well as internal stability are

jeopardized by such speculative movements.

I have outlined broadly an immediate problem which deserves to have the best thought of the banking world brought to bear upon it--which calls for understanding and intelligent action. It challenges particularly the attention of the banking community if the bankers are to have a full sense of responsibility for guidance and leadership when the country is confronted by difficult but by no means insoluble problems such as this. And as bankers, you and I must be willing to accept our proper share of public responsibility and to offer a leadership that is prepared to meet such problems.

Looking to our responsibility in the future, I was impressed by reading this statement in a newspaper:

"The election calls for a renewed sense of responsibility, not only in the President, but in all of us, for it is no longer a question for any of us whether or how far we are prepared to collaborate with the President, but whether and how far we are prepared to collaborate with the national will. It ought to mean that business and industry will face the challenge of formulating programs of collaboration with government for the good of the nation, to satisfy the desire of the nation for more security and more stability, for better homes and steadier wages, and greater assurance of continuous employment."

Let us as bankers, and I speak with feeling because I am a member of the fraternity of bankers--I have been in the banking business all of

my life--let us get the touch of reality. Let us forget our homesickness for a past that, desirable as it may have been, we cannot bring back, and let our record in the future be one of leadership in helping to direct the course of social and economic well being.

Let us change the record of the past, which has been one of opposition to every progressive move by the Government. The national banking act in 1860 was violently assailed as an infringement upon the rights of the people, or upon states' rights. The income tax of 1895, both before and after it was declared unconstitutional by a 5 to 4 court decision, had the organized and united opposition of business and bankers, and it took eighteen years to get a constitutional amendment. The Federal Reserve Act was bitterly opposed by business men and bankers through their organizations. Workmen's compensation acts have been opposed by organized business. The eight-hour day was opposed by organized business. Child labor laws have been opposed in many states by organized business. Social security legislation and old-age pensions are widely opposed by organized business and bankers. The Securities Exchange Act of 1934 was opposed by business and bankers. The Banking Act of 1933 was opposed by bankers and business. The Banking Act of 1935 was opposed by them.

Now, that is a bad record, and we don't need to blame anybody but ourselves because we find ourselves in the rear of the procession, and find ourselves discredited today with the mass of the American people. We might just as well admit it. We have failed to meet the challenge of our responsibility of leadership.

Now, I say to you as bankers, have the courage to think clearly, and to regain the touch of reality, and to take your place as the leaders in this great capitalistic economy which we want to preserve.

I thank you.

Chairman BYRNE. I think I speak for each person in this room when I say we have been highly privileged to listen to this searching and authoritative analysis by Governor Eccles of things, things which are past and things which are facing us and things which are in the future. We are very grateful to the Governor for coming here today, and I want to assure him that he is very welcome.