TRANSCRIPT OF TESTIMONY

OF

CHAIRMAN ECCLES

BEFORE THE

SENATE SPECIAL COMMITTEE
TO INVESTIGATE UNEMPLOYMENT AND RELIEF

ON

TUESDAY, JANUARY 4, 1938

(Charts referred to appear at the end of the text.)

MARRINER S. ECCLES

was called as a witness and testified as follows:

The Chairman: I want to say to the members of the Committee that I had asked Governor Eccles of the Federal Reserve Board to appear on Friday of this week, and only yesterday afternoon requested him to appear today. Mr. Eccles did not want to come at any time. I did not have to resort to sending a subpoena to bring him here, but at one time I thought I would have to do it. He is not only reluctant, but is a very reluctant witness. Nevertheless, he is here.

Governor Eccles, how long have you been Chairman of the Federal Reserve Board?

Mr. Eccles: Since February 1, 1936, which was the effective date of the Banking Act of 1935 so far as the reorganization of the Board was concerned. Previously, I was appointed as a member and as Governor of the Board beginning November 15, 1934.

The Chairman: This Committee is acting under a resolution with which you may or may not be familiar. The purpose of our inquiry is simply to ascertain the extent of unemployment, the cost of that unemployment, the revenues therefor; and then to endeavor to procure opinion from Government officials, business leaders and labor leaders, as to what, if anything, can be done by Government to encourage private industry to provide jobs and where such jobs can not be provided by private industries, to recommend the methods to be pursued by Government to render assistance.

I wish you would state to the Committee, first, the picture of 1937, as you get it from the information furnished to the Federal Reserve Board. I would like to know in what month industrial production reached its recovery peak; how that peak compared with 1929; what recession there has been to date; and, in that connection, we will be glad to have any information that you have, and which you can furnish to the Committee.

Mr. Eccles: Mr. Chairman, I have had very little time to give this the preparation it deserves, but I will undertake to outline, briefly, what I understand the situation to be.

I would like to say in appearing here that I am expressing my own views, and not necessarily those of the Board or the Reserve System or the Administration. I am not here representing anyone except myself.

The Federal Reserve Index of Production got up to 121 (that is, of the average 1923-1925 index figure of 100), in December, 1936. In August of 1937, it was 117. The recession, up to that time, was minor. In November the index was down to 89. The best estimate we can give at this time, for December, is that it would be around 83.

The index of production seemed to be levelling off in December for the first time since the decline started.

This is the sharpest rate of decline in production on record.

In this period the weekly wholesale commodity price index figure, which was 100 in 1926, averaged 87 in September, and on December 25th, 81.2.

The price index of farm products at the end of September, was 87.3. It fell to 72.9 per cent as of December 25th. Prices of commodities, other than farm products and foods, fell from 85.9 to 83.6, or a decline of 2.3, as against a drop of very close to 15 points in the farm products price index.

The Department store sales, which are an important figure, through October were 93; in November, 91, and the estimate for December is 90.

Rents had been going steadily up until about October. Then they levelled off, and are now tending downward.

Residential building continued to decline. It started to decline last spring, and has continued through December.

That is just a very brief outline of the present picture of production, prices and construction.

I might add that freight car loadings, which were at a high of 84 in April, were down in December to an estimate of 67.

Factory payrolls were at a high of 105 in April and May. We have no estimate or preliminary figure for December. However, the preliminary figure for November is 89. Of course, it will be lower than that in December.

Every one of the figures indicates that a severe decline has been under way in employment and in production. Some prices have declined considerably and others very little or not at all.

With reference to the security markets, high grade bonds, including Governments, have shown considerable strength, particularly Governments, during the last three months, whereas stocks, have undergone a severe decline.

Second grade securities, that is, bonds of certain types of business such as rails, have shown considerable weakness during the last three or four months. That is a typical development for a deflationary period, where high-grade securities tend to reflect the absence of opportunity for profitable investment and the prospects of increased buying power for money, whereas equity securities and real estate tend to go down in price, reflecting the deflationary trend, just as they go up much more rapidly in an inflationary trend.

The Chairman: Mr. Eccles, what, in your opinion, were the most potent factors influencing the recession?

Mr. Eccles: From the upturn in the latter part of 1933 until the latter part of 1936, non-agricultural prices had been pretty stable. Unemployment had gradually lessened. The national income had increased by more than $20,000,000,000, and the recovery had been orderly. It had been marked by a great degree of stability. It was hoped by many of us that the transition from Government spending to private activity, or from an unbalanced budget to a balanced budget, could be effected. When we look back, it becomes apparent that in 1936 private expansion was well under way. That is, there was a very substantial increase in private expenditures and in bank credit. An expansion of bank credit normally increases the supply of money, or the means of payment. The banks were, therefore, increasing the supply of money, based upon the requirements of private activities. Even in those situations where credit was not needed the deposits of many companies were put into greater activity than had previously been the case.

The volume of money which is created by the banks, either through private lending or Government lending, is only one factor.

Another factor is the velocity of the existing supply of money. That is, putting the money on deposit in banks to use.

During 1936 the Government was borrowing very heavily, while at the same time private business was borrowing. The Government was borrowing to take care of its relief, and also public works, and other programs. Also, at this time the payment of the bonus came in. Thus, in 1936 there was a large increase in the volume of bank credit, and in the velocity of existing bank funds toward the latter part of the year. Personally, I think that it was unfortunate that the bonus was paid in 1936, at a time when other large expenditures were being made by Government in other fields, and when expenditures were also being made on an increasing scale by private business. I think that had the bonus been paid possibly in 1934, it would have tended to compensate for the lack of activity at that time in private business. But it seems that we were all going in the same direction at the same time in the fall of 1936, and that this accentuated the inflationary development. A price distortion took place from the fall of 1936 to the spring of 1937, bringing about a very rapid increase in the price of stocks, in anticipation of great business activity, and profits; and bringing about a very large increase in building costs, and costs in the heavy goods industries, generally. An inflation psychology developed, and was followed up by the desire to convert money into things, because people were of the opinion that things were going higher. Nearly every business undertook to place future orders. There was an effort to buy, not only for current needs, but for future needs.

This accentuated further the strength of prices in many fields.

Senator Clark: Was not that precisely what the Government itself had tried to force under the N. R. A. scheme; this purchasing for future needs, as well as present needs, on the theory that the whole business was going higher? That was the whole theory of the N. R. A., was it not?

Mr. Eccles: I am not familiar with the history of the N. R. A. I was trying to answer the question of the Chairman with reference to --

Senator Clark: I did not mean to interrupt your trend of thought.

Mr. Eccles: I was not trying to answer the question as to what were the contributing factors to this present situation.

The increased construction costs discouraged the building of homes. Costs went up faster than rents, it made building for rental an unprofitable venture. The income of the great masses of the country did not rise as fast as construction costs. Because of abundant crops of the farmers, the prices of agricultural products, as I have indicated, did not go up as did the prices or costs of some labor and some materials, particularly in the heavy goods industry, so that the recovery got out of bounds. A distortion developed in prices.

Senator Lodge: Did I understand you to say that wages are too high; that they are getting too large a percentage?

Mr. Eccles: No, I did not say that, Senator. I think a question of that sort can not be answered by yes or no.

Senator Lodge: You think there is a maladjustment?

Mr. Eccles: What I am saying is that prices of construction and prices of many other things went up, while the buying power of a great

part of the population, particularly agriculture, did not go up correspondingly. They were unable to buy at the increased prices. If their prices had gone up in the same degree, it would have made no particular difference in so far as their ability to buy was concerned. In other words, if agricultural prices, wages and incomes, generally, had gone up in relationship to certain wages and certain prices, possibly, we could have continued to do business on an inflated or higher scale. At least, theoretically, that would be true.

The Chairman: Along that line, would it be due to the fact that agricultural prices are governed, to some extent, by world prices?

Mr. Eccles: Yes. World prices determine the prices of some of the basic agricultural products, whereas the prices of certain manufactured products are determined by the world price plus the tariff. The tariff enters into that picture as as factor; whereas this is not true with many basic agricultural products.

The Chairman: Would there be more rigidity in the prices of material and labor than in agricultural commodities when the basic commodities are priced at home?

Mr. Eccles: There is, of course, a great deal of rigidity in certain prices and wages, whereas in the case of certain wages and certain other prices there is more flexibility, and they adjust themselves very rapidly to changes in supply and demand. At the same time that the price increases took place there were demands by labor for an increased share of the increased profits from the increased activity of business. Such demands were perfectly justified, but, as a result of that, strikes developed. There was a feeling on the part of many business interests that

they would have difficulty in getting deliveries, and a great backlog of orders was built up. There was a seller's market. That is one reason why, even though prices failed to go up after April, there was no diminution in production or employment until about August. Business, generally, was living on a large backlog of orders. While this development was going on in the field of private activity, Government commenced to reduce its expenditures, or, at least, its contribution to community buying power was very greatly lessened. The failure of production to continue to expand, and construction to continue to grow, brought about, shortly, a contraction in the volume of credits as inventories began to decline and were converted into funds, and these funds were used to pay off loans, to some extent.

As values went down pressure for paying off loans developed because the margin of commodities or securities back of the credit decreased.

The Chairman: When did that occur?

Mr. Eccles: I am not speaking of any specific instance, excepting that as the value of collateral diminishes to a point where a bank may feel unsafe in continuing to carry it, whether it be on commodities or other assets, there is pressure by the lender, whether it be a bank or any other lender, for payment of the loan. That tends to bring about a certain liquidation. That has not been extensive. I think it has been very mild, because of the small amount of speculative credit that was expended.

The Chairman: That was a development of the fall, was it not?

Mr. Eccles: Yes, that is right.

The Chairman: When do you say there was a reduction in Government expenditure?

Mr. Eccles: I can take the picture for the 11 months of this year as compared with last year. It is estimated that the excess of cash expenditures over cash receipts for the first 11 months of 1936, as compared with the first 11 months of 1937, showed a difference of over $3,000,000,000.

Senator Clark: How much of that is represented by the payment of the bonus?

Mr. Eccles: I could not give the exact figure on that. Total bonus payments in 1936, of course, aggregated about $2,000,000,000.

Senator Clark: What I was trying to get at was how much reduction, if any, there had been between the two periods in the normal expenditures by the Government, or what you might call the normal and extraordinary expenses of the Government, outside of the bonus.

Mr. Eccles: I am not talking about Government expenditures. I am talking about the excess of cash expenditures over cash receipts. That would take into account, particularly in 1937, collection of social security taxes, which in 1936 were small, whereas in 1937 they have been large.

The Chairman: You are not talking about the expenditures of 1937 as compared with 1936, but you are speaking of the deficit in 1937 as compared with the deficit in 1936. Is that correct?

Mr. Eccles: That is right. I am talking about the difference between what the Government contributed to the community ability to buy in 1936 as compared with 1937. In other words, the payment of social security taxes is like the payment of any other taxes, in so far as the community does not have these funds available to expend after they have been

paid in taxes. The difference between the total collections and the total disbursements is the thing I am talking about. In 1936 the Government collected about three and one-half billion dollars less than it spent.

The Chairman: And had to borrow --

Mr. Eccles: That is right.

The Chairman: -- to meet the expenditures.

Mr. Eccles: That included the bonus payment. In the first 11 months of 1937 it is estimated that the Government expended more than it collected, including collection of social security taxes, by about $450,000,000, so that the Government added to the ability of the community, as a whole, to buy, $450,000,000 in the first 11 months of 1937, as against about $3-1/2 billion in the first 11 months of 1936. Of course, that was a very important factor. That was a very drastic decrease from the high point that the bonus and other expenditures had put us up to in 1936. As I look back, it certainly would seem that it would have been better if less had been expended in 1936 and more in 1937; in other words, if, in 1936, while credit was expanding and private activity was under way, there had been some lessening in Government expenditures, then if in 1937 the Government had been prepared to increase the contribution to the community to offset the decrease in private spending. In other words, the action of the Government, the fiscal policy, to my mind has got to be compensatory, in that it can diminish only when private credit is expanding, and should expand only as private activity diminishes.

That is a general statement.

The Chairman: I know it is a general statement, but isn't this a fact, that one reason why the deficit was less in 1937 was because,

through the Social Security taxes the revenues were higher?

Mr. Eccles: That is right.

Senator Clark: We were borrowing from the Social Security funds instead of borrowing on the money market for Government expenditures?

Mr. Eccles: That is correct.

The Chairman: It does not mean that the expenditures by the Government were less, but it means that the deficit was less because the revenue was greater, due to the Social Security tax.

Mr. Eccles: Well, what it means is that the Government contributed more to the ability of the community to buy in 1936 -- three and one-half billion dollars in the first eleven months -- than it did in 1937.

The Chairman: That means only that the contribution by Government to the community for expenditures is the amount of its deficit.

Mr. Eccles: You have a cash deficit and a bookkeeping deficit. Social Security is figured, of course, as a liability to a fund. In the case of the cash deficit, it would be the total difference between what the Government takes in and what it expends. After all, that is the thing that affects community activity. It is not the bookkeeping deficit. It is the difference between the cash receipts and the cash disbursements, and if the cash receipts, for whatever purposes, are greater than the cash expenditures, by three and one-half billion dollars, between one year and the next year, it means that private activity has got to supply the three and one-half billion dollars to offset it, in order to maintain the status quo.

The Chairman: I see what you mean. Whenever you have completed

your statement of factors I want to revert to another question. Have you completed your statement of factors, or are there other factors enter into the recession to which you wish to call attention?

Mr. Eccles: I will just briefly outline them. They are the costs and the price advances. Then there are the increases in inventories, which, according to the studies we have made, were about 35 per cent more in September of 1937 than they were in September, 1936. That is in the case of about 60 of the large corporations.

There was the downturn in construction, particularly in residential construction, due to the increased costs, and the failure of rents to rise sufficiently to make it profitable to build at the higher costs.

There was the change in the budget picture, which I have just outlined.

I might add to that the railroad situation which, due to the increased wage bill, and the increased costs of materials, tended to diminish the fund or the income of the railroads available for buying of equipment and doing needed maintenance work.

Of course, there are the utilities, which did not expand to the full extent which they, possibly, would have done had they felt that conditions were more favorable to their expansion.

All of these factors tend to feed upon the others.

As the stock market began to go down it tended to diminish buying power. At least, it tended to depress the holder of securities, and would tend to cause him to curtail expenditures, to some extent.

The Chairman: Now, reverting to an earlier month; when did the

Federal Reserve Board first increase the bank requirements?

Mr. Eccles: They acted the first time in July, 1936, when they increased reserve requirements by 50 per cent. At that time there were something over three billion dollars of excess reserves, and, on the basis of then existing reserve requirements, a sufficient amount to expand credit and increase deposits by something over thirty billion dollars, which would more than double the amount of total bank deposits that we had in member banks at that time, or that we had in 1929. It was perfectly evident that the huge volume of reserves was not necessary and, if used, could only create a very injurious credit expansion.

The Chairman: What effect, if any, did it have upon prices and conditions, generally?

Mr. Eccles: That first increase had no effect whatever. The increased prices and the increased activity occurred after this action to increase reserve requirements.

From the time these reserves were increased until December, when the Treasury adopted a policy of sterilizing gold, reserves had continued to increase rapidly, due to the foreign capital that was coming into this country, reflecting itself in an increase in deposits, and an increase in the excess reserves of the banking system.

When the Treasury acted on December 21, 1936, to keep gold imports, or the effect of foreign capital imports from adding to excess reserves, which was accomplished by the sale of Government securities or bills, and using the money from that sale to buy and sterilize the gold, that, of course, stopped a further increase in reserves, so far as they were

influenced by gold imports, or so far as they were influenced by foreign capital coming into this country. The gold imported in this period was just a reflection of the foreign capital that was coming in. The desterilization, in itself, was not deflationary. It was only anti-inflationary. It merely stopped a further inflationary development resulting from further increased idle reserves.

In January the Federal Reserve Board decided to increase the reserve requirements to the full extent permitted under the law, which was another billion and a half. The excess reserves at that time were over two billion dollars.

We figured that the further increase in reserve requirements would diminish the excess reserves to between a half a billion dollars and one billion dollars. At this particular time the volume of deposits was in excess of anything that we had ever had before. The excess reserves still available after the final increase would have made possible a further expansion of credit, taking members banks as a whole, without resorting to borrowing from the reserve system, of from two and one-half to three billion dollars.

This chart will give the Committee a picture of the deposits of member banks.

The Chairman: When was the peak?

Mr. Eccles: It has remained approximately the same since that period.

The Chairman: What year?

Mr. Eccles: 1937. It is up to the middle of 1937.

The Chairman: How does this compare with 1929?

Senator Clark: When does that chart start?

Mr. Eccles: It goes back to 1921. Here are the deposits in 1929 and here they are now (indicating).

The Chairman: What is the comparison between 1929 and 1937, January 1?

Mr. Eccles: The net demand deposits of the banks, including currency in circulation, by comparison with 1929 is not here. I do not have the figures. I have merely the chart. This is over $30,000,000,000 here. Here, in 1929, it is slightly less than thirty billion (indicating). This, in 1937, is about thirty-two or thirty-three billion. There is approximately three billion more deposits at member banks.

The Chairman: Have deposits ever been greater than the figure you indicate for January, 1937?

Mr. Eccles: They have never been that great by three or four billion dollars at member banks.

Senator Davis: They are greater in 1937 than they were in 1929?

Mr. Eccles: Yes. They are still greater -- substantially greater. I merely wanted to give you that picture.

The Chairman: Let us go back to January, 1937, when the Board determined to issue the order. What motive actuated the Board in issuing that order as to reserve requirements at that time, raising them to the maximum? Were they seeking a restriction?

Mr. Eccles: It was not done as a restraining or deflationary action. It was done for the purpose of putting the Reserve Board in a position where its action in the future could be effective.

The way that the reserve system would influence the use of credit on the part of the public, through the banks, would be to put the banks in a position where they had to borrow from the Reserve System in order to extend credit, and then the Reserve System could raise the discount rates, so that, in effect, the restraining action would have to be brought about largely by extinguishing any excess reserves, putting the banks then in a position where, if they extended credit, they would have to go to the Reserve System to get it, the Reserve System, in turn, raising the discount rate, so as to discourage the banks from borrowing from the Reserve System and, hence, discouraging them from making loans.

All during the period of the 20's the banking system operated without excess reserves. There was general borrowing from the Reserve System of substantial amounts by the member banks all during the 20's.

There has been practically no borrowing whatever from the Reserve System since 1933.

Last spring a great deal of pressure was being brought for the Reserve System to exercise a restraining influence upon advancing prices. There were many people who felt that the inflationary development that seemed to be under way last spring should be stopped by a restrictive monetary policy. I disagreed with them and, briefly quoting what was said at the time, because it is better to give what was said at the time than to look back and think what you might have said, I said on March 15th --

The Chairman: Of this year?

Mr. Eccles: Of 1937:

"I have been and still am an advocate of an easy money policy and expect to continue to be an advocate of such a policy so long as there are large numbers of people who are unable to find employment in private industry, which means that the full productive capacity of the nation is not being utilized. Under such conditions, to restrict the available supply of capital and thus to make it difficult, if not impossible, to employ these people would not only be anti-social but uneconomic."

I will not read all of it.

The Chairman: What steps were being urged upon the Board at that time, or what action did the Board take?

Mr. Eccles: The steps that were being urged were not only to increase the reserve requirements, but also to carry out an open market operation by decreasing holdings of securities in the portfolio. In other words, reduce or eliminate the excess reserves entirely, and raise the discount rates.

The Chairman: You did not use the reserve for open market purchases?

Mr. Eccles: We did not sell but we did purchase. We purchased about $96,000,000 of government securities in April.

The Chairman: In April?

Mr. Eccles: That is right.

The Chairman: When did the order as to the bank reserves go into effect?

Mr. Eccles: It went into effect, one half on March 1st, and one half on May 1st. It is not a flexible instrument. You can apply it only to two classes of banks. One class is termed the country banks which

does not necessarily signify banks in the country district, but means banks which are not reserve city or central reserve city banks. New York and Chicago are the Central Reserve cities. Then there are about 60 of what we call reserve cities. Any increase or decrease in reserve requirements at city banks has to be made to apply to all of them, just as any increase or decrease at country banks had to be made to apply to all of them.

The Chairman: What effect did it have upon the bank reserves?

Mr. Eccles: It decreased the excess reserves.

The Chairman: It decreased the excess reserves?

Mr. Eccles: That is right.

The Chairman: What are the bank reserves as of today, or as of the last date about which you can tell us?

Mr. Eccles: The member bank excess reserves at the present date are about one billion two hundred million. It is expected that they will increase to one billion four hundred million or one billion five hundred million as the currency in circulation diminishes. It is diminishing seasonally now.

The Chairman: That compares with what figure as of the date that the orders were issued by the Board?

Mr. Eccles: I would say that is possibly six hundred or seven hundred million less than the excess reserves at the beginning of 1937, but the present excess reserves are of sufficient amount for member banks, as a whole, to expand credit by from six billion to eight billion dollars, so it would appear that when credit is contracting, as it has been for

the last few months, it is not because of the inability of the banks to carry the credit, or extend more credit --

The Chairman: To what is it due?

Mr. Eccles: It is due to the desire of people to apply funds against loans as inventories are reduced, or as accounts are reduced, or as liquidation goes on. There is less opportunity to use funds profitably. Credit only expands, generally, when there is an opportunity to use funds thus borrowed or created profitably.

The Chairman: Due to the fact that prospective borrowers do not see how they can use those funds so as to make a profit?

Mr. Eccles: That is right, and as inventories are reduced and accounts are reduced, which always goes on in a period of business contraction, idle funds are created, and those funds are used to apply against debts if a concern has debts.

In connection with that, and in reply to those people who say there has been a restrictive policy, I would like to show you the trend of the interest rate structure here from 1920. This figure here on the bottom is bankers' acceptances (referring to chart). You see that they are less than one-half of one per cent.

The Chairman: Has it ever been lower than that?

Mr. Eccles: Yes. It was lower from 1934 to 1936. It is a small item, however. The volume of bankers' acceptances amounts to very, very little.

The Chairman: How about the customers' rates?

Mr. Eccles: This is the average customers' rates, in 27 leading

southern and western cities (indicating). It is at the lowest average that it has ever been.

The Chairman: What is the average at this time?

Mr. Eccles: The average at this time is about four and a quarter per cent.

The Chairman: You mean that is the average interest rate applied to customers by the banks in the southern and western districts?

Mr. Eccles: That is right, for banks in principal cities in these sections. That would include all types of loans.

The Chairman: How about other sections of the country?

Mr. Eccles: In 8 leading northern and eastern cities, excluding New York, the average customers' rate is a little less than three and one-half per cent.

The Chairman: Does the chart show any lower customers' rates than that?

Mr. Eccles: You notice that it fluctuates slightly. It is never a straight line. For a period of a few months they were possibly a fraction of a per cent lower.

The Chairman: In previous years --

Mr. Eccles: It has never been lower in previous years than at the present time. In 1936, 1935, 1934, 1933, 1932, 1931, 1930, 1929, all during the 20's --

The Chairman: In 1929 what was the average customers' rate?

Mr. Eccles: Around 6-1/4 per cent. All during the period of the middle 20's they averaged around 5 per cent in principal cities in the southern

and eastern sections. It is now less than 3-1/2. We get down to the New York City average customers' rate. It is less than 2-1/2 per cent.

The yield on long term Government bonds went down to about 2.3 per cent in December 1936. Then it went up to around 2-3/4 per cent in April 1937. It is now down to a basis of 2-1/2 per cent. 2-1/2 per cent, outside of this period in here, from August 1936 to March 1937, (indicating), is the lowest average yield that long term Governments has ever enjoyed.

The commercial paper rate is 1 per cent. It was three-quarters of 1 per cent from 1934 to the time the reserve requirements were increased finally. Call loans have continued at 1 per cent for several years.

I see no indication there --

The Chairman: Of a restriction of credit?

Mr. Eccles: Of a restriction of credit, and the lack of availability of funds, so far as the banks' willingness and ability to lend is concerned, that is, where they consider credit good. There could be a good many situations where banks could have double or quadruple the excess reserves they now have and would, still, refuse to make loans which they felt were not satisfactory. It is not a question of the amount of excess reserves that always assures credit to everybody, and which also assures that those having loans that are unsatisfactory or undesirable will not have them called. Excess reserves, existing today, in and of themselves, are adequate for a very substantial expansion of bank credit. The difficulty today is the absence of borrowers; not the inability of the banks to loan, but the unwillingness on the part of the public to borrow, because they, do not feel that they can do so profitably. I do not mean to say that a situation

could not develop where the excess reserves, if deflation continued in the country banking area, might not go down while they are going up in the reserve bank areas, which might call for action in dealing with one class of banks.

We are constantly studying where the reserve funds are. According to the last study we made, they are widely distributed throughout the country. It is only when excess reserves are widely distributed that you can put such a blanket increase into effect and cause the least difficulty.

Senator Davis: Did I understand you to say that you were opposed to increasing the reserve requirements?

Mr. Eccles: No; I was not.

Senator Murray: Isn't it true that those very large bank deposits which you speak of were due to the fact that during the period that the Government was spending so heavily we had a very low income tax rate, which permitted a large amount of that Government spending to drift into the hand of private capital? That is to say, while the Government was spending so heavily, there was a low income tax rate, which permitted a large portion of the Government spending to get into private ownership and it was not kept in circulation?

Mr. Eccles: I think the problem is not just that simple, Senator. I think that might be a contributing factor. Certainly, as the Government created money by borrowing, which it spent, that, in turn, increased the deposits of others in the banks. As business institutions took in more money than they paid out, and held that money idle, somebody had to pay out more than was taken in. That is why I was for the undistributed profits tax, and still am, with modifications. As a monetary factor it is a

very important element in our economy.

When business institutions take in more money than they disburse, either in dividends, in plant and improvements, or in the purchase of materials and labor, thus leaving their funds idle, that is deflationary in character; or, when they use those funds at a time like the present to pay off bank debts, it is deflationary in character.

This whole principle of a "rainy day" reserve is a fine principle to apply to the individual corporation or the individual person, but when you apply it to the economy, as a whole, it won't work. What we mean by a "rainy day" reserve is that each person and business will get out of debt, and if it is good for one it must be good for all. If it is good for the big company it certainly must be good for the little individual.

The process of everyone getting out of debt, of course, means deflation. We have never had an expansion of business activity except with an expansion of debt. Our whole capitalistic system is built upon a system of debtor-creditor relationship, and if everyone proceeded on the theory of getting out of debt and having a rainy day reserve to meet a depression our insurance companies would certainly have no place to loan the insurance premiums that are paid in to them. Our savings banks would have no place whatever to loan the funds that they have.

We are trying, through a housing bill, to encourage people, individuals, to go into debt to build houses. Now, we come along with a tax proposal encouraging corporations to get out of debt and to build up idle funds. That is, they take in more funds than they pay out, which means that the Government must pay out more than it takes in so that the public

will have these funds to spend during a business recession. In a business recession debt is extinguished. That is what tends to create the recession. Business expansion comes about through the use of credit, either Government credit or private credit.

Senator Lodge: Isn't it true that the advantages of incurring debts can be carried too far? You can go too far in that direction, too, can you not?

Mr. Eccles: Oh, yes. There is no question about that. I am not advocating that everyone can and should go into debt at any time, under any condition.

Senator Lodge: I wanted to get that straight.

The Chairman: May I say this, that as Chairman of this Committee I wrote a letter throughout the country to every daily newpaper, and to many business executives and labor leaders and economists with reference to the provisions of the resolution under which this committee is acting, and, with marked unanimity, certainly the newpaper editors and the business executives, were of the opinion that one factor that contributed to the business recession was the fear on the part of Capital or investment and, in turn, that fear was due, in great measure, to this tax. Inasmuch as you have mentioned the subject, I would like to ask you whether during the last years of the depression, say 1932, 1933 and 1934, when there was a real depression, the reserves of the corporations were used or not. Have you any figure?

Mr. Eccles: Yes. I want to speak of that. In answer to the replies which you received to your inquiry, that this tax was deterring business,

I would like to point out that we had this tax in effect last fall and this spring, when the activity of business, as I have indicated here, in forward buying and in the general expansion would, in no sense, indicate that the tax which was in effect deterred in any way the expansion which appears to have been too rapid in certain directions.

The Chairman: You state you are in favor of the principle. You do not mean that you are in favor of the tax as it is now being imposed?

Mr. Eccles: That is correct. I am not in favor of it in its present form. I would like to say something about the principle of the tax, but I am speaking here now from the monetary aspects of the tax, as I see it.

The question of taxes was raised as a factor in connection with this whole subject, as I understand it, and it is difficult to treat the subject without referring to this question of taxes and their influence.

Some of the studies that have been made indicate that from 1929 when the cash and equivalent of large companies was at its highest point, they have not used or diminished substantially their rainy day reserves. As a matter of fact, for a group of large industrial corporations the cash and equivalent as of January 1st, from 1922 to 1937, would indicate that they have had all the way from 2-1/2 to 3 billion dollars of idle funds, or their equivalent, which I suppose would be Government bills or short term securities.

The Chairman: 2-1/2 to 3 billion?

Mr. Eccles: Yes.

The Chairman: How does that compare with the previous figure?

Mr. Eccles: From 1-1/2 to not exceeding 2-1/2 billions up to and including 1928; that in every year from 1929 to 1937 they have had more rainy day reserves than they had in any year prior to 1929.

The Chairman: Of course, I do not want to go into the tax because there are many phases of it.

Senator Murray: You think that there is no justification for this campaign for the repeal of those taxes?

Mr. Eccles: I think the most deflationary thing that could be done would be to repeal completely the undistributed profits tax; that it would encourage the discontinuance of dividends; and the encouragement would be to pay debts and to keep funds idle on the theory of rainy day reserves. We do not want a reduction of debt because if we get a further reduction of private debt we are going to have to get an expansion of public debt. Neither do we want the funds to remain idle. We want them to be disbursed, if only to stockholders.

There is this factor that I would like to mention, so as not to be misunderstood in connection with this tax; if business could be exempted from the undistributed profits tax to the extent that earnings were invested in plant and equipment, and for expansion of any kind, that would put the money in circulation, and give employment. This would be justified from a monetary point of view. It seems to me that in a period when we want expansion, we could well say to business that any funds invested in new plant and equipment facilities in excess of depreciation charges, during a certain period, could be deducted from earnings, so far as the undistributed profits tax is concerned, at such time as such earnings develop.

The present prospect of lower earnings, or small earnings and the uncertainty of earnings, looking to 1938, might not be much of an encouragement for business to go ahead and expand. But if expanded earnings in 1938, 1939 or 1940, we will say, could be offset against expenditures for plant in 1938, that, in itself, would seem to me to act as some stimulant to the expenditure now of some of the idle deposits, and it might also tend to induce corporations to borrow, because they would have the prospect of being able to pay back that borrowing out of earnings, looking to the future.

The Chairman: Let me call your attention to an illustration. I have in mind a small corporation, whose bonds were put upon the market, and it has a mechanical device. In the first year the marketing of this product is successful, and the earnings amount to more than 20 per cent. Ordinarily, they would have been ploughed back into the business. It was the desire of the few stockholders to do that, but, faced with the tax, instead of the money being put back into the business for expansion, it is distributed in dividends. As long as that continues there is no way of providing competition for the established business of the country. It stamps out competition and prevents expansion in the purchase of equipment. Your idea is that some exemption should be provided to enable a corporation of that kind to use that profit of 20 per cent for expansion, or for investment in business. Is that right?

Mr. Eccles: I have advocated that.

The Chairman: You say you did advocate that?

Mr. Eccles: Yes. At the time this tax came out I privately expressed some views with reference to it, calling for an exemption of a fixed amount of $15,000 or $20,000 to all corporations. That $15,000 or $20,000, based upon, I think, the 1929 returns, would exempt about 90 per cent of all companies, and it would amount to less than 10 per cent of the total corporate income of the country. It seemed to me that an exemption of that sort is necessary for the smaller companies, which do not have access to a capital market and are not using the corporate structure for means of tax evasion. When I say "means of tax evasion", I refer to means of lessening the surtaxes of individual stockholders. The normal corporation tax which the small companies pay is already as great, in most instances, and possibly greater in a good many, than the stockholders of those companies would pay if they were a partnership. In other words, from the standpoint of equity, then, there is some justification in exempting the great bulk of the corporations of the country, and such an exemption, we will say of $15,000 or $20,000, would permit those companies with twice that earning to hold half of it, and pay out half of it, and so on, and, at the same time, the very large companies, which have access to the capital market, would find that it would be a very small proportion of their earnings.

The Chairman: One other reason given by the correspondence in the communications to the Committee for the unwillingness of capital to invest was the capital gains tax. Do you care to express an opinion on the effect that tax has had upon investment?

Mr. Eccles: Yes, I would. I would like to say another word in

connection with the other matter.

The Chairman: Yes.

Mr. Eccles: So that I shall not be misunderstood.

In a period of deflation inventories are reduced and are converted into cash. The cash may then be used to pay debts. Accounts are reduced. It takes less money to carry inventories, because of their decreased cost. The depreciation taken is not put back in, and it just adds to the cash of the corporation, and the average corporation, in a period of deflation, even though it shows no earnings and may even show losses, will increase its cash. It will get its rainy day reserve in the form of cash through the natural process of requiring less working capital; and debts are liquidated through that process. That is the way it operates; whereas, at the height of business activity, if corporations have no debts, and have idle funds, then, as the recession proceeds, they will very likely add to those funds, even though they may show bookkeeping losses. That is a factor.

I would like to say this, that in situations where companies have statutory or contractual obligations that, naturally, should be taken into account in connection with the undistributed profits tax, so as to avoid unnecessary hardships, and so as to make the tax more equitable.

You asked the question with respect to the capital gains tax. It has been difficult for me to see why a person purchasing securities at the bottom of a depression, as many did in 1932, and carrying them until they appreciate anywhere from 100 to 1,000 per cent, should be privileged to sell those securities and take that earning, which is money or buying

power, in exactly the same manner as do those people who earn money for personal services---I do not see why they should be permitted to take that fund without paying their proper share of the taxes.

Now, money made in that way is often made by those people who render the least service; not always, but often. Certainly, the professional speculator or operator in securities, who tries to buy at the low point, by having funds or credit, and to sell at the high point, is not contributing a great deal to the general wealth and well-being of the nation, and is producing no real wealth.

It has been said that if the capital gains tax were greatly modified, or eliminated, it would tend to restrain the stock market from going as high as it otherwise might go, and that, likewise, it would put a cushion under it on the down-side. We did not have the present capital gains tax in 1929, but this did not restrain the market from going pretty high, and neither did this restrain it from going very low in 1932. It seems to me when the market was going up there might have been considerable selling on the part of some people if the tax had been very much less, but, likewise, there would have been considerable buying on the part of a lot of other people who would have been encouraged to buy because of the opportunity of making a profit, thinking that the stocks would go still higher. It is my opinion that there would, possibly, be more buying on the upside than there would be selling.

Foreigners, who owned a substantial amount of our American stocks, were not heavy sellers of stocks at the high point of the market, and there was no capital gains tax applicable to them. It would seem that

if the shrewd foreign investor did not sell on the upside of the market when there was no capital gains tax, clearly, the American investor would not be more likely to sell.

The Chairman: The statement made by the Committee is not directed so much to the effect of that tax upon the capital gains, but the failure to permit the deduction of losses. If you want to include gain in estimating net income, should not you, likewise, permit the deduction of losses?

Mr. Eccles: Of course, you permit the deduction within the year.

The Chairman: Let us not consider it from the point of a speculator. Here is a man who is not a speculator. He makes $10,000 from the sale of one stock, and he loses $5,000 on another in the year. He has held that stock. He has had the certificate for five or six years. The argument is that he should be permitted to deduct that $5,000 loss, just as he should be taxed on the $10,000 gain.

Mr. Eccles: We try to draw a distinction between the speculator and the investor based upon the time his security is held. I think some of our most successful speculators are the people who never borrow money at all, who buy in the depression, and always hold during the business cycle. Those fellows are the real speculators. The pikers in the picture are the fellows that buy within the year and maybe sell within the year, or sell the following year, and who buy on credit. The real speculators today only pay on a basis of 40 per cent of the profit if they hold for five years or longer. Today the holder over a long period has got some real benefit. In answer to your question about being able to offset

capital loss against capital gain by carrying it over, I would say that I would be, personally, in favor of that. I think that that would make the tax much more equitable. Certainly if a person within a period of five years has capital losses equal to capital gains he should not be expected to pay a heavy tax on the capital gains and have no opportunity of offsetting that at some time against the capital losses. There should be an opportunity, over some period of time, at least, to do that.

The Chairman: I did not want to get you into the tax field.

Mr. Eccles: Apparently I have gotten into it very deeply.

The Chairman: I wish you would tell me what you have to say about the credit of the United States Government at this time.

Mr. Eccles: The chart on excess reserves which I showed you a moment ago shows that the reserve system has locked up three billions of dollars of excess reserves, so that it cannot be said that those funds are in the hands of the banks so as to force Government bonds to a lower yield basis.

The Treasury has been sterilizing gold, so it cannot be said that their action is one of trying to make an easy Government bond market for themselves, and, yet, in the face of the action which the Board took, and in the face of the action which the Treasury took, you have Government bonds today, long-term Government bonds, selling on a yield basis of around 2-1/2 per cent. It seems to me that that speaks pretty well for the Government credit.

The amount of funds available for investment, and the scarcity of desirable fields to invest them in is certainly, in part, responsible for the strength of the Government bond market.

The Chairman: What percentage of bonds is held by banks?

Mr. Eccles: These are the member banks, which hold almost 85 per cent of the total commercial banking resources. According to this chart here, along in the middle of the summer they held over 12 billion of Government bonds. I am not giving it exactly because what I have here is a chart.

The Chairman: That accounts for 85 per cent of the banks?

Mr. Eccles: Yes. That would account for approximately 85 per cent of the total banking resources, member banks. The non-member state banks are not in this.

The Chairman: By that I do not mean bonds issued which are guaranteed, as in the case of some of the corporations established, but those are the direct obligations of the Government. Is that right?

Mr. Eccles: That would include both.

The Chairman: Both?

Mr. Eccles: Yes. The direct obligations are slightly under 11 billion, and the guaranteed obligations are slightly under 2 billion.

The Chairman: There is one other subject to which I wish to direct your attention. You have referred to our gold owned by the Treasury. What is the amount, or what is the value of the gold?

Mr. Eccles: The gold which the Treasury has sterilized is something over $1,200,000,000.

The Chairman: What is the amount of the stabilization fund?

Mr. Eccles: Two billion.

The Chairman: What would be the effect of using that gold?

Mr. Eccles: There are several ways by which you can increase member bank excess reserves. One way would be for the Board to act to decrease the reserve requirements.

The Chairman: Yes.

Mr. Eccles: Another way would be to increase the purchases of Government securities in the open market, which we call open market operations. A third way would be to desterilize gold.

The Government borrowed money to buy the gold, and if the gold is desterilized, and the funds used to retire debt, what that would do would be to decrease the Government debt, on the one hand, and increase the excess reserves of the banking system on the other. It would not increase bank deposits, and it would not increase consumer buying power. On the other hand, if the gold were desterilized, and by "desterilized", I mean deposited with the reserve system, and the Government given credit, and the Government then spent those funds, not using the funds to reduce the debt, those funds would then go out throughout the country and would become increased deposits in the banks, and they would also increase the excess reserves. That action would, of course, be reflationary on two fronts; first, the increase in the reserves; secondly, the increase in the total volume of funds, and the increase in buying power at such time as the funds might be expended. That is merely the mechanism of it.

The Chairman: Let me get the mechanics. Say, for instance, we assume we are spending one billion of dollars for relief purposes and, of course, the expenditures are in excess of the revenues during the next year; instead of borrowing that billion dollars we desterilize this gold.

Mr. Eccles: The gold is an asset---

The Chairman: It would be using an asset of the Government, instead of the Government borrowing the one billion dollars?

Mr. Eccles: It would be converting an existing asset into a deposit that the Treasury could spend, and as the Treasury spent it, it would become deposits throughout the country, on one side of the bank ledger, and on the asset side it would be idle reserves of member banks.

The Chairman: From the Government standpoint, first, it would mean that, assuming revenues were decreasing and credits were in excess, the Government would either have to increase the public debt by one billion dollars or use an asset of the Government, amounting to a billion dollars. Is that right?

Mr. Eccles: That is right.

The Chairman: If deposited in the banks in the way you suggest it would be inflationary, would it not?

Mr. Eccles: Yes, it would. It would be inflationary. At least, it would be anti-deflationary.

The Chairman: You can call it either way.

Mr. Eccles: I do not know how inflationary it would be. One billion dollars of spending would, of course,---

The Chairman: It would be an increase in the amount of debt.

Mr. Eccles: A billion dollars of increased spending, if it worked quickly enough, and went into consumer-buying power, would act as a very great stimulus, in my opinion, and would tend, I think, to stop the recession.

The Chairman: You think it would act as a great stimulus, and would tend to stop the recession at this time?

Mr. Eccles: I think, whether that was done with gold or by other means---the point is that the prospect of private capital undertaking an expansion unless there is an increase in orders does not seem to me to be very promising. In other words, what we need to do at this time is to sustain buying power, so that it would become profitable for private business to employ people. Private business is motivated in its action by profits, and Government is not motivated by the same reason at all. Government is forced to act for social reasons, and it seems to me that, as inventories are reduced, the cash proceeds are either going towards paying off further debt, which is deflationary, or are going to lie idle. The question is, are they going to take that money and put it right back into inventories again? They are not likely to. If they would take that money and get it into plant and equipment that would put it into circulation. If buying power should substantially increase, so that it became necessary to put those funds into inventories, in order to meet orders that, of course, would put it into circulation.

The Chairman: But your contention is that that spending, if the funds are derived from taxation, by additional taxes, would not have that reflationary effect?

Mr. Eccles: It would not, it seems to me, at this stage of the business cycle. An increase in taxes, and especially in your lower groups, or sales taxes of any kind, would be deflationary. Taxes in the very high brackets are, of course, pretty high. I don't know how much more might

be put on in taxes in the group from $5,000 to $50,000. But an increase in taxes in a period of recession, in and of itself, is not likely to be reflationary, and may be deflationary.

The Chairman: Boiled down, debts should be reduced in times of good business, and when a recession comes we cannot hope to raise sufficient revenue to reduce debts.

Mr. Eccles: You can only balance the budget out of increased national income. I am as favorable as anybody could be to the objective of a balanced budget, and over a year ago I was advocating the need of approaching a balanced budget. However, I think that at this time to try to balance the budget either by substantial reduction in expenditures, or by increasing taxes, would be deflationary; and that it is not so much what the total debt of the Government is as it is the timing of the increase of the debt. In other words, assume that in 1936 there had been no debt at all, and, therefore, it would have been said that the Government could well afford to spend five or ten billion dollars. Nevertheless the spending at that time would have been very bad. It now proves to be the case that because they spent as much as they did spend, including the bonus, in that year, when private business was also expanding, it contributed to an unbalanced situation.

At the present time, when private credit is contracting, it seems to me necessary and desirable, if we expect to sustain buying power, that either private business must act to do it, and they must find a profit before they act to do it, or Government will be required, sooner or later, to do it. It has always been my view that the longer we let a deflationary

situation develop the greater the amount that is likely to be required.

The Chairman: How would you put it on the basis of the stock market, and without stopping deflation?

Mr. Eccles: Do you mean generally speaking?

The Chairman: Is there any way?

Mr. Eccles: I think when we look to a monetary policy as the sole factor for stabilizing economy we are going to be terribly disappointed, because it is not possible, through monetary action alone, to create complete stability in the economy or maintain a stable condition. It would not be difficult, of course, to put on the brakes tight enough to stop an inflationary development, but it is very difficult through monetary action to stop a recession. Your question was, how could that be done without bringing about a recession. Is that the question?

The Chairman: Yes.

Mr. Eccles: Until we have reasonably full employment it seems to me that we will have idle men and idle facilities. It means that we can produce more. It means, it seems to me, that we should make available sufficient credit to enable us to utilize the man power and the productive facilities that we have, and that a restrictive monetary policy should not be followed merely to correct these distortions that have developed due to monopolistic and restrictive practices. If you have a condition of reasonably full employment, and then prices begin going up, certainly a restrictive monetary policy should be adopted, because a further expansion of credit, when it was not resulting in further production of goods, would be bad, and if you were utilizing your man power and your

facilities close to capacity, certainly a further increase in the supply of money would only lead to increased prices. In other words, the available supply of credit should be restricted when such a condition develops, in order to keep the increased money supply from merely adding to increased prices.

The Chairman: Are there any questions, Senator Davis?

Senator Davis: If the Federal Reserve Board can put on the brakes, as the Chairman called attention to a few moments ago, surely you have some sort of accelerator there that you can start things off with, haven't you? What would you suggest?

Mr. Eccles: I only wish we did have an accelerator. What do you have in mind, Senator, that we have as an accelerator?

Senator Davis: Is there any way at all that the Federal Reserve Board can be helpful in a situation such as we are now in?

Mr. Eccles: I do not know that the Reserve Board can do any more than it is doing, keeping rates at the lowest they have ever been in the history of this country. We cannot induce corporations or individuals to go into the banks and borrow. We can only create a condition as favorable as it is possible to create for borrowing. We believe that that condition, generally, exists. If our surveys and our consideration, from time to time, show that banks need more funds in order to be able to make loans, then it seems to me it might call for action. At the present time, however, as I indicated awhile ago, there are close to a billion and a quarter of excess reserves. We expect those to reach close to a billion and a half during the month of January; at least, from one billion four hundred million

to a billion and a half. Now, if those excess funds are not being used, but are only being added to by credit contraction, how can we, by merely adding to those funds, substantially induce their use?

The Chairman: Following that question, have you any suggestions as to what Congress can do at this time which would be helpful toward facilitating recovery?

Mr. Eccles: The most important thing at the moment is to sustain consumer-buying power. So long as the public believes that prices are going lower it wants money instead of things. When it thinks that prices are not likely to go lower, but may go higher, then it wants to use its money. The present psychology is one that has created in the minds of the public the expectation of substantially lower prices.

Now, it seems to me that we are badly unbalanced in that we have what we term, on the one hand, sticky or rigid prices and wages, and we have, on the other hand, a continuation of the decrease in the prices of many raw materials, and in the wages of unorganized workers.

The longer the recession seems to go the farther out of balance we become. It seems to me that there is more of a disequilibrium today than there was last spring. It seems that what we ought to do is to put a bottom under or lift up the buying power of the farmers and the unorganized workers, through some means of sustaining that buying power, on the one hand, and then, if there is some way to get business, as well as organized labor, especially in the building field, but possibly in other fields, where the advances were spectacular, and were possibly too rapid, and where prices have gone too high---

Senator Davis: Are labor costs too high?

Mr. Eccles: In many fields they are too high, because the services

of labor are not being employed, I would like to refer to what I said about wages on March 15th, 1937:

"Increased wages and shorter hours when they limit or actually reduce production are not at this time in the interest of the public in general or in the real interest of the workers themselves. When wage increases are passed along to the public, and particularly when industries take advantage of any existing situation to increase prices far beyond increased labor costs, such action is short-sighted and indefensible policy from every standpoint.

"Wage increases and shorter hours are justified and wholly desirable when they result from increasing production per capita and represent a better distribution of the profits of industry. When they retard and restrict production and cause price inflation, they result in throwing the buying power of the various groups in the entire economy out of balance---"

Senator Davis: Do I understand what you are saying here is that labor receives too large a share of the total national income?

Mr. Eccles: Let me finish this, Senator.

Senator Davis: Yes.

Mr. Eccles (Continuing): ---"working a particular hardship upon agriculture, the unorganized workers, the recipients of fixed incomes and all consumers. The upward spiral of wages and prices into inflationary price levels can be as disastrous as the downward spiral of deflation."

That is the statement I made then, and that fits the situation now with respect to my views of what is in the interest of labor.

The Chairman: Your statement is that if it reaches a point where it causes labor to lose its job entirely, and to lose its purchasing power, it is too high?

Mr. Eccles: When it results in increasing prices and throwing prices out of line with consumer-buying power, it not only works against the interests of industry, as we have seen, but it works against labor, because the laborers lose their jobs.

The Chairman: That is true of prices of materials, too?

Mr. Eccles: Yes, that is right. In the building field it is typical. We found that, due to the rapid increase in building costs, due to both increase in building labor, reduction of hours, and of work, and an increase in prices, industry lost its market, and labor lost its job.

Senator Davis: Are you of the opinion that the wages of labor in the building industry should be reduced?

Mr. Eccles: I am of the opinion that labor, as well as industry, would be better off if they voluntarily took a reduction to an amount that would put back the costs and wages to where they were before most of the advances at the end of 1936. If we could go back to that level and bring up the buying power of the other groups to where it was at that time we would be in a position, certainly, to go forward.

Senator Davis: To what other groups do you refer?

Mr. Eccles: I am referring to the agricultural workers and, generally, the unorganized worker groups. As to farm labor, I think that possibly it has taken some reduction from what it was getting.

Senator Murray: Isn't it a fact that the corporations increased their

prices away beyond what was justified by increases in wages, and was not that the real cause of the cessation in the building industry?

Mr. Eccles: Not altogether. That was part of the cause. Of course, unless corporations are permitted to make a profit---

Senator Murray: Do not the corporations demand a larger profit than they should be satisfied with in this country and are they not getting too large a profit?

Mr. Eccles: Averaged over a period of years, of course, that is not true. I think that is the difficulty. If we could in some way stabilize profits, that would be well, but what we seem to do is to have a very large profit for short periods, and then great losses for other periods. If the corporations did assume a policy of keeping prices down and stimulating production, and thus getting a greater volume, they would, I think, in the long run, make more profit, and be better off.

Senator Murray: Do not they pay enormous bonuses to their head officials for the purpose of encouraging them to increase these prices, and make such enormous profits?

Mr. Eccles: I think, in the aggregate, that all that they pay to the officials is a very small factor, and that, in itself, it would not be, in dollars, an important factor in the picture.

Senator Lodge: I understood you to say that rising prices created a condition in which people wanted to exchange their money for goods and that it was, therefore, a good thing from the standpoint of employment. Is that right?

Mr. Eccles: That is right. I would not say rising prices.

Senator Lodge: The expectation of prices rising.

Mr. Eccles: That stimulates speculative buying. If people generally, even though they did not expect costs to go up, were sure that they would not go down, it would lead a lot of people to buy. Prices do not necessarily need to go up to stimulate buying. When they start going up people buy beyond current needs.

Senator Lodge: At the present time prices are so low that they are deflationary.

Mr. Eccles: At the present time the general psychology is that prices and things may go lower, and to the extent that people feel that prices are going lower, there is a hesitancy to use the funds available, which are in abundance, to buy.

Senator Lodge: How do you reconcile that with the attack on high prices and monopoly?

Mr. Eccles: For the very reason that prices are so high that a lot of people in the lower income groups, and agriculture, are unable and unwilling to buy.

Senator Lodge: I have also been thinking that they were too high, and I have been saying so. I understood you to say that the thing that is deflationary is low prices and the anticipation of lower prices.

Mr. Eccles: The expectation of lower prices. I hope one would not conclude from that statement that the only way we can keep activity is to keep raising prices indefinitely, because if we proceed on that theory we will have to make an adjustment from a higher level.

Senator Lodge: That is the point I make.

Mr. Eccles: We got out of balance last year, and have been getting

farther out of balance all year, because there are some very flexible prices that go down rapidly, on the one hand, and some very sticky prices and wages on the other hand. You are either going to have to bring up the buying power of the one group through some means or other, or you are going to have to bring down the wages and the prices of the upper group, or you have to do some of both. My view is that you have got to sustain consumer buying power, generally, which would tend to stop a further recession in these prices that have already gone, possibly many of them, too low.

Senator Lodge: You think that sweat shop labor and that kind of thing ought to be raised?

Mr. Eccles: I certainly do. On the other hand, if industry, the big industries, and labor organizations, would make an adjustment downward, it would prove to be in the interest of both.

Senator Davis: How do you determine that the building labor is asking too high hourly rates and pay?

Mr. Eccles: Because no one will buy their services. That is the best evidence of that.

The Chairman: In discussing wages in the building industry I understand you are discussing the hourly pay and not the annual wage of the worker.

Mr. Eccles: Yes. I am glad, Senator, you brought that out because I, possibly, have not made myself clear. A high hourly wage has brought about a low annual wage. The cost of construction and the cost of many materials is determined, in part, by the hourly wage, and if the hourly

wage were less, the annual wage, in my opinion, would be far greater.

Senator Davis: Of course, labor's position, I assume, is that when they voluntarily consent to a reduction of the hourly wage, they have no guarantee that any reduction would result in an increase in the annual wage, but they fear that it may just increase the profits of the builder or contractor, and, instead of benefiting, they would lose. Do you know of any plan by which labor can be assured of an increased annual wage if there is a decrease in the hourly wage?

Mr. Eccles: No, I know of no plan unless the Government, itself, would become the guarantor, and that would involve a very complicated mechanism, and, I suppose, a good many difficulties.

Senator Davis: You agree that labor is afraid that a voluntary reduction of the hourly wage would not result in an increase of the annual income, and that there could be no guarantee offered?

Mr. Eccles: I think justly so. There certainly would be no benefit merely for the bricklayers, for instance, to agree to take a 20 or 25 per cent less hourly wage in order to get more employment. That, in itself, would not reduce the cost of building enough to be a factor. It would be of no great importance, even if labor itself, the carpenters and plumbers, and all, would take some cut unless, on the other hand, some of the materials were, likewise, brought down. And, likewise, with industry. I can not blame industry for holding up prices and restricting production when merely by reducing their particular prices that in itself is not going to give them a capacity volume of business. They are only part of a total picture. Naturally, they have inventories that cost them

a certain amount, and they do not want to take a loss, and they naturally, restrict production and hold prices. They do exactly the same as labor does. Labor holds wage rates and works less days. It is a parallel case. If there were some way whereby we could get all the big building industries, including steel, and get the principal people in the labor organizations, all to take an adjustment, I think we would go forward with very little stimulation on the part of the Government.

Of course, there are many in the labor field in the lower paid groups that, possibly, should take no adjustment. I am speaking of those getting the higher hourly wages, which have been substantially advanced during the past 12 or 15 months.

Senator Murray: That would have to be the result of mutual arrangement between labor and the employers.

Mr. Eccles: That is right, and merely for one group of labor or one industry to do it would, in itself, serve no purpose. That is why the thing does not come about quickly. We have seen that from 1929 to 1933, all during that period, there was very little adjustment in certain prices, whereas in the case of other prices there was practically no bottom, as in the case of agricultural prices, for instance. That is the problem we have here; one part of our economy, where there is no control over prices, or wages or hours, and there is no bottom; and, on the other side, there is organized control, where wages and prices go up, and then they stay there, and it is very difficult to get them down. That seems to me to be the root of the problem, and merely letting nature take its course is not going to improve the situation.

It seems to me what we need, and what we have got to have, is at least to stop, through some governmental action, a further diminution of consumer-buying power. We are not going to get a balanced budget by restriction, because the budget, as I have said before, can only be balanced out of increased national income. We have to turn the cycle by people having greater buying power, and by those who do have that buying power being willing to use that buying power because they have more confidence in a stable price structure.

Senator Lodge: Do I understand correctly that you favor putting one billion dollars of this sterilized gold into circulation for public works?

Mr. Eccles: I did not express that opinion. I was merely asked as to the mechanics of the operation. I prefer to express no opinion on that. That seems to be a responsibility of others.

Senator Lodge: I thought you said that.

Mr. Eccles: No, I did not say that.

The Chairman: What you stated was what would be the effect of doing it.

Mr. Eccles: That is right. I made no recommendation. I am not recommending. I am merely attempting here to outline these things.

The Chairman: You did say that you believed it would be a great stimulus, and would be an important factor in ending the recession.

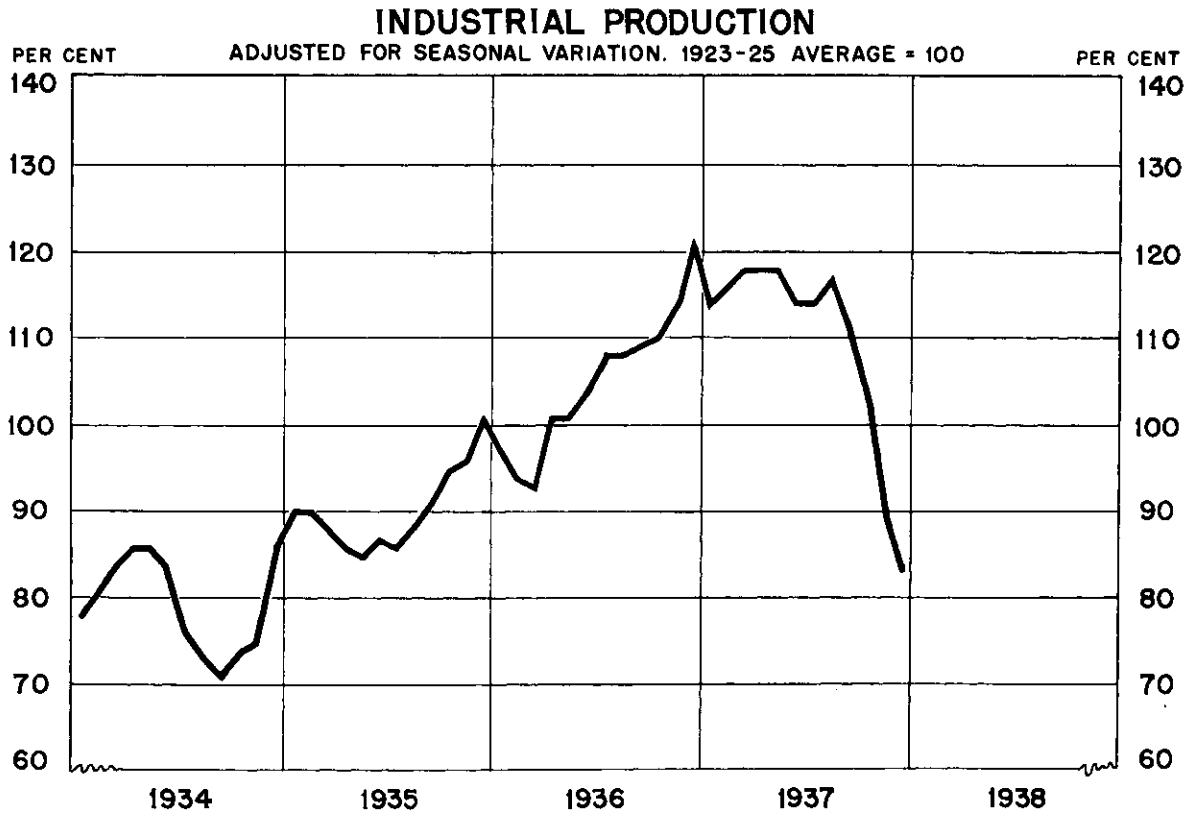
Mr. Eccles: That is right.

The Chairman: If there are no further questions, the Committee stands adjourned until 10:00 o'clock tomorrow morning.

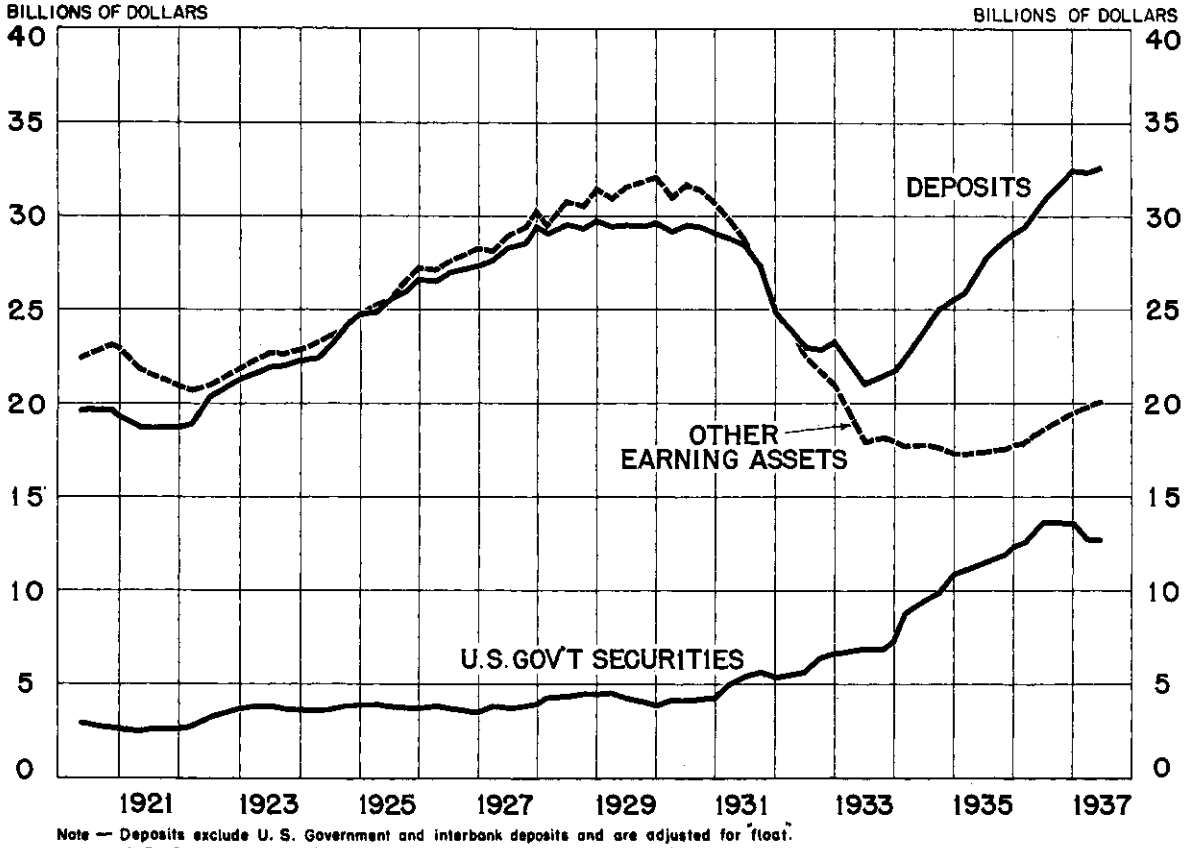
Mr. Eccles: Do you wish me to come back tomorrow?

The Chairman: No. We do not want you to come back. You have been very kind. Thank you.

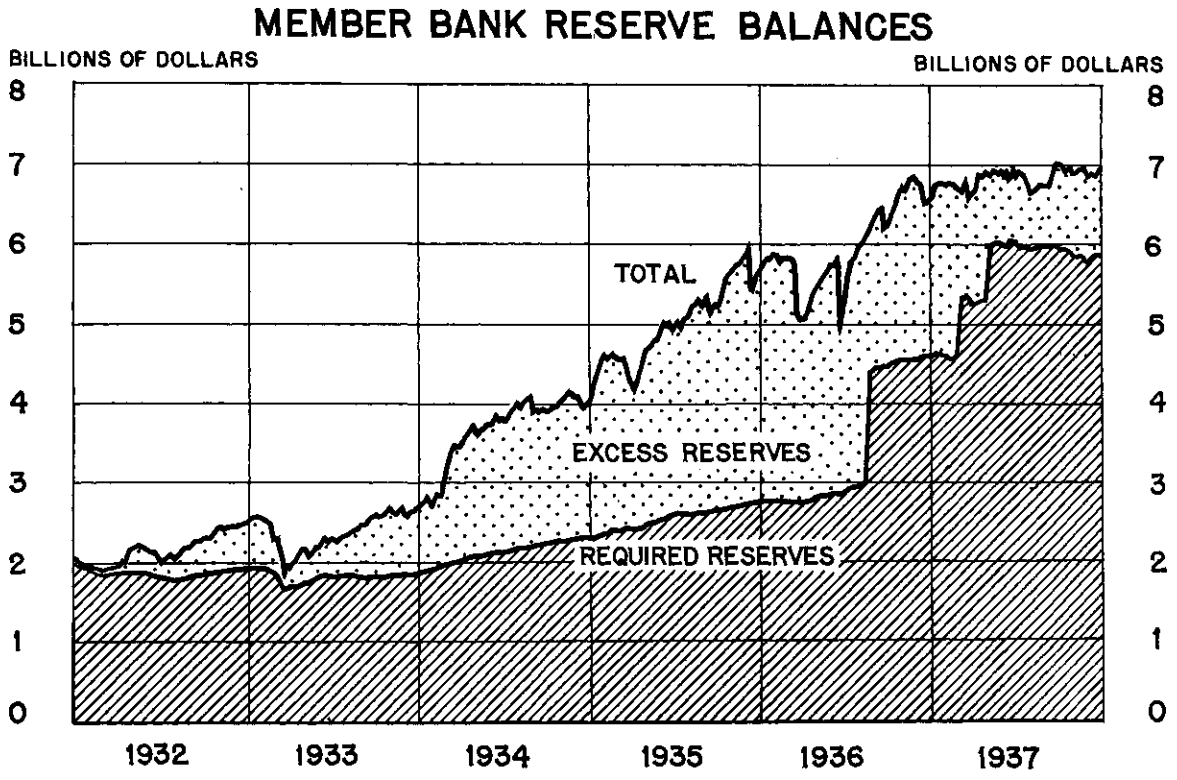
(Whereupon, at 5:10 o'clock p.m., the hearing was adjourned until tomorrow, January 5, 1938, at 10:00 o'clock, a.m.)



MEMBER BANKS

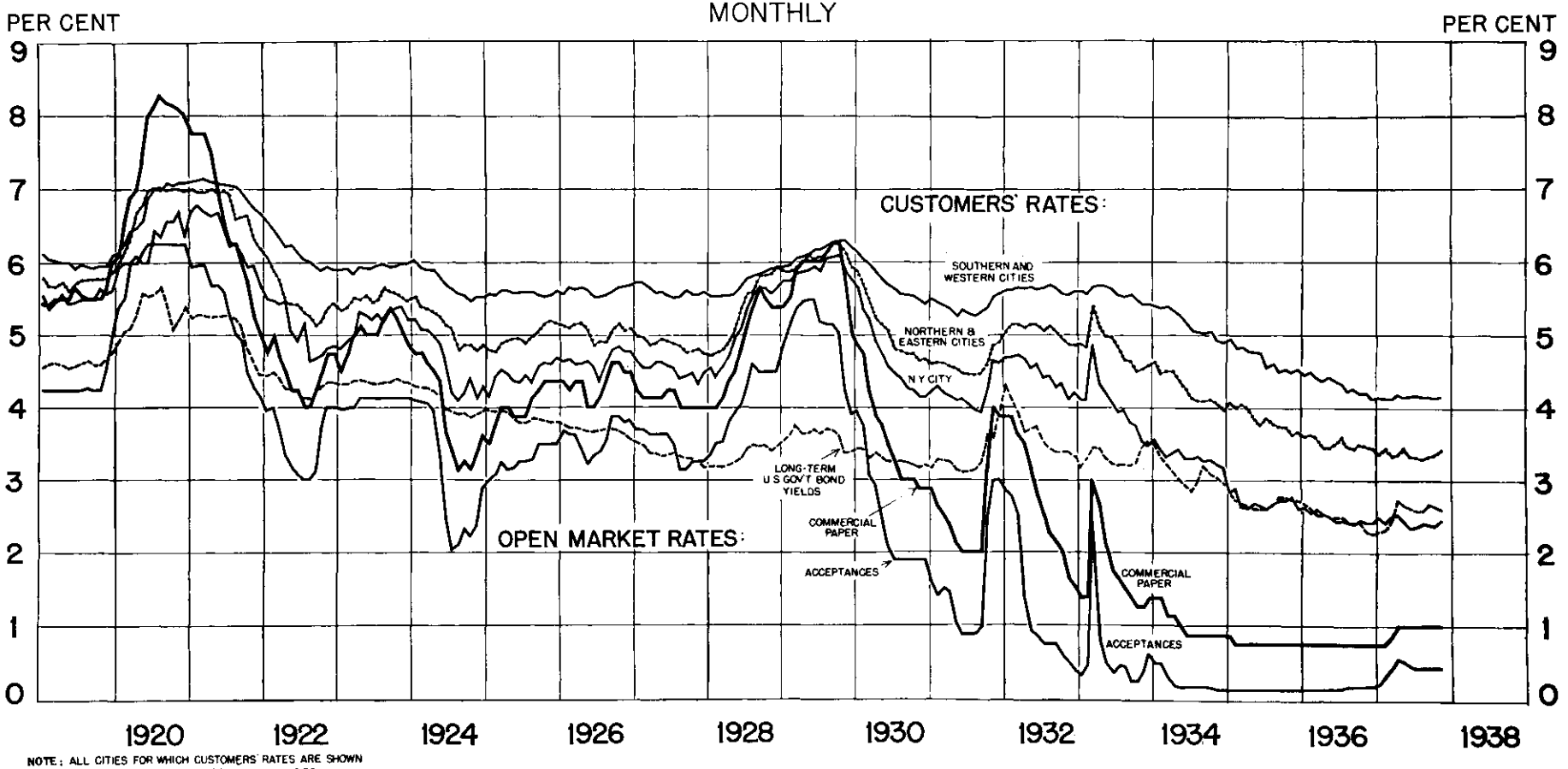


Note — Deposits exclude U. S. Government and interbank deposits and are adjusted for "float."
U. S. Government securities include direct and fully guaranteed obligations.



MONEY RATES

MONTHLY



NOTE: ALL CITIES FOR WHICH CUSTOMERS' RATES ARE SHOWN ARE RESERVE BANK OR BRANCH CITIES