

MEANS OF COMBATING INFLATION

Statement of
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Board of Governors of the Federal Reserve System

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STATEMENT OF MARRINER S. ECCLES, GOVERNOR OF THE FEDERAL RESERVE BOARD

Mr. ECCLES. Mr. Chairman and members of the Committee, as Governor of the Federal Reserve Board, and as a past chairman, one who has been with the Federal Reserve Board for nearly 14 years, and as one who has watched very closely the inflationary developments, it is an opportunity and a privilege for me to meet with this committee again.

Everyone, I think, recognized, when this country commenced a large defense program, and later got into the war, that Federal deficits were going to develop on an increasing scale, that the Government's requirements for war purposes were going to utilize a large amount of the materials and labor that normally would be available for the civilian economy, and that the people would be receiving purchasing power from the Government's large and increasing purchases that would exceed the supply of civilian goods and materials available to them, unless taxation was so high that it drew into the Government a sufficient amount to pay for the Government's war program on the basis of a balanced budget. That has never been done, and it was not done in our case.

Taxes were increased to the fullest extent that the public was willing to bear, and that Congress was willing to vote. This left a large residual amount of purchasing power in the hands of the public. That purchasing power came from bank-created money. It came from bank credit which was necessary to finance the Government's deficit.

In order to prevent inflation and maintain stability, this country, within a reasonably short time after the war started, put into effect a full harness of controls, the allocation of scarce materials by the War Production Board, building permits, wage controls, price controls, rationing, export licenses, and excess-profits taxes as well as increased individual income taxes and excise taxes, with the result that we got through the war with a comparatively small inflationary development. I think from 1940 to 1945 the cost of living went up something like 25 percent—which was rather a satisfactory record in view of the fact that the public debt was increased from forty-some-odd billion dollars to over \$270,000,000,000, and that the supply of money—bank deposits and currency—increased more than two and a half times.

It should have been apparent to all that with the public having such a large amount of purchasing power in the guise of bank deposits, currency and Government securities—which was potential purchasing power—and with a backlog demand that had accumulated for all kinds of goods, particularly consumer durable goods and housing, over a period of 5 years, that to take off, as was done in 1945, practically all of the controls, with the exception of price control—which was completely ineffective removed from the other harness of controls—made an inflationary spiral inevitable.

We should not be surprised that there was this inflationary development, but under the circumstances we should be surprised that the inflationary development has not been greater than it is.

The public have not only had what would be considered their current requirements, the requirements that they would have had for the various goods and services had there been no war, but the public, you

must remember, have been trying to buy automobiles, houses, and many other consumer durable goods, and industry has been trying to buy the capital goods that it would normally buy, plus the backlog demand that had accumulated. So that, in effect, you have had an effective demand—and by effective, I mean a demand backed up by purchasing power and easy credit that should take years to fill—the current plus the backlog—which the public have been trying to fill in a period of 2 or 3 years. How can you fill a demand for goods and services that would normally take years to fill in a period of 2 or 3 years, without getting inflation?

You have the example of housing. The cost of housing, since the war ended, has more than doubled. Easy credit for housing, as has been made available by the Federal Government under title VI and under the Veterans' Act, has not necessarily produced more housing. It certainly has produced an inflation in the housing field. I use that merely as an example.

Easy credit certainly has not produced more automobiles or other consumer durable goods. But the demand has been so great in the field of automobiles that possibly it could not have been met even if they had all been sold on a cash basis.

Now, we have been talking about what we are going to do with this inflationary situation every year since the war ended. And up to the present time, it seems to me, there has been practically nothing done to deal with the inflationary pressures which should have been obvious, but there has been quite a good deal done to add to the inflationary pressures that existed when the war ended.

I realize it is difficult to resist the numerous minority pressure groups. Each one wants the benefits of inflation for himself, but he wants the others to pay for them.

The farmer wants a floor under his prices, but he does not want a ceiling.

The real-estate people, the building-materials people, want easy credit so that they can readily dispose of, at inflated prices, the homes and materials they have to sell. But they certainly resist having any excess-profits taxes in order that the Government might recapture some of the profits that are thus made.

Labor has always wanted price control, but they have vigorously resisted wage control.

The bankers want higher interest rates, but they do not want the Federal banking agencies to have increased power over the expansion of credit.

You know the familiar pattern. And now, after 3 years, you have been called together to consider this problem which has been with the Congress constantly, and the American public constantly, and there has been little or no willingness to face up to it, realistically, either by the public or by the Congress, or by the administration.

This situation has gone so far that to stop the inflationary development could well bring about a deflationary development.

You have a great many inflationary forces still in the situation. The supply of money is still expanding through bank credit. Although the Federal Government's fiscal policy, due to a favorable budget situation, has been anti-inflationary, to the extent of about \$14,000,000,000, that has been almost completely nullified by the inflationary effects of a bank-credit expansion of \$12,000,000,000.

A favorable budget picture, which is the most effective anti-inflationary force that could be available to the Government, because it would deal with the basic causes, because it would be reversing the trend that existed during the war, which created the inflation, is no longer available, and there are prospects, next year, of a budgetary deficit which will be increasingly serious if we still have the inflationary situation. I see little hope of securing a budgetary surplus so long as we have an increasing military expenditure with no terminal point, or so long as we have a world-aid program with no terminal point, in such amounts as this Government is now spending, and so long as the cost of maintenance of the veterans' program, interest on the public debt, and other expenditures of the Government that seem impossible to reduce, continue—unless sufficient revenue is made available through taxation to meet the appropriations made by the Congress.

There is not much use talking about controlling inflation unless the fiscal policy calls for a budgetary surplus. Although bank-credit controls are necessary, desirable, and would be useful and effective, they are supplementary to a sound fiscal policy.

It would be impossible, if the country should run into budgetary deficits, to put into effect a restrictive monetary and credit policy.

The purpose of this hearing this morning, as I understand it, is primarily to consider what can be done, particularly in the monetary and credit field, to curb inflationary development. That seems to me to be the most important anti-inflationary proposal in the President's program.

The program taken as a whole seems to me to be more of a political program than an economic one, because there is in the program action called for which would be very inflationary.

The mistake, of course, as I have indicated, was made back in 1945 and early 1946, when the entire harness of controls was prematurely removed, and that includes the removal of excess-profits taxes, which was possibly one of the major mistakes that was made at that time, because that opened the door for a justifiable demand for increased wages.

The American public—and especially those minority groups, minority pressure groups, who were trying to get some advantage for themselves—are primarily, or at least partially, to blame.

What we are interested in at this time, of course, is not so much recrimination. What we are interested in is what can now be done, at this late date, to overcome as far as possible the mistakes of the past.

I do not believe it practical to put back a complete harness of war-time inflationary controls, and I do not believe that to put back some and leave off others would do the job. I do believe that it is too late to avoid a serious deflationary adjustment at some point. The disequilibrium and the distortions have already been created. I do believe that the inflation can go further if nothing is done and a budgetary deficit develops. It can be long postponed, and can be catastrophic in its effects.

I do believe that the sooner inflationary development is stopped, the less serious the adjustment, or the deflationary developments, will be.

I do believe it essential that credit controls of sufficiently broad power and authority, both in the consumer credit and in the bank reserves field, be made available.

That can be, at the moment, the most useful, the most practical, and the most effective.

I do believe that everything within the power of the administration and the Congress should be done to maintain a budgetary surplus.

I do believe that the Federal Government should do everything within its power to encourage the State to postpone every expenditure that it is possible to postpone, and set an example to the States by doing likewise.

I do believe that the Federal Government should not, for what seem to me political reasons, encourage a housing program in excess of the amount of labor and materials available, and encourage further inflation thereby.

I do believe that the Federal Government should do everything within its power to bring down food prices, by encouraging more and not less production.

I do believe that we should—and I may sound naive in this regard—adjourn political considerations, and I say that for both parties, and consider honestly and openly the economic facts of life.

Mr. Chairman and members of the committee, I have spoken, as you observe, off the cuff and from my heart, about this general problem of inflation which you are considering, and I am sure that there are many questions that you may desire to ask, particularly with reference to this matter of bank credit control, as covered in the President's message, and which happens to be in my particular field.

You make like also to consider the question of housing credit, which is also covered in the President's message. The Board has given considerable thought to its inflationary impact.

The CHAIRMAN. Mr. Eccles, you have implied that the President's program might in some respects be inflationary. Do you care to comment generally upon the President's program, generally or specifically, in that respect?

Mr. ECCLES. Well, it is rather involved. I have indicated, Mr. Chairman, that there are many aspects of the program which are inflationary, and others which, of course, are deflationary, and that it thus tends to balance off.

Now, as to getting into each of the specific subjects I must say that I would like to avoid getting into the specific subjects, because it seems to me that the discussion could be endless.

The CHAIRMAN. We are here to discuss the President's program with respect to inflation. You have indicated that the mistake was made when we removed the excess-profits taxes in 1945. The President's first proposal is to recommend that the excess-profits tax be reestablished, in order to provide a Treasury surplus and to provide a brake on inflation. Perhaps you would like to comment on the statement made by Mr. Fred Vinson who at that time was Secretary of the Treasury, in his appearance before the Ways and Means Committee, wherein he said—

clearly the repeal of the excess-profits tax will stimulate production. Today we are starved for new houses, new cars, new radios, and the like. The best offense against the use of our wartime savings to bid up prices on these scarce items is to remove the scarcity. Production and more production is the key. To this end

the elimination of the oppressive influence of the excess-profits tax would make a real contribution.

Mr. ECCLES. I, of course, did not agree with that statement, and I so told Mr. Vinson. I happened to have a very close relationship with him at that time, when he was Secretary of the Treasury and still have a very friendly relationship. I still have a very high regard for him.

The CHAIRMAN. I might say that the committee has a very high regard for him.

Mr. ECCLES. But I did express opposition to it, and I decided to write a memorandum to him giving him my reasons why I thought a mistake was being made, and I wrote him a letter in which I said:

Referring to our brief conversation when you expressed surprise at my opposition to the repeal of the excess-profits tax at that time, I am venturing to enclose a memorandum outlining my reasons for my position.

I have some excerpts from this memorandum here that you might be interested in, for the purpose of getting the other side of this story.

The underlying reasons for maintaining high taxes apply with equal or even greater force during the critical period of postwar because, first, we still face an unbalanced budget. Every dollar of Government expenditures not raised by taxes will have to be borrowed, and, to the extent that banks furnish these funds, new supplies of money will be added to the already enormous accumulation of liquid funds in the hands of the public.

Taxation is the last bulwark against inflationary forces because of the weakening or the removal of other controls such as the War Labor Board exercised over wages, and hence prices, or such as the War Production Board exercised in the construction field with building permits.

The most prudent course, at this juncture, would be to defer tax reductions until such time as the supply is more nearly in balance with demand and we have begun to approach at least a balanced budget.

At this stage we would be wise to err on the side of too much rather than too little revenue. Taxes can always be reduced. Since the basic problem today is one of shortages of goods in relation to demand and purchasing power, a prudent fiscal policy requires that high taxes be maintained in order to reduce the public debt so far as possible.

Not only is the backlog of demand unprecedented, but the supply of money in the hands of prospective buyers is at an all-time high and will be further increased as employment in peacetime occupations occurs.

The situation would be entirely different if we were confronted with a progressive deflation, if inventories were in excess of effective demand. Then the problem would be to create more goods and to give employment, and fiscal policy would call for, first, reducing the taxes in the lower income brackets in order to increase purchasing power.

Any further reduction would benefit primarily those best able to pay. This is particularly true with respect to the repeal of the excess-profits tax. By and large, business and industry, which is in the excess profits, has never been so well off. Never have such vast accumulations of cash and equivalent in Governments been bigger; never have there been bigger earnings after taxes and never have there been such glowing prospects of profits that are to be made in filling the unprecedented backlog of demand from domestic as well as foreign sources.

It is highly significant that expectations of outright repeal of the excess-profits tax are having four adverse effects: It is doing much to lift the stock market; it is drawing into this field speculative funds. It is whetting the appetite of labor for bigger demands, reinforced by strikes. It is inducing corporations in the excess profits group to avoid further sales in the last quarter of this year, because obviously profits after January would go untaxed, so far as excess profits are concerned. It is inviting inventory speculation in anticipation of profits resulting from rising prices.

and so forth.

The argument that business needs a special tax incentive to produce and to employ people at this time is inconsistent with the basic economic facts. The

war demonstrated that if business has orders it will go ahead, producing and furnishing employment notwithstanding high taxes.

Business has never had such a peacetime prospect for orders as it has today because demands, foreign and domestic, are so large and so far in excess of supply. With such intense demand, and the sharp competition for markets, production would go ahead if there was no reduction in the excess-profit taxes.

And I did advocate some reduction at that time.

It cannot be logically held that the removal of this tax will give needed incentives to existing business. As for new business enterprise, its main problem is to obtain the materials and the labor in order to get under way in competition with established industry. Instead of benefiting from repeal of the excess-profits tax, the smaller corporations would lose the advantage of the exemption; and to repeal the excess-profits tax and leave the normal tax as it is would work still further to the advantage of the larger, and to the disadvantage of the smaller, corporations, generally speaking.

The argument is frequently made that the repeal of the excess-profits tax will make no great difference in revenue collections because corporations will pay in dividends to the stockholders what they would otherwise be taxed in excess-profits tax. This would only be true, however, if dividends received were taxable at the same rate and if there was a sufficient effective tax on undistributed earnings to induce corporations to pay them out to individuals instead of retaining them and thus adding to the value of corporate securities,

and so forth.

It seems to me that the record, since the repeal of this tax, has proven that it did not stop inflationary developments by inducing enough further production, as was indicated. Overlooked was this terrific backlog of demand, supported by the very large volume of purchasing power, and the principal effect of this tax was, of course, to take off any pressures that industry might have for raising prices, because, after they got into the excess-profits tax, the benefits of price increases would go largely to the Government. Repeal of the tax, of course, gave them a greater incentive to raise prices because the benefit of the price increases went to them.

It also took away from the corporations a great deal of any resistance to raising wages, and we saw very promptly, with little or no resistance, a first round of wage increases, which was certainly a corollary to the repeal of the excess-profits tax.

We then saw a second round of wage increases, and now we have had a third round.

Of course that is the inflationary cycle. It has been supported by an expanding credit and expanding money supply; so that we have, first, an excessive supply of money and purchasing power in relation to goods and services. That creates an excessive demand, and that brings about a price increase. That brings about increased profits. And, of course, you cannot blame labor, wherever they are able to get increased wages to take care of their increased cost of living, for doing so. And of course they not only, in many instances, got their increased cost of living taken care of, but they got in excess of their increased cost of living.

So that the cycle is: Increased credit, increased prices, increased profits, and increased wages. You have an inflationary cycle. It is not just wages and prices.

I merely indicate here the fact that this tax was removed, I think, prematurely, as were other controls, and that we lacked, in the country, the patience to make haste slowly; to realize that our need for housing and our need for consumer durable goods, our need for expansion of capital facilities, could not be met overnight; that it

could only be met gradually, where our capacity to produce would not only take care of the normal demand but also could gradually build up the backlog demand.

We did not realize that, and we have the result that I have indicated.

The CHAIRMAN. Mr. Eccles, why did we reduce the gold reserves from 35 percent and 40 percent to 25 percent, do you recall?

Mr. ECCLES. I would like before answering that to say just one more word on the question of the excess-profits tax. I am not favoring its reenactment at this time because it would have to be part of a whole program, and I think the question is a very involved one. It would have been an easy matter to continue the tax in force and effect and to have gradually reduced it until it would have been practical to repeal it. But at this late date, to impose an excess-profits tax, the question first arises: On what basis? You have to first determine what is excess; and to determine what is excess you have to determine the formula for deciding the basis upon which to apply it. I will not go into that, but that is a very involved and a very difficult thing to do, and certainly it cannot be done in any short time, in a special session of Congress. I think I, therefore, would not favor its reenactment. I think that our whole tax structure needs to be overhauled—and that is a major job—and that it should not be done piecemeal by an attempt to impose, at this time, an excess-profits tax.

The CHAIRMAN. Do you think the administration made a mistake in taking it off in 1945?

Mr. ECCLES. Well, I just read my letter and excerpts from the memorandum. The date of that was October 20, 1945.

Mr. BUCHANAN. Do you think the Congress made a mistake in reducing taxes this year?

Mr. ECCLES. I do. And I have so stated, publicly, and before committees.

Mr. BUCHANAN. Does the President have the power, at the present time, to check the inflationary spiral? It has often been repeated here that he does have the powers; that the Federal Reserve Board has the powers. Does the President have the powers at the present time?

Mr. ECCLES. I do not think the President has the powers at all. And certainly the Federal Reserve Board does not have the powers.

Mr. PATMAN. If you will pardon me for interrupting, Mr. Chairman, specifically, does the President have the power to increase the rediscount rates of the Federal Reserve banks?

Mr. ECCLES. No; he does not, and I would like——

Mr. PATMAN. He has no such power?

Mr. ECCLES. No.

Mr. PATMAN. And one other question. Does he have the power to prevent the Federal Reserve System from guaranteeing the par value of Government bonds?

Mr. ECCLES. That is a responsibility of the Federal Reserve open market committee. The Federal Reserve System is, of course, a public organization. The Federal Reserve Board is a public body, appointed by the President, for long terms, and confirmed by the Senate. They are not a part of any administration.

Mr. PATMAN. And a member is not subject to removal by the President?

Mr. ECCLES. No, sir; any more than a justice of the court is subject to removal by the President.

The CHAIRMAN. Just a moment—

Mr. ECCLES. I was just going to say that the Federal Reserve Board is an independent body, an agent of the Congress, as shown by the legislative history of the Banking Act of 1935, when Senator Glass insisted that the Secretary of the Treasury, who was formerly the ex officio Chairman of the Board, and the Comptroller of the Currency, who was the head of a bureau of the Treasury, should both be left off the Board that was provided for in that act, for the reason, as I said, that there was too much political pressure exercised, and that he could speak as one who knew, because he had, during his period as Secretary of the Treasury, felt that the Board was unable to exercise its independence in a way that it should be able to exercise it.

Now, it has been indicated, in the press, that the Board is a part of the administration. As I have indicated, it is not a part of any administration. It is expected, of course, to cooperate with, and work with, in every way it can, any administration, and it is supposed to advise with the Congress, and it is required to make its reports to the Congress.

Now, the President does have the responsibility of designating the Chairman of the Board, and the Chairman is looked upon as being the liaison between the President or the administration and the Board or the banking system.

I always considered, while I was Chairman, that it was my responsibility to try to persuade the administration, as far as I could, to go along with the views that the Board might have with reference to the questions upon which the Board had responsibility and to try to maintain a liaison that would maintain a harmonious relationship. Now, I was not demoted. I just was not reappointed as Chairman. That is, of course, as I have said, a privilege of the President. The Chairman is the liaison, and, of necessity, the administration must have a liaison with such an organization as the Federal Reserve System. I just wanted to make clear that relationship and what seems to me the responsibility of the Board, for the record.

Mr. SPENCE. Mr. Chairman.

The CHAIRMAN. Mr. Spence.

Mr. SPENCE. Mr. Eccles, if the controls—price control, allocation, priorities, and rationing—had remained unweakened, and had continued, what effect do you think that would have had upon the conditions which now exist?

Mr. ECCLES. If what?

Mr. SPENCE. If controls had been continued for a longer period, what effect do you think that would have had upon present conditions? You said pressure groups have weakened them. I think that is true. Suppose they had been continued, however, what effect do you think that would have had upon the inflationary conditions that now exist?

Mr. ECCLES. I just do not think you would have the inflation that you now have.

Mr. SPENCE. You think that could have controlled it?

Mr. ECCLES. I do not think there is any question about it. In spite of Canada being so close to us, and being under the pressure and influence of the actions that we have taken, they have not had anything like the inflation that we have had. And that certainly is true of other countries—I am thinking of Australia, for example. Of

course, they are small countries. Great Britain possibly could not have survived without the imposition of the very high tax structure and the very tight controls of every kind. She would have had an inflation such as some of the continental countries have and such as some of the Asiatic countries have. But considering her short supply of goods and the fact that she was in the war from the beginning to the end, and that she had all the monetary inflationary pressures, yet she, through maintaining and keeping controls, has been able to survive and maintain an excellent degree of stability, considering the problem she had. We had no such problem because we had no destruction of our productive capacity. Our productive capacity was greatly increased during the war. Our population was increased. Our manpower was increased. And we are a country of great natural wealth, great facilities for production. So that we had less reason than these other countries, which had much shorter supply, and which did not have within their own borders the resources that we had.

I think we have done an exceedingly poor job in dealing with the inflationary situation, and we could have done a very good job.

Mr. SPENCE. So you think the weakening of the controls is the cause of our present predicament?

Mr. ECCLES. I think the taking off of the entire harness of controls is the cause of our present predicament.

Mr. SPENCE. Do you not recognize that those controls were so weakened that they became ineffective and were allowed to die?

Mr. ECCLES. You are speaking of price control?

Mr. SPENCE. Price control, rationing, and so on.

Mr. ECCLES. Well, that is a very different matter. On the question of the removal of price control, I was in favor of the vetoing of the price-control bill, because I felt that by the summer of 1946 price control was largely encouraging black-market operations and tax evasion, that price controls could not stand alone with the remaining harness of controls taken off, and that the greatest friends of the continuation of price control were the black market operators and the tax evaders, just as the bootleggers were the greatest friends of prohibition. It was a perfectly natural development. So the taking off of price control in the fall of 1946 was certainly overdue.

I think it is perfectly obvious that if you have price control you have to have rationing, and you need allocation of your scarce materials, and you need building permits, you need wage controls, you need export licenses, and tax control. All that was just part of a harness, and to think that this cart could be pulled by a horse without a harness, of course, just does not make sense.

Mr. SPENCE. Do you not think that a large part of that was due to the fact that those controls were so weakened that they did not operate? They operated very well during the war, did they not? They saved the Government billions and billions of dollars in its purchases, and they became so weakened, as you said a while ago, by pressure groups, that they were ineffective at the time they were removed. I do not think they could have been continued, under the circumstances.

Mr. ECCLES. No. This is what happened—and I want to give you the record on that, because they were not weakened by the pressure groups. Naturally the pressure groups were all fighting to get rid of them. The farmers were anxious to get rid of price controls, and labor wage controls, and business excess-profits taxes, there is no ques-

tion about that. But they were doing a good job until they were removed. And this is what happened:

The sudden end of the war in 1945 brought drastic reductions in military procurement. The question of maintaining controls became immediately a major public issue. The policy of the administration on this matter was enumerated on August 18—4 days after the war ended—by Executive Order 9599. The President instructed the Federal agencies to move as rapidly as possible, without endangering the stability of the economy, toward the removal of price, wage, production, and other controls, and toward the restoration of collective bargaining in a free labor market. The day following the surrender of Japan all controls over manpower were dropped, and OPA removed rationing restrictions on gasoline, fuel oil, and all processed foods and heating stoves. Several hundred items were removed from price control within the first hundred days after VJ-day.

On August 21, 1945, the WPB discounted the controlled-material plan—upon which allocations were based—which had become the cornerstone of the War Production controls.

The controlled-material plan was a relatively simple device for dominating the industrial economy by giving WPB complete controls of a few strategic commodities such as steel, copper, lumber, and so forth. A great many control and priority orders were revoked by the end of August, including controls over most metals, except tin, lead, and antimony. Industrial construction restrictions were first eased and then, on August 15, 1945, construction L-14—which was the building permit upon which you determined where your materials were going to be used, whether they were going to go into housing or something else—was revoked by WPB and with it went all limits on new construction.

You had an inflation in that field which is quite fantastic, and you have had scandalous profits made by builders and promoters, who started with little or no capital, and the building industry, such as lumber and other concerns, with excess-profits taxes off, have made profits that certainly would not stand publication.

Before the end of August, we took off controls over transportation and so forth, of all kinds. That may have been all right; I do not know.

The Price Administrator was specifically instructed by the President, on August 18, 1945, to take all necessary steps to assure that the cost of living and the general level of prices would not rise.

However, reconciling labor demands for higher wages and industrial demands for higher prices, and profits, presented difficulties which the stabilization program was in the end entirely unable to solve.

Mr. BROWN. Mr. Eccles, are you making any suggestion as to what we should do now to curb inflation?

Mr. ECCLES. Yes, sir; I did, I think before you came in.

Mr. BROWN. All right. I will read your testimony.

Mr. PATMAN. The only thing I heard you say—

The CHAIRMAN. Very briefly, would you restate what you recommend at the present time?

Mr. ECCLES. What I said at this time is this: It seems to me that credit controls are the simplest, the easiest, and possibly the most effective instruments that could be made available, and yet they are only supplemental to a sound budgetary program which would pro-

vide for a budgetary surplus, or certainly avoid deficits. I indicated that in the field of housing, everything should be done to avoid continuing the inflationary effect of the housing program, because otherwise the credit instruments cannot be very effective, on the one hand, if the Government is stimulating or encouraging an expansion of credit on the other hand, beyond the available supply of building and materials.

The CHAIRMAN. Specifically, would you recommend the passage of S. 866, the Taft-Ellender-Wagner bill, at the present time?

Mr. ECCLES. No; I told the Senate committee the other day that I felt that that would be a very inflationary instrument. I would favor the objectives of that bill as a deflationary program which should be held in abeyance and used to cushion a deflationary development. If you use all the deflationary instruments in an inflationary period, what are you going to have available to cushion a deflation?

I think the expansion of unemployment insurance, the increasing of old-age pensions, are likewise anti-deflationary weapons. Anything that the Government can do to postpone nonessential public works or other expenditures, whatever they may be even though the appropriations may have been authorized should still be done at this time so as to maintain, if possible, a budgetary surplus.

Mr. BUCHANAN. How about the slum-clearance and urban-redevelopment program, under S. 866? Should those programs be begun now?

Mr. ECCLES. I do not think so; no.

Mr. BUCHANAN. The planning of them?

Mr. ECCLES. I think it is all right to do planning now, and I think anything that could be done at this time to get these building codes of the various cities on a rational basis should be done. Anything that can be done in preparation to meet a deflationary situation, should it develop, of course, should be done.

Mr. PATMAN. Mr. Chairman, I would like to ask Mr. Eccles some questions.

Mr. SPENCE. I would like to ask one more question, first.

Do you recommend that the reserve requirements of the State nonmember banks be under control?

Mr. ECCLES. I said the other day that it would be my recommendation that no legislation be passed if the nonmember banks are going to be excluded from this control. The discrimination, at the present time, against the member banks, is already pretty severe. Certainly, if the national banking system is to be maintained and made strong, it should not be put at an additional very great disadvantage as against State banks because the national banks must be members of the system.

Mr. SPENCE. I recognize the dual banking system, but the State bank is a creature of the State, organized under the laws of the State.

Mr. ECCLES. There is nothing proposed in this bill—I should not say the bill—there is nothing in my proposal that nonmember banks should be covered as well as the member banks that I believe to be unconstitutional. I am not a lawyer, but I can give you these as my reasons: The Wagner Labor Relations Act, it was determined by the Supreme Court, covers all banks because they are engaged in interstate commerce.

I understand the Wage and Hour Act likewise covers banks, for the same reason. And certainly there has been no question about the Board's regulation W covering consumer credit. It has always applied to all banks. Regulation U, covering margins on collateral loans, has always applied to all banks.

There has certainly been no discrimination in those fields, and there is nothing unusual in this proposal that the nonmember banks be covered.

The program that the Federal Reserve Board authorized me to present before your committee and before the Taft committee at the last special session of Congress, in November, to consider these problems, covered the nonmember banks.

The program that was submitted on April 13 in response to the President's Economic Report before the Joint Committee on the Economic Report—Mr. Taft's committee—includes the nonmember banks.

There has been unanimity, always, on the part of the Board and of the staff—and, I think, the System—that the nonmember banks should be included in any credit control measure.

The CHAIRMAN. Mr. Eccles, do you think that should prevail in the absence of an emergency?

Mr. ECCLES. Yes, I certainly think it should prevail in the absence of an emergency.

The CHAIRMAN. Regulations T, U, V, and W were promulgated in compliance with powers given to the President under the Trading With the Enemy Act.

Mr. ECCLES. No, no; only W.

The CHAIRMAN. Where do you get T, U, and V?

Mr. ECCLES. T and U were established under the Securities Exchange Act of 1934.

The CHAIRMAN. Could he impose those credit controls now?

Mr. ECCLES. Yes.

The CHAIRMAN. Will you review what T, U, and V were?

Mr. ECCLES. Regulation U is the authority of the Board to impose margin requirements on collateral loans, secured by listed securities, made by banks.

The CHAIRMAN. Is that something in addition to these marginal requirements?

Mr. ECCLES. No, that is part of it. That is the one that covers banks; there is another regulation that covers the brokers.

The CHAIRMAN. Is that T?

Mr. ECCLES. That is T.

The CHAIRMAN. What is V?

Mr. ECCLES. V was under a wartime Executive order that provided for war production loans guaranteed by the Military Establishment, and they were administered by the Federal Reserve System, which acted as the agent for the Army, Navy, and the Maritime Commission in the V-loan program. That has all disappeared with the liquidation of the war.

The CHAIRMAN. In your opinion, if the Federal Reserve is given the authority to increase reserve requirements, by what percentage would they increase them for the different bank categories?

Mr. ECCLES. Well, the proposal is 10 percent.

The CHAIRMAN. I know that. That is the ceiling. What do you think the Board might do with respect to increasing the reserve requirements? Would they raise them 1 percent, 2 percent, 5 percent, 7 percent, or 10 percent?

Mr. ECCLES. That, of course, would be impossible for me to say at this time. As a matter of fact, if the authority existed the effect of the authority itself is perhaps sufficiently important so that use of the power may not be needed, or, at least, it may be needed to a far lesser extent.

The CHAIRMAN. What are the total reserves of all the banks now?

Mr. ECCLES. The reserve requirements, do you mean?

The CHAIRMAN. Total reserves.

Mr. ECCLES. You mean in dollars and cents?

The CHAIRMAN. Yes. What I am trying to get at is how much a 10 percent increase in your authority, if it was used, would increase the reserves.

Mr. ECCLES. Well, this authority would give the Board power to increase the reserves, roughly, something like 11 billion dollars—that is, reserve requirements.

The CHAIRMAN. Twelve billion dollars?

Mr. ECCLES. No, I do not think it is 12 billion dollars. I said around 11 billion dollars.

The CHAIRMAN. In April or May of this year, in your testimony before the Joint Committee on the Economic Report, you said this, in advocating an increase of 10 percent in the reserve requirements for demand deposits and 4 percent for time deposits: That that would give the Federal Reserve System power to increase reserve requirements about 12 billion dollars.

Mr. ECCLES. Yes. Well, I say 11 billion dollars because the statement you have quoted included a power, which the Board had not used, of 4 percent in the case of the central Reserve cities—New York and Chicago. That amounted to about a billion dollars. Five hundred million dollars of that authority has been used.

The reserve requirements of New York and Chicago are now 24 percent. The Board has the authority to increase them another 2 percent.

Mr. SPENCE. Is it not true that the reserve requirements in most State banks are very small?

Mr. ECCLES. The difficulties with the proposal to eliminate the non-member banks are these: I will try to give you some of the objections that I have, and I think this represents the Board's view as well.

State banks, at present, are required to carry only—and it varies by States—10 to 15 percent in reserves in the banks of Reserve cities. That can be carried in cash in their vaults or in balances with the city correspondent, and some States permit them to carry Government or municipal securities.

Mr. BROWN. Right there, Mr. Eccles, suppose the State has a requirement for a certain amount? And suppose the Federal Government comes along and establishes a requirement of another amount? What do we do in those circumstances?

Mr. ECCLES. We do not interfere with that. The State can make any requirement they want.

Mr. BROWN. We never undertook to regulate the reserves of the State banks up to now.

Mr. ECCLES. We do not undertake to regulate the reserves of the State banks even now. All we do is say that in addition to the reserves the State banks are required to carry they must carry an additional amount of 10 percent—the same as member banks—with the Reserve banks of the district.

Mr. BROWN. I do not think your comparison is very good. I do not see how, under the Constitution, you can go ahead and regulate the reserves of State banks. In other words, you would practically control State banks.

Mr. ECCLES. No, there is nothing against the dual banking system in the proposal at all, for the very reason that at the present time possibly 2,000 of the State banks of the country are members of the Federal Reserve System. All of the State banks could be members of the Federal Reserve System and you still would have a dual banking system. This in no way destroys the dual banking system, but it prevents the State system from destroying the national system and the Federal Reserve.

Mr. BROWN. I understand that when you are a member of the Federal Reserve you have to abide by their rules.

Mr. ECCLES. They would not be members at all. They would have locked up, in effect, a reserve equal to 10 percent of their demand deposits, and that could be supervised and policed by the State bank supervisor. So that, so far as the Federal Reserve is concerned, it would have nothing whatever to do with the regulation or the supervision of State nonmember banks, with the exception that whatever requirement they made of the banks in any class of cities which are members of the System would apply also to the nonmember banks in the same cities.

There is no reason why a nonmember bank would join the System—certainly if this additional reserve requirement is imposed on members only. Even today it is practically impossible to get members into the System. There has been practically no growth in membership in the System, because the advantage—especially if you are a bank in a non-Reserve city—of not being a member is great because of the discrimination that is placed upon membership.

For instance, a member bank in a non-Reserve city today must carry 14 percent of its demand deposits in collected funds with the Reserve bank of that district. They must also carry such cash and currency in their vaults—and that is not considered a part of the reserves—as are required.

In the State banks, cash and currency is considered part of the reserve requirement.

A member bank must also, for its own convenience and as necessity to its operation, carry, I would say they average, at least another 10 percent of their deposits in balances in what we call their city correspondent banks so as to enable them to get certain services that the Federal Reserve cannot and does not give them.

I have an enumeration of some of the discrimination that now exists which I would like to read.

A member bank today, for practical operating purposes, has to carry at least, I would say, 25 to 30 percent of its deposits in cash reserves and balances with its city correspondents, whereas the balance that the country bank has with its correspondents for certain services also takes care of its reserve requirement.

Now, if we impose an additional 10 percent on the members and do not apply it to the nonmembers, I would expect a large exodus of the smaller member banks, including the national banks; they would withdraw from the Federal Reserve System because it would be so advantageous to them from an earnings standpoint.

The CHAIRMAN. Mr. Eccles, would it be convenient for you to be back this afternoon?

Mr. ECCLES. Yes.

The CHAIRMAN. I think I should make the statement now that if we can finish with Mr. Eccles this afternoon, Mr. Snyder, Secretary of the Treasury, will be here tomorrow morning, and it is our hope that we may conclude the hearings with Mr. Snyder's testimony and go into executive session tomorrow afternoon.

The committee will recess until 2 o'clock.

(Whereupon, at 12:30 p. m., the committee recessed, to reconvene at 2 p. m. the same day.)

AFTERNOON SESSION

Present: Messrs. Wolcott, Smith, Talle, Sundstrom, McMillen, Kilburn, Buffett, Hull, Banta, Nicholson, Spence, Brown, Patman, Monroney, Folger, Buchanan, and Multer.

Mr. SMITH. The committee will come to order.

I believe Mr. Patman had the witness when we recessed for lunch.

Mr. PATMAN. Mr. Eccles, what caused, more than any one thing, the depression of 1920?

Mr. ECCLES. The inflation of 1919 and 1918.

Mr. PATMAN. That was the greatest contributing factor, was it not?

Mr. ECCLES. Yes, sir. If you had not had the war inflation of 1917, 1918, 1919, and 1920, you would not have had the severe deflation, credit deflation of 1920 and 1921.

Mr. PATMAN. The point I want to ask your opinion on is this: What caused it to start?

Mr. ECCLES. Restrictive credit policy.

Mr. PATMAN. That is right. It caused the banks to call their loans and as soon as the banks called their loans, everything collapsed, is that not correct?

Mr. ECCLES. That is right. But that policy at that time was an extremely drastic policy.

Mr. PATMAN. What was the credit policy which was initiated by the banks at that time which was so rigid, Mr. Eccles?

Mr. ECCLES. You had no open market committee in existence.

Mr. PATMAN. I understand.

Mr. ECCLES. The only instrument of control was the discount rate of the member banks—that was the principal instrument of control. I do not mean the member banks, I mean the Reserve banks.

Mr. PATMAN. It did not work, however, did it?

Mr. ECCLES. Each of the Reserve banks acted separately, upon their own initiative, in that field of Reserve bank credit in their district. There was no uniform, over-all, national credit policy, as there must be today with an open market committee, composed of the Board and five of the presidents, which committee is able to buy and sell in the open market and allocate its purchases and sales to each of the Reserve banks without having to get the consent or approval of each of the Reserve banks. This was put in the Banking Act of 1935.

The discount rates must be approved every 2 weeks and if the Board does not approve of the rates submitted it can determine the rate or the rates on the various types or classes of paper.

In 1920, the member banks were very heavy borrowers from the Reserve banks. The war was largely financed by the customers of the private banks buying Government securities and borrowing to do so from the banks where they did business. They were encouraged to buy and to borrow to buy, and a great deal of the financing was done not by the banks buying the securities directly—I am speaking of the commercial banks now—but by the banks loaning to their customers, and the customers borrowing and putting up the bonds they had purchased as collateral.

Now the banks in turn borrowed from the Reserve bank of their district, whereas in this last war the financing was done by the Open Market Committee purchasing Government securities in the market and thus supplying reserves to the member banks—not the member banks borrowing at all. The effect of it was to supply reserves to the member banks and thereby they were able to stabilize and hold the Government security market on an even basis to finance the entire operation, and it was only through the method which we developed, I think, that it was possible to finance a 200-billion-dollar war debt upon a basis of complete stabilization.

Mr. PATMAN. Do not overlook the point I am trying to bring out, Mr. Eccles. What restrictive policy did the Board put into effect which caused the immediate calling of loans in 1920? In May, was it not?

Mr. ECCLES. Yes, sir. Well, what was done was this—and I think it was done by the Reserve banks. I do not know that the Board disapproved of the policy, but at least the initiation of the restrictive policy I believe was largely made by the Reserve banks of the district, which raised the discount rates. But you can raise the discount rate and still a lot of borrowing may be done. But they put pressure on the banks to pay off —

Mr. PATMAN. Pay the Federal Reserve?

Mr. ECCLES. That is right; pay off the loans they had.

Mr. PATMAN. And that compelled local banks to call upon their customers?

Mr. ECCLES. That is right. That caused the local banks to call upon their customers and it caused a serious credit deflation, because the source of credit was denied or nonexistent. That is not involved at all in this proposal before us now.

Mr. PATMAN. Did they raise the reserve requirements?

Mr. ECCLES. They had no authority to raise the reserve requirements. They had no authority whatsoever. The reserve requirements were fixed in the statute, by the Federal Reserve Act.

Mr. PATMAN. And it was changed in 1935?

Mr. ECCLES. The authority to change came in 1935.

Mr. PATMAN. Now, in 1936, the soldiers of World War I were paid about a billion and a half dollars, on June 15, 1936. The reserve requirements of the banks had not been changed since 1917, I believe, but within about 2 months after the money was paid, the reserve requirements of banks were raised; is that right?

Mr. ECCLES. That is correct.

Mr. PATMAN. Why did you raise the reserve requirements back at that time?

Mr. ECCLES. Because we had a growing speculative development, particularly in inventories. Inventories had grown about \$5,000,000,000. There was a very rapid accumulation of inventories, as prices were rising rather rapidly. That was one of the factors.

Mr. PATMAN. You think that was caused by the payment of that money to the veterans of World War I?

Mr. ECCLES. Well, I think it was a psychological situation. A lot of people felt that the depression was over and now was the time to buy, and there was a lot of forward buying. That tended to help it. There was also, in that year, about a \$4,000,000,000 public works and public relief program, I think, whereas in 1937 you had no veterans' bonus and the social security taxes went into effect and amounted to about a \$2,000,000,000 tax on the public, in excess of the expenditures for relief. So that the entire budget picture was changed very rapidly from a substantial deficit to practically no deficit. I am speaking of a cash deficit.

Mr. PATMAN. Well, we had what was called a recession in 1937, did we not?

Mr. ECCLES. Yes; but if the Board had taken no action at all on the reserves, I am sure it would have made little or no difference, for this reason: That increasing the reserve requirements did not extinguish the excess reserves or raise the interest rates.

Mr. PATMAN. I know, but you raised them three times, Mr. Eccles. You raised them a hundred percent in 1 year.

Mr. ECCLES. That is right; but there was more than enough excess reserve—you see the gold imports had created such a large amount of excess reserves that the interest rate went to zero. The Government was borrowing, in one period, actually, at a negative interest rate on its Treasury bills. The reason for that was there were \$7,000,000,000 of excess reserves in the banking system, with absolutely no opportunity or place for loans or investment.

It was not as though there were a lot of Government bonds available to the banks. The increase in reserve requirements in 1937 did not even sterilize the excess reserves that had already been created by the gold imports that had come in.

Mr. PATMAN. What I cannot understand is why you would, for the first time in 20 years, not only raise the reserve requirements, but double them in 1 year's time.

Mr. ECCLES. We only had authority for 1 year.

Mr. PATMAN. But you doubled them in 1 year?

Mr. ECCLES. That is right.

Mr. PATMAN. Why would you keep on doing it if it had no effect?

Mr. ECCLES. For the very reason that it is not the most flexible instrument. The open market operation is a much more flexible instrument to deal with. Increased reserve requirements have to apply across the board and not to the individual bank. They have to apply generally to a class of banks. Therefore, it is not the most desirable or flexible instrument to use if the open market power is available.

Now, all we could do, toward increasing reserve requirements at that time, was to wipe out to a considerable extent the excess of reserves, so that the open market operation could function and be effective.

I would say as of now that we would not need, nor want, nor desire, the authority to increase reserve requirements if the traditional power and authority that was given to the Reserve System in 1913 could be made effective. We are not asking for additional power. We are asking for a partial substitution of the power that we are unable to use so long as we stand ready to support the public credit, so long as we stand ready to support the long-term $2\frac{1}{2}$ -percent rate. That in itself makes the use of the discount rate and the denying of the bank's credit unusable, or ineffective. For this reason the banks do not need, nor are they willing, to borrow today, because they have a portfolio of Government bonds which is equal, for the banks as a whole, to about 50 percent of their total deposits. Those deposits were created when they purchased those Government bonds. That is where they came from. That volume of bonds is about \$65,000,000,000. All the banks need to do is to sell some of those bonds or bills or certificates, and they immediately get funds to take care of their loan expansion.

The Federal Reserve stands there today to support that market, as they are the only residual market. So that the control over credit is in the hands, today, of 15,000 banks, and not in the Federal Reserve authorities. If we could withdraw from the support of the Government market, if we could deny the banks the reserves that they are able to get through the sale of the Government securities that they have, instead of borrowing from the Reserve banks, we would have a sufficient control to absolutely stop the expansion of bank credit, because, as we withdrew from the market, we could then raise the discount rates to such an amount that it would be very, very effective.

Today to raise the discount rate is practically meaningless, except as it may have a psychological effect—because the banks would just sell us the bills and the certificates that they own, the bills yielding about 1 percent, certificates, $1\frac{1}{2}$ percent, with the discount rate being $1\frac{1}{2}$.

In other words, the discount rate is still a little higher. Even with the discount rate as low as $1\frac{1}{2}$, the total borrowing of the Reserve System is something like \$200,000,000, which is practically nothing.

Now, if we should raise the discount rate to $1\frac{1}{2}$, $1\frac{3}{4}$, or 2 percent, it would be purely academic. So long as we support the Government short-term rate, that is.

Now, in that connection—and this is all part of the same story—I think that the present Government short-term rate has been in effect too long. I think that the short-term rate should be permitted, by the Treasury, to rise.

There is authority existing today, of course. That is not a matter for Congress. The Federal Reserve has tried to support a short-term rate agreeable to the Treasury, or to persuade them to permit the rate to go up. We were able to persuade the Treasury to permit the short-term rate to go up from $\frac{3}{4}$ to 1 percent and from 1 percent to $1\frac{1}{4}$. and thus take the pressure off the long-term $2\frac{1}{2}$ -percent rate on Governments which got down to the point of selling at 2.2 percent. But within the last few months the Federal Reserve has been unable to persuade the Treasury to favor the raising of the short-term rate. Therefore, the open market committee has supported the bill and the certificate market at the short-term rate established by the Treasury.

Now, I do not believe that there is any justification for pegging, or supporting the long-term rate at $2\frac{1}{2}$, and also pegging and supporting

a short term rate at 1½, or on bills at 1 percent. I feel—and I know the Federal Reserve people as a whole feel—that we must, so far as we can see it at the present time, and I can give you reasons, if you want them, continue to support the 2½-percent rate.

Mr. PATMAN. The only reason is that it would break every bank in the country if the bonds went much below par, is it not?

Mr. ECCLES. Well, I do not think it would do that.

Mr. PATMAN. It would be possible, however?

Mr. ECCLES. If they had to sell the bonds while they were down, it would certainly impair some of them. But I will mention it in just a minute, if I can, Mr. Congressman, but to try to peg the short-term rate, and hold that down below the point at which it would normally go in a free market in relationship to the 2½-percent rate does not to my way of thinking make very much sense in the present situation. I would certainly feel that if Congress should give to the Board the authority to increase the reserve requirements, as has been proposed by Chairman McCabe when he appeared before this committee yesterday, that they would also favor, as the Federal Reserve does, and I would also hope that the Treasury would favor, permitting the adjustment in the short-term rate to a market rate. Then we would let the discount rate go up.

Now, there may be some people who think that that would create such uncertainty that that will tend to slow up borrowing. I do not think any such thing. I think that the raising of the short-term rate is minor insofar as its monetary effect is concerned, but it is an important part of the overall credit-control mechanism, and I feel that it would not be logical or sensible to increase the reserve requirements of all banks and keep the discount rate down one and a quarter, which would have to be done, and force the short-term rate and continue to hold the short-term rate down to 1½.

Now, aside from its monetary and credit effect, there is a serious question of bank earnings. Especially is that true of the banks in the central Reserve cities and in the Reserve cities. I do not say that that is major, but it is certainly a factor, because all of the commercial paper and business rates are related to that short-term rate.

Their costs have gone up, just like other costs, due to the inflation, very rapidly, and their earnings have dropped very, very fast during the past year. To increase the reserve requirements by 10 percent, which would force them to dispose of 10 percent of their earning assets—their bonds, would affect their earnings quite seriously, and that really is where some of your formidable objections to this bill come in. I feel that as a part of this control, if it is going to be made effective, the short-term rate should be permitted to rise. Failing to permit it to rise, and increasing the reserve requirements and diminishing their reserve assets would put the banks under pressure to go out and seek loans at as high rates as they were able to find, maybe longer term loans, even though it did impair some of their liquidity. We feel that if you should increase this reserve requirement, take away from them that much of their earning assets, that that should be partly overcome by permitting the short-term rate to rise. We would not force it up. It will automatically rise. It cannot go very high if you support the 2½-percent rate. It is not going to create very much uncertainty, so long as you hold the 2½ percent rate, because the range

with which the short-term rate can rise would be within its present 1½ and I would say possibly 1½ percent. That in itself is not a very great rise.

So I do not agree with those who say that is all that is necessary, because it creates so much uncertainty. It cannot create uncertainty so long as you hold the 2½-percent rate. But if that rate rises, our discount rate rises, in the trend of a credit tightening, and that, in turn, will reflect itself on all other loans and investments. If your dollar is diminishing in price, then, certainly the cost of interest should go up some. The owner of money, the savers, the insurance people, and the investors generally certainly should not be the only ones to suffer to the extent that they have suffered, by holding down the interest rate beyond what seems to be necessary.

Now, getting to the 2½-percent rate, people say, "Well, why do you not let the 2½-percent rate go up, so that it will reflect the demand for savings and for investment, so that more people will save and not spend so much? If you let the rate go up, it would be a very important anti-inflationary factor."

Well, to let the 2½-percent rate go up raises some very, very serious problems, and these are some of the problems that it raises:

In the first place, it would unstabilize the entire Government bond market, and when the public debt represents 60 percent of the entire debt, you are not playing with any small and minor item. You are playing with \$250,000,000,000 of a total debt structure of around \$400,000,000,000. That is not the tail of the dog. That is the dog. If you are going to have stabilization in the Government market, you cannot have the public in a position of complete uncertainty as to how far the price of securities—Government bonds, and, of course other bonds and mortgages—would reflect the price—municipals; they would all reflect the price of a drop—the uncertainty as to what the market value of their assets as well as what the cost of interest was going to be. That is especially true for the reason that the Government has falling due in the next 12 months \$49,000,000,000 of debt—\$49,000,000,000 in 12 months. Another \$46,000,000,000 within the next 5 years. There is close to a hundred billion dollars in 5 years, with \$49,000,000,000 in 1 year.

The job of refunding that much debt is no simple and easy task in a market that is unsupported and unsecured and unstable. How do you price the issues each week and each month that you have to offer to the public? Who is going to buy the issues, and at what price, when they do not know what the price may be after they have bought them? How can you finance long-term or short-term municipals, and corporate and other securities that are falling due every day and every week, and when new money is being raised, when there is no basis upon which to price them?

We have not had any situation such as this before. This is completely unprecedented. And this idea of trying to say what we ought to do because of what has been done, is no more realistic than trying to say, "We are going to fight the Third World War on the basis of the way in which we fought the First World War." And I say that the Federal Reserve Board does not have the authority, as has been claimed by some which they have failed to use, and because of which, if they did use it, this request for new authority would not be necessary. That just is not so, unless we are willing to use the traditional

authority, the power that we have, to withdraw from the important and vital support of the public debt, and raise the discount rate, and deny the banks reserves. Otherwise they would get such reserves as they want. Without more power and authority over the banks, or by withdrawing from support of the Government market—either without one or the other—then, I say that this Federal Reserve System is the greatest engine of inflation that man could contrive, and the limits to which additional money can be created by the will of the banks is fantastic.

Now, we have pointed this problem out over and over since 1945. The Federal Reserve Board has been conscious of this problem during the war, and in our report to the Congress in 1945, the Congress was told that the Board lacked the power to deal with the monetary expansion of credit.

In 1946 we told the Congress.

In 1947, before the Taft committee, on the 25th day of November last year, we told the Joint Committee on the Economic Report the same thing.

On April 13 of this year, I appeared for the Board before the same Taft committee and again told the Congress of the inadequacy of powers to curb bank credit expansion, and you have now had \$12,000,000,000 of bank credit expansion during the past 2 years on top of an inflationary situation, a monetary inflation situation, which even without that \$12,000,000,000 was explosive, and you have nullified, by the bank credit expansion, the entire effect of a favorable fiscal policy in which the Government has taken \$14,000,000,000 more away from the public than they put back.

And I say that that condition is likely to continue. True, during the first quarter of this year, it was deflationary, as I pointed out before this committee and the Taft committee. It was deflationary because during that period there was such a large amount of taxes collected—\$7,000,000,000, practically, in the quarter. That money was used to pay off bank-held debt, and the banks were under heavy pressure during that quarter. It is a time of seasonal decline, too. But in spite of all that pressure, there was still an expansion of total bank credit on balance, and for the first 6 months of this year there has been an expansion of bank credit of, I think, \$1,300,000,000.

There is every indication that with the growth in prices, with the general inflationary situation, there will be now an accelerated bank credit expansion for the rest of this year, adding to the money supply.

Mr. PATMAN. I want to ask you one other question, Mr. Eccles, and I will be through. The charge has been made that the President has the power to check inflation by increasing the rediscount rate of the Federal Reserve banks, and stop the Government's support of the bond market. You covered that in two parts this morning, but I want to ask you whether that is true or false.

Mr. ECCLES. The President has no such authority. The Congress gave that authority to the Federal Reserve Board, on the question of the discount rate. The initiation comes from the banks—from the Reserve banks, but they are required to submit, under the law, discount rates every 2 weeks, and we, therefore, for practical purposes, have the authority to control them because we could refuse to approve them and instruct them to fix a rate.

Mr. PATMAN. And in the support price, the Open Market Committee has the entire power?

Mr. ECCLES. The Open Market Committee has the power and the authority to operate in the open market.

Mr. PATMAN. And the President has no power or authority on either one of these issues?

Mr. ECCLES. No; but the Secretary of the Treasury has the responsibility for raising such money as the Government needs to meet the appropriations made by the Congress that are not covered by taxes. The Treasury likewise has the responsibility of refunding the public debt.

Now, it is true, I suppose, that legally the Open Market Committee could say to the Treasury, "You must price your securities at such and such a price. We will not support the market at the prices that have been outstanding." But, as I brought forth before this committee, the Open Market Committee and the Federal Reserve Board are in favor, with the Treasury—and I think with the great majority of bankers and the public generally—of holding the long-term rate. Now, where there is the difference of opinion is in the question of the short-term rate, and it is hoped that we can negotiate short-term rates that will reflect the market demand for short-term money in relationship to our support of the 2½ percent long-term rate. So the President cannot be charged with responsibility for not using that power, and I said before this committee in December, in answer to questions of Chairman Wolcott, when we were being somewhat criticized for not tightening up and letting the market adjust, as I recall the matter, that I was sure that the Open Market Committee, if the Congress felt that we should withdraw support from the market, if they would want to indicate that and take the responsibility for it, that certainly we would do it. But so far the Open Market Committee has felt that we were choosing what we considered to be the horn of the dilemma which seemed to be more in the public interest to choose.

This matter has all been gone over, and it has been discussed and debated at great length. It seems to me that it is pretty largely a question of trying to have our cake and eat it. The banks, outside of a few of the bigger banks which have nothing but short-term securities—and you must think of that, those who have bills and certificates—of course, when you drop the market, it is not too important to them, because a short-term piece of paper cannot decline much—but outside of the larger banks with bills and certificates, there is not very much support for breaking the two and a half percent rate. The banks, as a whole, are opposed to breaking this rate, the nonmember banks possibly more, if anything, than the members. The banks, as a whole, want to prevent inflation, and yet they do not stop making loans, they are unwilling to have the Federal authorities exercise any control over their reserve situation, they do not want the Board or anyone else to have the powers that have been proposed by the Board as the only means of dealing with this, and they do want the Open Market Committee to stand there and provide them a market for their Government securities when they choose to sell them and without a discount.

Now, I say that is an untenable position for the banking fraternity to take. We cannot deal with this thing and do both. And, of

course, the Congress hesitates to give us these powers—and I am not promising too much for them——

Mr. PATMAN. You mean if the powers are granted to you, you are not promising that you can do very much with them?

Mr. ECCLES. Well, not alone, as I indicated this morning.

Mr. PATMAN. You indicated this morning that we would have to balance the budget and have a surplus?

Mr. ECCLES. Yes. I am saying that it is certainly an important factor in the picture.

Mr. PATMAN. That is all I care to ask, Mr. Chairman.

Mr. SMITH. Mr. Eccles, you seem to give the impression that the President does not exercise much power over the policies of the Federal Reserve System. Do you wish to convey that idea?

Mr. ECCLES. Yes, sir. I do not think the President has undertaken at any time, in any way—either President Truman or President Roosevelt—to indicate to the Federal Reserve System what they ought to do, because they had recognized that the Federal Reserve was an agent of Congress.

Mr. SMITH. I mean through the Treasury, principally.

Mr. ECCLES. Well, of course, we have to work very, very closely with the Treasury, because the question of managing a \$250,000,000,000 public debt is an important one, and the Treasury has responsibilities, as we have responsibilities, and there is a divided responsibility, yet there must be complete coordination of the operation.

In most countries the central banking system is owned by the government, and is a mechanism of the treasury. It has little independence. In this country there has been a strong feeling that there should be a political independence on the part of the Federal Reserve System. Yet there must be an effort at a liaison with any government in power. I do not believe that a central banking system can be in a position where, if the Congress appropriates the money, they can then say to the Treasury—which is a part of the Government—"You cannot go out and raise the money except under our dictation, and at such price as we may determine." That is something that just has never been done and I have expressed it in this way: The Reserve, the Open Market Committee, and the Board should have an independence to the extent that they would be expected, as the agent of Congress, to advise with, and to have always their day in court, with an effort at trying to persuade any administration as to what would seem to be, to them, a proper monetary policy, and, I have always gone so far as to say, a proper fiscal policy.

Mr. SMITH. And you would also expect the Federal authority to exercise the same influence over the Federal Reserve; would you not?

Mr. ECCLES. I do not say that they have. But what we try to do is try to advise. Then the question is, if you cannot persuade, and you cannot agree, how far should the central banking authority go in enforcing their will? That is a matter that has not been determined, certainly.

Mr. SMITH. Mr. Eccles, you are supporting the bond market at two and a half percent; is that not a fact?

Mr. ECCLES. We are supporting the long-term market, and all the other bonds in between on a relative basis down to one and one-eighth.

Mr. SMITH. I mean the long-term market. Now, what if the Treasury sets a certain rate? You want that rate to go higher; do you not?

Mr. ECCLES. We have recommended that the short-term rate ought to be permitted gradually to go up.

Mr. SMITH. Why? Just in a few words.

Mr. ECCLES. I will tell you why: For the very reason that we feel that the banks would be more likely to buy short-term Government securities in the market if the rate was a little better, and would be less likely to be out reaching for loans. That is certainly a possibility. We also feel that when the banks come in possession of excess reserves from two sources, over which they are not responsible—one is gold imports, which creates excess reserves, and the other is the purchase, by the Federal Reserve System, of securities from nonbank investors—largely insurance companies, savings banks, and institutions of that sort—noneligible securities, largely, or even eligible securities—when you do that, you create excess reserves in the banking system which they have no control over.

When they get that money as excess reserves, and money idle to them, we would then like them to buy short-term Governments. We would supply the Governments. In other words, we buy the long ones in the market, we buy the gold, and sell the short-term securities, and one sterilizes the other, so that through the sale of the short-term Governments to the banks we sterilize the effect of the gold imports and the purchase of the long-term markets. And if the short-term rate should go up, we think that that might be a factor in getting the banks to be more interested in purchasing the short-term securities.

Mr. SMITH. How much of a factor?

Mr. ECCLES. I cannot say that. I do not think it is major.

Mr. SMITH. It is not major?

Mr. ECCLES. Some of them think it is major. Mr. Sproul, I think, thinks it is major.

Mr. SMITH. You have dwelt on it quite a bit and I just wondered what importance you attach to it.

Mr. ECCLES. Well, it is certainly a corollary to increasing reserve requirements—a very definite corollary to it.

Mr. SMITH. It is that important?

Mr. ECCLES. It is that important, that it certainly should be done as a part of an over-all credit-control program.

Mr. SMITH. No; I said, Do you consider that important?

Mr. ECCLES. Yes; I do.

Mr. SMITH. All right. Now, you said the Treasury did not exercise any power or control over the Federal Reserve policies.

Mr. ECCLES. I did not say they did not exercise it. They exercise a good deal of influence but not statutory authority or power. But they exercise a lot of influence.

Mr. SMITH. No; that has nothing to do with statutory authority or influence. It is inherently a power. If you think that rate ought to be increased because it is affecting your reserves and ability to handle your bond market, that is not a matter of influence at all. So it is true, then, that the Treasury, or the administration through the Treasury, does affect, importantly, the policy, in that particular respect, of the Board of Governors of the Federal Reserve System.

Mr. ECCLES. I said that was minor, and that is the Open Market Committee and not the Board itself.

Mr. SMITH. Mr. Eccles—

Mr. ECCLES. And I will say this for the Treasury—that during my term as Chairman there was not a period in all of last year, and

up until the first part of this year, when the recommendations of the open market committee, with reference to monetary policy, were not accepted. It has only been very recently that the Treasury did not accept the recommendation of the open market committee with reference to the June and the July financing. That is the refunding. So that any responsibility that you may lay upon them in failing to respond applies to that time.

Now, I will say this: There was a period in there, when Mr. Vinson first went in, right after the war and before Mr. Morgenthau went out, that we just could not get them away from an extremely cheap money policy of a buying rate on bills and a special discount rate, and we were very patient, and we finally did get the situation changed, after Mr. Vinson had had an opportunity to become a little more familiar with his job.

He was taking advice from some of the economists in the Treasury who we and the Board think were giving him some very bad advice.

Mr. SMITH. Mr. Eccles, going back to 1936, you sterilized your gold purchases by paying for the gold with Government debentures; is that not correct?

Mr. ECCLES. We sterilized the gold how?

Mr. SMITH. You sterilized your gold imports? What was the year—was it in 1936 that that took place, involving about \$3,000,000,000 of gold?

Mr. ECCLES. As I recall, the bill rate was very, very low, and the Treasury increased the public debt by issuing bills and using the money to sterilize the gold. It was costing them very little. That is right. That was the gold imports that they purchased.

Mr. SMITH. Did that involve the Federal Reserve Bank System in any way at all?

Mr. ECCLES. No; it did not involve them at all, because the gold never got into it.

Mr. SMITH. In other words, you are saying to this committee that that had nothing to do with the credit with which the Federal Reserve System was concerned in its banking operations?

Mr. ECCLES. That was just the same as if it had continued to stay abroad.

Mr. SMITH. And the fact that it did not get into the credit structure had something to do with the Federal Reserve System, did it not?

Mr. ECCLES. Well, if it had come into the System it would have added to the excess reserves, and it would have possibly made for even easier money than it was; and, as I said, the short-term rate was practically zero.

Mr. SMITH. Which, of course, affected the Federal Reserve Banking System. Then why do you come in here and try to lead this committee to believe that the Federal Reserve Banking System is an independent institution, which operates absolutely independently of the Treasury or the executive branch of the Government, when, as a matter of fact, the two are so completely coordinated that there is no possibility of separating them?

Now, the law provides specifically for making—

Mr. ECCLES. It appears that you misunderstood me, Dr. Smith. I answered the question, and then you castigate me for coming in here and saying something that I did not say.

Mr. SMITH. Well, let us get the record straight, because I do not want to do anything of the kind. Did you not say, or did I not under-

stand you to say, that the executive branch of the Government has no power over the Federal Reserve System?

Mr. ECCLES. No statutory power. They have influence.

Mr. SMITH. No statutory power, but they have influence?

Mr. ECCLES. That is right. That is true of every independent agency.

Mr. SMITH. To start with, the President appoints the Chairman, and he appoints all of the governors?

Mr. ECCLES. No; I was not appointed by Mr. Truman. I was appointed by Mr. Roosevelt.

Mr. SMITH. I know; but we are not speaking about one particular President.

Mr. ECCLES. The President does appoint them, that is right, for long terms, and the Senate confirms them, and he designates one of them as Chairman.

Mr. SMITH. So that the Board of Governors of the Federal Reserve System are an integral part of the general political body; is that not true? They are a part of the United States political authority; is that not right?

Mr. ECCLES. That is right; sure they are. As an agent of Congress, they would be that.

Mr. SMITH. Well, we can be a little more specific, because we have the words right before us, "The Board of Governors of the Federal Reserve System is a governmental institution." It is a governmental institution.

Mr. ECCLES. That is right.

Mr. SMITH. If it is a governmental institution, to be sure, the executive department has certain powers and controls over it, whether they are spelled out in a law or whether they are not. You helped to finance the war at the instance and direction of the President of the United States, and you are now handling the securities, bonds, debentures, notes, and so forth, that were issued by the Federal Government, and you have fixed a price at which you are, as you say, stabilizing the bond or security market. That, of course, is in the interest of the Federal Government.

Mr. ECCLES. It is in the interest of the American public.

Mr. SMITH. Well, I am talking about the executive branch of the Government now, because we want to get this thing clear and get the idea out of the minds of the people that the Federal Reserve Banking System is a private institution, because the law says it is not.

Mr. ECCLES. What about the open-market committee? The President does not appoint them, and they are not confirmed by the Senate. Five members of them are Reserve bank presidents selected by a board of directors of 12 banks, the majority of which are elected by the private bankers.

Mr. SMITH. That is true, but there is still a certain amount of control which the Board of Governors of the Federal Reserve has over those 12 banks.

You know what the law is, and we need not go into that at the present time.

Now, Mr. Eccles, I want to ask you this question: How long do you think you can continue to support the bond market, or to manipulate the bond market, or peg the prices of bonds, or rig the Government bond market, until you are forced to come in here and say to us, "We

have got to have a specific law to hold down prices—a rigid price-control law?”

How long is that going to be?

Mr. ECCLES. Let me answer that by asking you a question, because it is not clear just what you mean.

Are you advocating that we withdraw support from the Government bond market and let that seek its level? Is that what you are advocating?

Mr. SMITH. I am not advocating anything, Mr. Eccles. I am just trying to explore the situation to see what is in store for us in the future—where we are headed for.

You do not think you can continue to support this bond market forever without more controls, do you?

Mr. ECCLES. Yes; we can support the bond market for a very long period of time. But I would say this to the Congress, with reference to the bond market; that one of the things—and the most important thing—in the picture that requires our support of the Government bond market is the failure to have a budgetary surplus, because the public expenditures have been increased by congressional appropriations and the taxes have been cut by Congress, and therefore we no longer have a budgetary surplus which, in and of itself, would tend to reduce the public debt and which would be anti-inflationary in the picture, and which would very greatly reduce the necessity for the support of the Government bond market.

It seems to me that the Reserve System, the Board and the open market committee, are put into an almost intolerable position; a position which I must say, at least, is extremely difficult. We could deny the banks reserves upon which credit is expanded by withdrawing or letting the Government bond market seek its own level.

That is one side of the dilemma. And I have indicated rather at length the problem that that would seem to us to create—and I would say that there is unanimity with reference to that subject in the Reserve System. And the other question is that the banks—and up to date the Congress, and, prior to this time, the administration—because last November and last April, when I came before the committees and presented this program and thought that we had the support of the administration in that field, we woke up to find that the administration, and particularly the Treasury—did not support the credit-control program which we abandoned any more than the bankers and the Congress did. So the System has been left with a dilemma here, charged with responsibility and without authority except using an authority that nobody wants us to use.

Mr. SMITH. There again, Mr. Eccles, you admit that the executive branch of the Government has control or affects the Federal Reserve.

Mr. ECCLES. No; upon the Congress. They did not have any effect upon us. We came here and presented the program, even though they opposed it. We came here and presented it.

Now it appears that I was not a proper representative in presenting the program, because I was not redesignated. I thought I was presenting to the Congress—and in that connection I would just like to read into the record, here, something on that subject—I thought we were carrying out a part of the Government's anti-inflationary program.

Mr. SMITH. But, Mr. Eccles, you spoke about the Treasury. The Treasury Department cooperates—

Mr. ECCLES. Well, the Treasury; yes. The Treasury happens to be the agency of the administration that opposed the program for controlling bank reserves.

Mr. SMITH. Of course.

Mr. ECCLES. And they did not offer an alternative. We thought, certainly, that we had the cooperation of the administration, but we were not deterred from pressing it even when we found we did not have the cooperation. And when we came up here again, on the 13th day of April, and presented before the Taft committee our thought with reference to the regulation of credit and the management of the public debt—we thought we were completely in line with the President's statement. When he was asked by Congress what he thought of the program that Eccles had presented before the committee asking for these controls, 2 days after, in the Wall Street Journal there appeared the statement, "Eccles bank credit proposals do not have support of the President"—that was the first I knew of it—"Truman disavows the program, while Snyder declares he did not know what it was about."

Another statement in the Washington Post, on the same date: "Eccles spoke for himself alone, Truman explained."

Now, I spoke entirely for a unanimous Board in presenting that program, and that program that was presented then was identical with the program that is now presented, with the exception that it included nonmember banks. That is the only difference.

Mr. SMITH. Mr. Eccles, it would appear that you are in disagreement with the President on his recommendations, that they would have the effect of still further inflating credit; is that correct?

Mr. ECCLES. Well, I mentioned this morning that it seemed to me that the President's program was more political than it was economic. As I see an economic program to deal with inflation, it should be the type of a program that does not increase purchasing power or increase the money supply but should be the type of a program that certainly tries to hold it in balance or reduces, if anything, the money supply.

Now, certainly that program does not do that. And I would say this for the Republicans' answer: that that, likewise, is a political answer; and, as I said before the committee this morning you cannot meet these economic programs without facing the economic facts of life. And we are where we are because for 3 years since the war ended we have, I think, given too much consideration to the various pressure groups—and nobody, of course, likes to stop inflation for the benefits that they may get, as I said this morning.

A boom is a pleasant sort of a thing for the majority of the people. Unless we face up to the economic aspects of it, why, of course, it is going to continue to run its course, and it can continue to go for an indefinite period if bank credit continues to expand—that is, more money—and budgetary deficits continue to grow.

But to say that we are going to get a bust next week or next month or next year or the following year—you cannot say. The thing can go on for a considerable time. And the dollar can continue to be devalued and devalued and devalued. So that, when a deflation finally does set in, you have wiped out, as has been done in many

countries in the world with which you are familiar, the middle class of people—their savings, their insurance, their pensions. You have wiped out about only half of it now. But you can continue the process until you wipe out that much more. And when the adjustment comes, certainly the debtors then—that have gone into debt in the inflationary period when the dollar was worth little—will be put to a terrific test; and you will get widespread bankruptcy in a deflationary period, and the state will have to intervene.

When that time comes it will have to intervene at levels perhaps even higher than these. That may well be if the deflation goes long enough. You cannot go back to 1940, no matter what; and I do not think that now the economy could stand the deflation that could take you back to 1945. I do not think that is possible now. If this thing continues, and you get a further devaluation, the present levels could look low to you, and they may well be levels below which a deflation could not carry you because of the unemployment and the bankruptcy that deflations create.

I just mention that to point out the seriousness of the inflation that has already been created since the war, and the Federal Reserve Board does not want the responsibility—and is not going to take it because we have time and again sent our reports out.

I have made statement after statement; the Board has made statement after statement to the Congress, to the public and to the Administration—and the record is there.

I am particularly glad, at this time of my demise as chairman, of the opportunity of upholding the record of this Board. It is a voluminous one, and a good one, and I will stand on the record before these committees and before the public.

Mr. SMITH. Mr. Eccles, you are taking this thing very seriously, and I appreciate it. I think it is a very wholesome thing for this committee to realize that a man in your capacity, and with your knowledge of the finances of the Nation, really regards our situation as being critical and dangerous.

I do not suppose I am overemphasizing that, am I?

Mr. ECCLES. I have been pointing out that it was a critical situation that we were developing for a long while.

Mr. SMITH. Now Congress ought to do everything in its power to hold down expenditures, should it not?

Mr. ECCLES. It certainly should.

Mr. SMITH. Even if it is only a dime?

Mr. ECCLES. Absolutely. They should set an example of saving to the public.

Mr. SMITH. All right.

Now the President recommends that we spend some money—quite a sum of money—to build a structure in New York City for the United Nations to house Stalin's agents. I have figured out that the project, under our present system of financing, status of the debt, foreign policy, and so forth, the United States would pay most, if not all, of the cost which would not be \$65,000,000, but could reach twice that figure at the end of 34 years, the period fixed for its repayment.

Do you think it wise for the Congress of the United States to provide that money, particularly at this time?

Mr. ECCLES. Well, I do not want to say whether the providing of that particular money is justified or not. I am not sufficiently familiar with the arguments and with the debates upon the question.

Certainly, no matter what the situation is, the Government, in every period, must spend some money. Now, whether that is some of the money that could be cut out, or whether some other money could be cut out, it seems to me the appropriations committees or the Administration, who are making the suggestion, are better able to judge what the expenditures in the budget should be made for.

I would not want to say that you should cut that money for that building or that you should cut some other particular expenditure. All I am saying is that, in the overall, certainly, if we do not find a way of reducing the budget or increasing the income, we are not going to do very much as an anti-inflationary measure in the fiscal field.

Mr. KILBURN. Will you yield, Dr. Smith?

You said in your statement that the budgetary deficits were increasing?

Mr. ECCLES. No. I did not say that. What I meant to say was that the budgetary surplus was disappearing, and there is every indication that we will run into budgetary deficits. And I went on to mention, this morning, that if we carry out the military expansion program and other obligations that are being discussed—

Mr. KILBURN. There was a budgetary deficit every year up until last year, when the Republican Congress came in.

Mr. ECCLES. No; you had a surplus in 1946. In the fiscal year 1947 you had the biggest surplus the country has ever had—in the fiscal year just ended—but you likewise had a surplus in the fiscal year ending in June of 1946. You had a substantial surplus in the fiscal year ending June 30, 1947, as well as this year.

Mr. SMITH. Mr. Eccles, those of us in Congress, after all, have to use our efforts to cut the budget, and we have got to cut where we can. If you do not care to express yourself on this United Nations tower of Babel, that is all right.

Mr. ECCLES. Well, I will express myself on that. Maybe I should not, without knowing more about it, but at least my first hand feeling is that that is something that could be deferred; that the United Nations seem to be housed in a manner in which they can operate.

Mr. SMITH. Mr. Eccles, you are one of the most forthright and honest persons in the Government with which I have come in contact since I have been in Washington. I have the utmost faith in your integrity.

Mr. ECCLES. Thank you, Dr. Smith.

Mr. NICHOLSON. Yes. But, Dr. Smith, where does it leave us? We are just where we were when we started out.

You are asking us to do one thing, on the one hand, and do something, on the other, that is just exactly the opposite, and I cannot understand it. I cannot understand how it can be done. We either do one thing or nothing. But you ask us to do two things. One, to build houses, for instance.

Mr. ECCLES. Who asks you?

Mr. NICHOLSON. Well, the people who come before this committee.

Mr. ECCLES. I know; but you said "you ask us," as though it was the Federal Reserve or as though it were me.

Mr. NICHOLSON. Well, as I understand it, the Federal Reserve, under the proposition that is before us, wants to take control of the whole banking situation.

Mr. ECCLES. No. We already have certain controls. All we want to do is to have given to us additional authority so as to be able to

put some mild, I would say, restrictions upon the banks of the country insofar as their further credit expansion is concerned.

Mr. NICHOLSON. Are they all member banks?

Mr. ECCLES. No; they are not all member banks.

Mr. NICHOLSON. Do you want to force banks who are not members to become member banks?

Mr. ECCLES. No; we do not.

Mr. NICHOLSON. Or to stop competition?

Mr. ECCLES. No; we do not want to force them in at all.

What we are doing, by this proposal, is to not further expand the discrimination that now exists between the national banks and member banks and nonmember banks—and that discrimination is very substantial.

We started on that this morning when adjournment took place, and I would like to cover that further. I would like to put into the record a list of items of discrimination that already exist and that already weaken the system, and if this further restriction is put on member banks—and the nonmember banks are left free—it will be only adding another discrimination, which is certainly a major one. It is possibly more important than nearly all the others put together, because when you tie up 10 percent of the deposits of one group of banks that already have a much larger percentage of their deposits tied up, because they are members of the System, than nonmembers, then you can readily see that a lot of banks are going to get out of the System. And, to the extent that you leave loopholes in our banking structure, you are unable to make an effective thing out of control and regulation.

It seems to me that at the present time—and the record shows it—the nonmember banks have an earning power of 2.58 and the members 2.01 percent. That already is true because the reserve requirements of members, the amount of cash they have to carry, and the balance which they carry with correspondents are possibly twice those which are carried by the nonmember.

Mr. NICHOLSON. So that the nonmembers can buy this short-term stuff a great deal easier than a member bank can.

Mr. ECCLES. It can. They can make loans.

Mr. NICHOLSON. Yes. And it creates a competition, there; where the nonmember can take up, according to your figures, almost 1 percent of short-term loans.

Mr. ECCLES. But what happens here is that we do not want the banks to expand either their loans or their investments. I mean, we want to curb their loans and investments to the extent that you could increase their reserve requirements, say, 10 percent, and that would take 10 percent of their total deposits. Ten percent of their total deposits would require them to dispose of, to the Federal Reserve, about 20 percent of their Governments.

Now, they are not going to like that; and unless they can get higher rates on what they have left, or on their loans, it will affect their earnings; and that is one of the reasons why we want the short-term rate to go up. But the very fact that the holdings of their Governments have been very substantially reduced, reduces their liquidity and reduces very greatly their desire to expand credit.

Now, I do not believe it would be necessary to put all this power into effect at once. I think the very fact that the Reserve System

could make that apply to all banks means that the banks are going to keep as liquid as they can in order to meet that requirement and they would hesitate to be selling their Governments for the purpose of making loans. So that its effect would be one of restriction—just the very fact that the authority did exist.

If you exclude the nonmember bank you are going to induce national banks—because of the desirability, because of the advantage they get—to get out of the national banking system, and, therefore, you weaken the whole Federal System; and you, in turn, would increase the number of state nonmember banks.

Many of the state banks that are now members of the System will be tempted to withdraw from the System because of the disadvantage, because of the penalty and because of the discrimination imposed on them because they are members of the System. And I have here a whole list of matters—items of discrimination that already exist; and this Congress, or the American public, cannot afford to weaken the Federal Reserve System in any manner.

It does not seem to me to be good judgment to say, on the one hand, that you are going to increase our power and then, on the other, exclude the nonmember banks, so that you weaken it because of the discrimination.

There is nothing unusual in applying it to all banks. And I want to call the committee's attention to a special report that was sent to the Congress on January 1, 1941. That is very important now because of the opposition of the Federal Advisory Council and the opposition of some of the bankers.

This report was sent to the Congress with the unanimous approval of the Board of Governors, the presidents of the 12 reserve banks. This report was sent to the Congress, and in this report it was proposed, among other things—

that Congress provide means for absorbing a large part of the existing excess reserves, which amount to \$7,000,000,000, as well as such additions to these reserves as may occur in the future.

As I indicated a while ago gold imports had been coming in at that time because of the devaluation policy. The Federal Reserve had Governments that they could sell in the open market to absorb the excess reserves, and the net result is the banks had added to their deposits \$7,000,000,000, by the gold imports, and on the opposite side of their ledger, they had \$7,000,000,000 of idle excess reserves, so that the supply of money was so great—excess money—and the demand was so small for credit that the Government was able to borrow on bills at the zero interest rate, and the rates on private credit were exceedingly low. The banks were so much concerned about their solvency and their earnings that they favored, in the council, all of whom are bankers, authority to increase the reserve requirements of all banks to the extent of doubling the then existing authority, which instead of being 10 percent as now proposed by us, would have been approximately 20 percent.

That is what they proposed in order to absorb these excess reserves and get control of the money market and raise the rates.

What happened? The banks still have the effects of that gold inflow invested in Government securities. The banks, when the Government began to finance deficits, immediately had available to them a market for their excesses, and they bought Governments. They

were able to take care of the expansion of the currency. So that as long as the public debt is the size that it is, with the large amount of Governments available, and the demand for credit available, the banks have no excess reserves, they have not had excess reserves for years, and they are never likely to have any excess reserves when there is an opportunity to buy Governments. Those Governments are just the same as excess reserves so far as their liquidity is concerned, or there ability to extend private credit and create additional money supply because they can sell those Government bonds, and they get the reserves with which to extend the credit.

So I say, that they are not consistent—

Mr. NICHOLSON. Well, they could not do it if everybody did it at once, could they?

Mr. ECCLES. They are only going to sell the bonds to the extent that they get demands for loans because they want to get interest on Governments until they can get a better rate on something else. So there is no problem of everybody doing it at once, because it would mean that people were just marketing an interest-bearing Government bond to take a non-interest-bearing, idle deposit, unless they had some other place to put it.

Where you may well get a flood of selling would be if there was an indication of dropping of the market price. Those holding securities, trying to get the best price, thinking in terms of what happened after the last war, when $4\frac{1}{2}$ percent totally tax-free bonds went to 82, you can well imagine what an avalanche of sales might then develop because they would want to try to get the best market, and that is one of the reasons and one of the best reasons why we have to stabilize the market, and why we have to maintain the long-term rate.

Mr. SPENCE. What was the bonded indebtedness of the United States at the time the bonds went to 82?

Mr. ECCLES. Something around 24 to 25 billion dollars. I might ask this question: If Government bonds, totally tax exempt, yielding a rate of $4\frac{1}{2}$ percent, without any support by the Federal Reserve System, could go to 82 or 83, then when our national debt was \$25,000,000,000 only, the query is, where would a $2\frac{1}{2}$ percent fully taxed bond, taxable bond go, if the Federal Reserve withdrew from its support, when there was a debt of \$250,000,000,000?

Mr. SPENCE. I just do not know. But I am just giving you a picture of the relative size of the debt and of the difference in the interest rate.

Mr. TALLE. Mr. Chairman.

The CHAIRMAN. Mr. Talle.

Mr. TALLE. At the outset, Mr. Eccles, I want to thank you for a clear, detailed and well organized presentation.

Mr. ECCLES. Thank you.

Mr. TALLE. There are two points I would like to raise. The first has to do with the nonmember banks. In the event we overlook the question of constitutionality, as to whether there is authority or not—let us waive that for the moment—and assuming that we did enact a law to require the nonmember banks to increase their reserves by the percentage stated, and in the event that those banks chose not to comply, what would be the penalty or the sanction that would be imposed on them for noncompliance?

Mr. ECCLES. I think possibly the same sanction that is imposed upon the member banks for noncompliance. In the case of the member banks, where they are deficient in the reserve, there is a penalty in the form of an interest rate on their deficiency. There is no limit in the statute as to what that penalty can be, as I understand it. They are permitted to average their deposits over a period of a month, in the case of the country bank, and 2 weeks in the case of the Reserve city banks, and 1 week for the central Reserve city banks. This is permitted in order to have the needed reserve requirement every day, these banks would have to carry an excess. Therefore, we permit them to average it over a peak. This would likewise, I assume, and certainly should, apply to the nonmember banks in the same manner. The nonmembers in the Reserve cities and the country banks should be able to average in the same manner as their competitor member banks would average them and the same penalty for deficiencies should apply.

The difference would be that the nonmember banks, we would expect, would be supervised and policed by the State banking commissioners. The Federal Reserve has a very close relationship with the State banking commissioners because we have around 2,000 State banks which are members, and because of that fact we work with them in connection with examinations and regulations, decentralized down to each Federal Reserve district and branch.

We do not duplicate the work of examination. We arrange with them, as a general rule, that they will make one examination and we make the next examination. So that this relationship with the State nonmember banks, through the State banking commissioners, is not a difficult thing to accomplish. As I indicated this morning, we have had a relationship with these nonmember banks in connection with the other regulations that have been given to the board over them.

Mr. TALLE. In the case of a State member bank, would the Federal Reserve System have the right to expel it from membership in the system in the event it did not comply.

Mr. ECCLES. We would not do it for that reason because we would put the reserve penalty on them and that is all that is necessary. They are not going to pay a rate of 4, 5, 6, 7 or 8 percent, for money, if they are getting 3 or 4 percent. They are just not going to pay any such penalty. So there is no question of expelling.

The Reserve System does have a considerable power to expel banks from the system. As to just what those powers are, I am a little hazy.

Mr. TALLE. Could the Federal Reserve Board reach a nonmember bank, influence a nonmember bank indirectly by working through the nonmember banks' correspondent bank which was a member of the Federal Reserve?

Mr. ECCLES. No, you cannot reach them that way. You mean by permitting a nonmember to carry the balances with the correspondent bank?

Mr. TALLE. I was thinking of whether the Federal Reserve Board could work through a national bank, which was large enough to be a profitable correspondent bank for, let us say, a country nonmember bank?

Mr. ECCLES. I do not know how we could in this regard.

Mr. TALLE. It would be a rather devious method, at any rate?

Mr. ECCLES. Yes, sir; the difficulty is that if the country bank carried its balance, its increased requirement, in a correspondent bank, then that correspondent bank in turn would have to carry a reserve against that balance. That is what we call inter-bank balances, and that is one of the processes of pyramiding. One of the best arguments for a unified banking system—and that is what was conceived of in the early days of the Federal Reserve Act—of course, was to get all banks into the Reserve System and to increase the importance of the Reserve System on the basis of par clearance and the facilities of collections. But naturally the reserve city banks and the correspondent banks, those who fought against the Reserve System in the beginning, have continued naturally to resist any action on the part of the Federal Reserve that might tend to reduce the balances that they get from their correspondent banks, upon which they only have to carry 20 or 25 percent reserves.

Therefore, the reserves of a nonmember bank that met the reserve requirements of the State bank commissioner, when they get over to a correspondent bank, those reserves become deposits and that correspondent bank has money to loan, can loan those reserves, except that they must carry against those deposits a certain amount of reserves.

But we are not trying at this time to interfere, any more than is necessary, with the correspondent bank relationship. We are not doing anything to compel membership in the Reserve System. We are merely faced with a problem here of what to do to put some pressures upon the banking system, as a whole, and for it to be effective and not weaken the System, the nonmember banks must be covered.

I mean pressure so as to restrict their credit expansion, to hold it down. There is nothing in this proposal that would bring about or force a credit contraction. It may be too mild. It may be altogether too mild to have very much effect, because if the banks own \$65,000,000,000 of governments, and they could sell \$10,000,000,000, to meet the requirement, they still have a huge potential for credit expansion.

I just wanted to show that this proposal is not very onerous and is not very restrictive, because they would still have, even if they met the increased requirement, the possibility of selling \$10,000,000,000 worth of governments, and would still have \$55,000,000,000 of governments left.

There has been some talk about a compromise then on this bill, and only making it 5 percent. Well, I would say that the 10 percent is still not a very restrictive requirement in itself. Yet I do think that for the present it may be sufficient.

The CHAIRMAN. \$12,000,000,000?

Mr. ECCLES. \$11,000,000,000. As I say, they have got \$65,000,000,000 worth of governments. They could sell the \$11,000,000,000, taking the system as a whole, and have \$55,000,000,000 left. They could sell \$5,000,000,000 of the \$55,000,000,000 and then expand on that; with this increased requirement, it reduces the multiple credit expansion, which is desirable. It would reduce the multiple credit expansion from about 6 to 1 now to about $4\frac{1}{2}$ to 1. Now, every dollar of reserve is the basis for \$6 of credit expansion.

With this requirement every dollar would be a basis of 4½ dollars of credit expansion. That is with the amount that is proposed.!

But, as I said, the banking system as a whole will still have an awful lot of governments left, and they could sell \$5,000,000,000 and still get a considerable expansion of credit.

I am not saying that they would do that. I think if you raised the short-term rate, and you had the power to put this 10 percent additional on, that the desire of the banks, under these conditions, would be to try to keep liquid, based on the experience of the thirties, and that might well restrain credit expansion. It certainly would make them extremely selective and very cautious and would put much more restraint on than any voluntary program can or would put upon the banks. I just hope that if anything is going to be given to the board it would not be an amount that would be completely inadequate, because the whole question of the use of this is, as I said, supplementary to other things, but at this time, I believe it is desirable and possibly the most helpful thing that could be done in a hurry to help hold the line.

The CHAIRMAN. Will you yield, Mr. Talle?

Mr. TALLE. I yield to the chairman.

The CHAIRMAN. That brings us right back to this question, as to how you are going to use, immediately—how much of this power you are going to use immediately.

Mr. ECCLES. We may not have to use any, Mr. Chairman. It depends upon whether the banks make that necessary. It depends upon two things: It would depend upon the extent to which we had to buy bank securities from nonbank investors, the extent to which gold flowed in. Those two factors alone will add to excess reserves in the banking system. These excess reserves, if the banks continue to expand credit, should be sterilized by some increase in the reserve requirements to meet that excess that was created, and if the banks then continue to expand credit and sell us governments, we should again raise the reserve requirements to sterilize the effect of such bonds as they sold.

Now I can only say that you would have to use this authority based upon the conditions that would develop, and conditions that would develop after we had such authority may be different from the conditions which exist if we do not have the authority.

The CHAIRMAN. If we gave you 10 percent additional authority, and you put it on tomorrow or the next day, what would be the effect?

Mr. ECCLES. Nobody would think of putting it on in any such a manner, when the banks do not have idle balances. When we increased reserves in 1937 the idle money was already there. They did not have to sell anything to get it or collect a loan to get it. The reserves were there and with all the increase we put on they still had an excess and the short term rate never went above half of 1 percent.

The CHAIRMAN. I have a letter here to the effect that it is going to interfere with respect to reserves. This comes in from the economic adviser of some of this country's leading corporations which have assets of over 75 billions of dollars and he goes on to say this:

Suppose the Congress should give the board power to raise reserve requirements and the board should raise them. Then the commercial banks would either sell Government bonds or call commercial loans. In the first instance the board would either buy the bonds and in so doing raise the reserves of the banks and,

believe it or not, actually negate its previous action, or banks would become insolvent and our new President, Mr. Dewey, as Mr. Hoover, would be a victim of the Reserve Board's stupidity.

If the banks call commercial loans, consumer goods would be sacrificed in the markets, and then production of these goods would decline.

Immediately the demand for industrial equipment and other capital goods would decline, and the country would enter the vale of depression.

It makes me sick to think that we might have to return to such conditions that ultimately would lead us to state capitalism or communism. The imposition of increased reserve requirements would force me to advise these clients to liquidate their holdings of Government bonds and prepare for depression.

Mr. ECCLES. Well, of course, there is nothing new about that letter. We would get plenty of opposition. In the first place, what that fellow says just is not true.

The Reserve System is not going to be so stupid as to overnight increase the reserve requirements of all banks in the country 10 percent, so that they are forced immediately to sell \$11,000,000,000 worth of bonds.

The CHAIRMAN. Let me put this question to you: How much do you think the reserve is apt to be raised in the next 6 to 8 months?

Mr. ECCLES. I could not even guess that for the very reasons that I stated. From the very fact that it was there, the banks would undertake to pursue a credit policy—I know I would if I were a banker—so as to meet that requirement, exactly the same as I would meet it if it were in effect. I would set aside enough of my Governments to say, "Well, now, if they increase reserve requirements, those Governments will be sold, so I cannot count them. That is not part of my liquidity. That is not available for me to dispose for lending," and I would consider my lending policy, and I would consider the credit policy I would pursue on an assumption that I might be required at any time to meet that requirement.

If banks actually do that—certainly nobody wants to take away from the banks earning assets—if they will pursue a policy of a non-general expansion of credit, if they will pursue a policy with the money they have, and the reserves they have received from gold imports, and the money that went into them, from our purchase of nonbank securities, of buying from the Federal Reserve the short-term securities that they held, certainly there would be no necessity or desire to impose a requirement on them that would require them to dispose of earning assets.

But if, on the other hand, they do as they are now doing, and as they have been doing over the past 2 years—taking the year as a whole—expanding their credit and thus increasing the supply of money when we already have an inflationary condition, and a voluntary scheme does not stop them from doing so, it would be up to the Federal Reserve, after getting a raise in the short-term rate, to increase the reserve requirements, slowly, as the conditions warranted.

Now, I am only one member of the Board. I cannot speak for the others. But I am just telling you that is the way I would look at it and, based upon my experience in dealing with these problems—and I have had considerable both as a private banker, over a period of 20 years, and as a Reserve official for 14 years—that is the way I would do it.

The CHAIRMAN. Thank you.

Mr. Talle.

Mr. TALLE. Another question I have in mind, Governor Eccles, has to do with the gold reserve requirements back of Federal Reserve notes and Federal Reserve bank deposits. Historically, they were 40 and 35 percent, respectively, until June of 1945. Of course, I realize certificates have been used in lieu of gold since 1935.

Mr. ECCLES. That is correct.

Mr. TALLE. But the change was made from 40 percent and 35 percent to an even 25 percent for both, in June of 1945. Would it not be desirable to move back to the larger percentages, under present conditions?

Mr. ECCLES. I do not think that would be desirable. I think it would do no immediate good and may well give the public a feeling that it was an anti-inflation action whereas it would not be effective, and it would not do any good for the present.

At the present time the reserve requirements, if they were increased—the gold reserve requirements—if they were increased to 35 and 40, respectively, on currency and bank deposits with the Federal Reserve banks, it would require \$16,069,000,000. The excess of gold now held by all of the Reserve banks is \$5,717,000,000. But, as a practical matter, the excess amount is \$4,642,000,000, because in practice we have found that you cannot get closer than 3 percent to the limit. There is an operating ratio. So that I would say that if we increase the reserve requirements to 35 and 40 percent, you would have \$4,600,000,000 of excess reserves. Therefore, there would be no pressure whatsoever upon the ability of the Reserve banks to expand currency to meet the public demand for currency, or to purchase Government securities in the market, or to make loans to member banks in order to provide reserves.

If the excess amount that I have mentioned disappeared, as it was used up, through an expansion of currency, or if inflation continued, or through an expansion of the purchase of Governments by the Federal Reserve System in the support of the market, then you would be up against this problem: The Federal Reserve System would be entirely unable to help the Government in its refunding operations, would be entirely unable to support the Government market, and we would likewise be unable to meet the increased demand for currency from the member banks whose customers required currency, and we would have to come back to the Congress, as we did before, and say to the Congress: "You must reduce the reserve requirement because if you do not reduce the reserve requirement, the possibility of a collapse in the Government bond market that should eventuate, or our inability to supply the banks with currency, and, in turn, their inability to furnish it to their customers would seriously impair the whole banking system," and I am sure that the Congress would merely reduce the requirement again. But it does not make very much sense, it seems to me, to try to control the expansion and the contraction through the medium of an indirect gold standard. That is really what we are trying to do, and when we say we want to impose that reserve requirement, there is a much more honest and a much more direct way of dealing with the problem. It would amount to this: As the excess reserve got close to the limits, the smart people, the people that understood the restrictions, would immediately say: "Well, the Federal Reserve System Open Market Committee now is limited, in its purchase of Governments. They will not be able to

buy more than another billion dollars or another \$500,000,000. Their limit is there. Or perhaps \$2,000,000,000."

So the big boys, the insurance companies and others, might say, "I think we had better sell our securities to the Federal Reserve System while we know that they are able to support the market," and you may well have enough sale of Governments that they would use the excess reserve they held rapidly, whereas others would not use it at all, but the very fact that it had a limitation, the very limitation itself, could induce a lot of selling of Government bonds, which certainly would be undesirable and unnecessary, and I see no value whatever in changing to that, except if the Congress indirectly wanted to say to the Reserve System, "You shall not support the bond market." Or if they wanted to say, "We are going to put you in a position where you cannot support the public credit."

I say the much more honest way to do that is to say, "Do not support the 2½ percent rate," and the other way is not to vote for appropriations or for tax reductions that create budgetary deficits, but support budgetary surpluses, so that the question of the Government being able to take care of its refunding, can be accomplished without any help from the Reserve System. That is really the direct way of getting at it.

This is a Mr. Spahr idea. I think Mr. Burgess also makes a point of it. I disagree fully and completely with both of them, and although Allan Sproul and I disagree on some things, we agree completely and fully on this issue, and so do all of the economists of the Reserve Board and the economists of the banks and all the presidents. And the people who talk about this one are what I call a few gold standard money cranks.

MR. TALLE. I recall, when the change was made in 1945, that it was argued by some people in the administration that deflation was just around the corner and that lower reserves would permit a greater expansion of money and credit. This feared deflation did not occur however. Quite the opposite development did occur, and now we are faced with rapidly increasing inflation. Should not then, in line with the administration's theory of 1945, the larger percentages be restored?

MR. ECCLES. That is fine, but let us bring the public debt down. The idea is you want to go back with these figures but you do not want to go back with the public debt. The action of Congress just recently would indicate that there is no intention of reducing the public debt, and, therefore, it is no time now to change the item. When you reduce the public debt substantially, then you can talk about changing the ratio that was reduced in order to help meet the expansion of the public debt.

There is just one other point I would like to make—and this is a practical operating point—unfortunately, each of the Reserve banks is required to carry gold and Governments against its particular deposits and against its particular issue of currency. That, in one sense, we have 12 central banks. Some day I hope that can be changed. I argued before the appropriate committee of Congress in 1945 that the currency of the various Reserve banks should be interchangeable. We showed that it would save hundreds of thousands of dollars a year in the shipments of currency. We got nowhere. But now the very fact that we have, in 12 separate compartments, currency issues, gold reserve requirements, and Government

bond portfolios, means that some banks may have a deficiency in gold, where others have a large excess.

Now, as a matter of fact, if you should increase reserve requirements—gold reserve requirement, that is—to the 35 percent and the 40 percent, respectively, and we maintained a 3 percent operating margin, as of July 31, there would be 4 banks that would be deficient in gold reserves, even though the 12 banks had an excess of \$4,600,000,000. That would make it an extremely inconvenient operating job for no useful purpose.

Mr. TALLE. Are the deficits large?

Mr. ECCLES. No; they are not large.

Mr. TALLE. I think for June they amounted to a little over \$105,000,000.

Mr. ECCLES. Well, they are not large. In fact, they are comparatively small. New York, as an example, 1 bank, has almost half of the entire excess. I have here a statement with the arguments on this issue that I would like to put in the record.

The CHAIRMAN. You may put it in the record.

(The document referred to is as follows:)

Restoration of the previous ratio of required gold certificate reserves held by Federal Reserve banks of 40 percent against Federal Reserve notes and 35 percent against Federal Reserve bank deposits has been proposed to your committee as an anti-inflationary measure. This proposal would make no contribution whatever to the fight against inflation. It would not sterilize new acquisitions of gold nor would it give the Federal Reserve System any additional powers to curb inflationary expansion of bank credit.

The present reserve requirements of the Federal Reserve banks stand at a uniform level of 25 percent. Congress established them at this level in consequence of the wartime expansion of currency and Reserve bank credit. The previous requirements of 40 percent against notes and 35 percent against deposits, incorporated in the Federal Reserve Act of 1913, were largely arbitrary.

To restore the prewar levels now would only entail needless operating difficulties for some of the Federal Reserve banks. The combined banks at present hold gold certificates amounting to 50.6 percent of their total note and deposit liabilities, or approximately \$6,000,000,000 in excess of the proposed higher requirements. Thus, they would not prohibit Reserve banks from providing member banks with additional funds on which to base a considerable further expansion of bank credit.

If Reserve banks were to be prevented by this device from issuing currency and member banks were thus unable to supply currency to their customers, it would precipitate the kind of money panic which the Federal Reserve System was created to prevent. Likewise, if the Federal Reserve System, because of an artificial limitation, were unable to supply credit to member banks, the results could well be demoralizing in the Government bond market.

Although the Reserve System as a whole has gold certificate reserves in excess of the proposed higher requirement, there is considerable variation among individual Federal Reserve banks. As a practical operating matter, these banks cannot permit the ratios to go down to the vanishing point and hence require a working margin of at least three percentage points.

If the higher requirement were restored, some Federal Reserve banks would have a substantial deficiency, others would be below or close to the necessary operating margin, while still others would have a large excess.

Reserve banks with a deficiency would be obliged to sell some of their Government securities to or to borrow from Reserve banks which had an excess. The reserve position of the individual Federal Reserve banks is constantly changing with seasonal and other movements of funds in the economy. Therefore, the proposal would entail operating difficulties and constant inconvenience without accomplishing any useful purpose.

Expansion or contraction of Reserve bank credit should be determined by the needs of the economy and not by the amount of gold certificates which Reserve banks happen to have, which in turn is contingent upon international movements of gold.

Likewise, inability to supply credit to member banks would compel the System to withdraw support from the Government securities market and perhaps even to sell securities which it now holds at whatever prices or yields they would bring in the market.

The Reserve banks do not control the amount of currency which the public wishes to hold. It is the depositors of the banks and the recipients of checks who determine the volume of outstanding currency. They create the demand and member banks come to their respective Federal Reserve banks to obtain such amounts of currency as their depositors or others presenting checks may desire to have.

If the Reserve System were unable to meet demands for currency it would jeopardize public confidence and might lead to runs on banks and to hoarding of currency, such as occurred in 1931.

It is already within the System's power to invoke such drastic measures. The System has rejected such a course because of the possible disastrous effects on the entire financial situation of the country.

The proposal would appear to be designed to force the Federal Reserve System to abandon support of the Government securities market and thus bring about sharp increases in interest rates. It is inconceivable that Congress or the public desire either to create a run on the currency or collapse of the bond market. If that were the will of the majority, it should be done openly and frankly and not by indirection.

Excess Gold Certificate Reserves over requirements of 35 percent Gold Certificates against deposits and 40 percent against Federal Reserve Notes, July 31, 1948

[In thousands of dollars]

	Total required reserves (35 and 40 percent)	Excess of gold certificate reserves
Boston.....	894,530	-16,063
New York.....	4,550,294	2,534,050
Philadelphia.....	997,087	75,232
Cleveland.....	1,362,301	152,012
Richmond.....	960,567	112,849
Atlanta.....	830,445	243,526
Chicago.....	2,889,077	1,521,868
St. Louis.....	699,706	-60,623
Minneapolis.....	439,810	51,992
Kansas City.....	708,449	154,123
Dallas.....	579,575	-1,472
San Francisco.....	1,777,952	949,514
Total.....	16,689,793	5,717,008

Mr. ECCLES. I would also like to put in the record the statement of the more important points of discrimination between member and nonmember banks. I will supply that for the record later.

Mr. TALLE. I would like to have that statement inserted in the record, Mr. Chairman.

The CHAIRMAN. Without objection, that will be done.
(The document referred to is as follows:)

SOME OF THE MORE IMPORTANT HANDICAPS UPON MEMBERS OF THE FEDERAL RESERVE SYSTEM AS COMPARED WITH NONMEMBERS

1. Reserve requirements are more onerous for member banks than for nonmember banks. Member banks are required to carry certain percentages of their demand and time deposits respectively in noninterest bearing balances with the Federal Reserve banks. Apart from these required reserve balances, member banks have to carry vault cash to meet deposit withdrawals and some balances with correspondent banks, none of which can be counted in fulfillment of statutory reserve requirements. Nonmember bank reserve requirements not only may be lower in amount but may usually consist of vault cash and balances carried with city correspondents, who may render services that are not available at the Federal Reserve banks. In some instances and to some extent reserves of nonmember

banks may be invested in United States Government and other specified securities. To a considerable extent, therefore, nonmember banks receive direct or indirect compensation for a substantial part of the reserves which they are required to carry under State law.

2. Nonmember banks may receive immediate credit for checks cleared through their correspondent banks, whereas credit to member banks for checks cleared through Federal Reserve banks may be deferred from 1 to 3 days for out-of-town items.

3. Member banks are prohibited from charging exchange on checks received from Federal Reserve banks for collection and therefore are deprived of revenue which might otherwise be obtained from this source. Many States permit such charges to be made and there are at least 2,000 State banks that make such charges regularly. Member banks are at a competitive disadvantage particularly as compared with some nonmember banks in their dealings with country bank correspondents because nonmember banks may follow a practice of absorbing exchange charges for their customers, whereas member banks are not permitted to do so.

4. In most States, those having a population of a million or more, a national or State member bank must have a minimum capital of \$500,000 in order to maintain a branch outside the city in which it is located. This is not required of nonmember banks. Even where branches are not involved minimum requirements for capital are frequently less for nonmember banks than for member banks.

5. There are much greater Federal restrictions on investments and loans of national and State member banks than in the case of nonmember banks.

6. There are certain Federal restrictions on holding companies and interlocking directorates which are not applicable where only nonmember banks are involved.

7. Any State nonmember banks is free to choose whether its deposits shall be insured by the Federal Deposit Insurance Corporation and therefore can save the substantial cost of the assessments for such insurance but member banks have no such choice.

Mr. TALLE. In that connection, I would like to ask one question: If you look at total deposits, they are small, are they not, for the nonmember banks?

Mr. ECCLES. That is right, they are a billion and a half, as against about 9 billion dollars.

Mr. TALLE. About 15 percent?

Mr. ECCLES. No, that is the reserves. I have got that right here. All member bank deposits; if you exclude the interbank deposits—that is, the demand and time deposits, not taking into account the interbank deposits—is 110 billion for all member banks. For the nonmember insured banks—and I have not thought of making this cover the uninsured banks, although it could do it, if Congress saw fit—I could not make a good argument for not including them, but they do not amount to much, the only argument being that they are such a small amount—but at the same time there is no economic argument for not including them—would be 19 billion dollars.

The important part about this is that the 19 billion dollars would get larger and the other would get smaller, because you offer every inducement for banks to get out of the System—the State banks that is—and every inducement for the national banks to convert to State banks, and you offer no inducement for them to come in. I, you are going to strengthen the Federal Reserve System and the national banking system, there should be more inducements to come in, and not less inducements, as this would bring about, if you excluded the nonmember banks, that is, this proposed legislation.

Mr. TALLE. That is all, Mr. Chairman.

The CHAIRMAN. Mr. Monroney, do you have any questions?

Mr. MONRONEY. No questions.

The CHAIRMAN. Mr. Folger?

Mr. FOLGER. Mr. Eccles, have you read the committee's bill with reference to title II, dealing with bank reserves? It is a confidential print. I do not know that this is a bill.

The CHAIRMAN. There are merely some technical changes.

Mr. ECCLES. No, I have not read the bill to which you refer.

Mr. FOLGER. It refers entirely to member banks, defining the four categories: Member banks in central Reserve cities, member banks in Reserve cities, member banks not in Reserve or central Reserve cities, and, fourth, all member banks, but no such change—

shall have the effect of requiring any such member bank to maintain a reserve balance against its time deposits in an amount equal to more than 10 percent, or a reserve balance against its demand deposits in an amount equal to more than 36 percent thereof, if such bank is in a central Reserve city, 30 percent if it is in a Reserve city, or 24 percent thereof if not in a Reserve or central Reserve city.

What are the figures as they now obtain with respect to these several categories?

Mr. ECCLES. Six percent, time deposits; demand deposits, 14 percent on the banks in non-Reserve cities; 20 percent, banks in Reserve cities; 24 percent, banks in central Reserve cities, which are just two cities, New York and Chicago. There is authority to increase those reserves by another 2 percent.

Mr. FOLGER. That would make it 26 percent?

Mr. ECCLES. That means adding 10 percent to each of those categories. That would make them, instead of 14 for example, 24; instead of 20, 30; instead of 26, 36; and 10 percent on all savings, no matter what the category is in all three categories of banks.

Mr. FOLGER. I noticed, in the chairman's statement, that he refers to his testimony before the Senate committee, and he says:

Since I presented that statement to the Senate committee, the Board has this morning had an opportunity to meet and to discuss the proposed legislation at length. The Board are agreed that the inclusion of the nonmember banks is essential to make the proposed legislation fully effective.

Do you know of that determination by the Board?

Mr. ECCLES. I certainly do. I was responsible for getting that meeting. I will be glad to tell the committee just exactly what the situation was.

Mr. FOLGER. That inquiry is a preface to this question:

That says in order to "make the proposed legislation fully effective." That does not deal particularly with the discrimination that is urged against now—and, I think, properly so—but it would be difficult to make this legislation effective if you did not include the nonmember banks, would it not?

Mr. ECCLES. That is right.

Mr. FOLGER. That would have that effect?

Mr. ECCLES. It would.

Mr. FOLGER. What is done with respect to nonmember banks now with respect to their reserves? Does the Federal Reserve System undertake to influence that?

Mr. ECCLES. Nothing whatever. And, as a whole, they are the ones who have been, in proportion to their size, the greatest extenders of credit. The central Reserve cities—New York and Chicago—in relation to their size have been the smallest extenders of credit and have been more responsive to the need for credit restriction.

Mr. FOLGER. State member banks can withdraw from the System at any time, can they not, by just a mechanical operation?

Mr. ECCLES. Yes, that is their privilege. It is very simple.

Mr. FOLGER. National banks cannot get out?

Mr. ECCLES. Well, national banks cannot get out of the System, but they can get out of the national banking system and into a State system, which would relieve them of this requirement. That is the loophole.

Mr. FOLGER. They would have to convert themselves to State banks?

Mr. ECCLES. That is right.

Mr. FOLGER. And then get out?

Mr. ECCLES. That is right. I would just like to say that I have been in the banking business since 1913. I was president of two banks in 1920. I was the president of a banking organization all during the collapse of the year 1929 and thirties. That organization owned 28 banks, both Reserve city banks and country banks. And I would say this to the committee: If I were in the banking business today and this restriction was imposed upon my bank as a member bank, unless I had a very substantial amount of interbank deposits and I had to have Federal Reserve connection for clearing, and so forth, I would withdraw from the System because I would be able to maintain smaller reserves by a considerable amount than are now required, without the imposition of the increase, and I could put the saving in those reserve requirements, as well as the reserves that I would be carrying with my city bank correspondent, into short-term Governments.

Then this 10 percent that would be imposed upon me as a member—I can likewise put that in Governments. So why would I need membership in the Federal Reserve for borrowing purposes if I had any source of liquidity that I could thus create by getting out of the Reserve System?

Mr. FOLGER. Mr. Eccles, I believe you—and, I think, other witnesses—have indicated that this proposed legislation is just conceived as a supplementary aid to the reduction or minimizing of the inflationary trends or developments that have come about—wholly supplementary to the other things.

Mr. ECCLES. I tried, in my general statement this morning, to make that point. I do not want to underemphasize its importance, and neither do I want it to be overemphasized and have the public or the Congress expect too much and to think that this is by any means a cure-all. I think it is secondary to a sound and proper fiscal policy.

Mr. FOLGER. To many other things that might be done?

Mr. ECCLES. I covered that this morning, Congressman Folger, rather fully, and, if you would excuse me, I would like to avoid the repetition.

Mr. FOLGER. I do not ask you for that. You mentioned the very important fact that the fiscal policy and the budgetary system that we have assure a surplus in the Treasury rather than a deficit.

Mr. ECCLES. During an inflationary period.

Mr. FOLGER. Yes.

Mr. ECCLES. In deflationary periods I am for deficits because you need to put a cushion under the deflation, and the most effective means of putting a cushion under the deflation is public spending and Government deficits.

But unless you have surpluses now, how can you, how are you, in a deflationary period, be in a position to have deficits?

Mr. FOLGER. That thought, I suppose, led you to observe that public spending, in the way of building and other things, is something to be resorted to in a deflationary period and not in a period of inflation.

Mr. ECCLES. Very, very definitely. Unless you use your fiscal, monetary and credit policies as a compensatory mechanism to moderate the inflationary development, and also moderate the deflationary development, I do not see very much hope to avoid the excesses of booms and busts.

Mr. FOLGER. That is all.

Mr. TALLE (acting chairman). Mr. Buffett, do you have a question?

Mr. BUFFETT. Yes. Mr. Eccles, our managed currency venture is running into stormy weather; is that the situation?

Mr. ECCLES. Well, our gold standard ran into stormy weather, as I recall, from 1929 to 1933. But I do not think either the managed currency or the gold standard had anything to do with the creation of the stormy weather.

Mr. BUFFETT. You do not think that the final brake on Government spending in the hands of the producers of the country has any influence on Government spending?

Mr. ECCLES. I do not understand the question.

Mr. BUFFETT. I say, you do not think the decisive brake on public spending in the hands of the producers can exercise a determining influence on Government spending?

Mr. ECCLES. I still do not get your point. Could you put your question again, or put it differently?

Mr. BUFFETT. I will try to rephrase it.

When the producers of a country have some method of protecting themselves against reckless Government spending, then they have an instrument in their hands to restrain inflation, do they not?

Mr. ECCLES. Well, inflation can come from an overexpansion of private credit as well as an overexpansion of public credit. But I will say this: To the extent that you get private credit you usually get a certain amount of production to support the credit—unless you have an inflationary condition—and all that credit does is add to the inflationary pressures. Whereas, in the case of Government spending, Government credit—that is, where they borrow in excess of their tax revenue—you do not get either goods or services available for the consumer to buy.

For instance, European loans or grants do not produce any goods whatever. But they do put pressure upon the goods that we produce.

I am not arguing against the European aid program, but I am merely pointing out an economic fact.

Certainly the worst possible conceivable waste that one can think of are the military expenditures because they certainly are a burden upon our manpower and upon our productive facilities, and they produce nothing available for the consumer to buy. Or any expenditure by Government, for that matter, that is wasteful, that is not absolutely essential in a time of inflation. Now, in a time of deflation, where you have idle men, idle material, Government spending based not upon balanced budgets, but Government spending based upon deficits pumps new purchasing power into the stream and gives employment and production that otherwise may not exist. It is a very different matter under those conditions.

Mr. BUFFETT. Have you ever explored the difficulties of restraining military expenditures in a country where the producer has no way to protect himself against expanding military expenditures? In the gold-standard country he has a method of protecting himself. He can go to the bank and say: "I do not like the way they are running things; I want gold in exchange for paper money."

Mr. ECCLES. That has never been possible, though.

Mr. BUFFETT. It was possible in this country until 1933.

Mr. ECCLES. Oh, no.

Mr. BUFFETT. You mean I could not go to the bank and get gold coins?

Mr. ECCLES. Well, a few people got gold. That was all right. The amount of gold today, in dollars, is based upon the price at which we fix it. We could double the amount of gold in the world in terms of dollars if we said we would pay \$70 an ounce instead of \$35 an ounce. But when the price of gold was \$20.67 an ounce the total amount of gold in the world was about 11 billion dollars. There was over a hundred billion dollars of obligations in this country alone, payable in gold.

Mr. BUFFETT. Why did the people not want the gold at that time? Because the price level was reasonable?

Mr. ECCLES. Surely, that was the reason. But the fact that they could get gold did not keep it stable, because they could get gold, from 1929 to 1933, up to the time of the bank holiday, and the price of gold was \$20.67 an ounce.

The fact that they could get it, and the fact that the price of gold did not change, certainly did not keep the economy stable, and you had a decline, from 1929 to 1933, of a terrific amount, even though you could get gold.

Therefore, I say that the idea that the gold standard keeps your money safe and keeps the economy stable is a myth and a fiction, based upon the historical facts.

Mr. BUFFETT. Well, it has done a better job than any managed currency, as far as I can learn.

Mr. ECCLES. Well, you had a very different world picture before the two world wars. The gold standard worked fairly well, but it was never really a gold standard in the sense that we think of it. It was a sterling standard. Up until the First World War it was the Bank of England that managed the gold standard. We called it an international gold standard. What it really was was an international sterling standard; and sterling, at that time, was the currency of the world in the same way that the dollar is the currency of the world today.

When the war came along and Britain lost its creditor position in the world, they were no longer able to manage the gold standard. They tried to get back on it and were unable to, and what was thought of as a gold standard, but which was a sterling standard, disappeared.

Now you have no chance of getting back to the gold standard in the sense that it would be an international gold standard where gold is freely exchangeable within the various countries and within the country. It will be used, to a certain extent, as an international yardstick; but even at that, it has not proved to be very effective.

Mr. BUFFETT. Then what hope can you offer the bond holder or prospective bond buyer in this country that his bond is not going to

deteriorate as much in the next 30 years as the French bonds and money have deteriorated in the last 30 years?

Mr. ECCLES. I certainly am going to offer him no such prospect, unless the Congress of the United States, in carrying out the monetary and fiscal policy of this country—and that, after all, is where the source is—can create a greater degree of economic stability in the future than we have had in the past.

The stability of the purchasing power of the dollar depends upon the amount of goods and services made available at any given time in relationship to the purchasing power.

Mr. BUFFETT. Have you made any detailed study of the spending pressures that Members of Congress are subject to in good times?

Mr. ECCLES. I have great sympathy for them. I have great sympathy for anyone who has to run for election every 2 years and go out and face his constituents. I realize the problems and the difficulties, and I realize that the pressures are simply tremendous. And it has been due to those pressures, as I pointed out this morning, that the condition of inflation that we now have has been brought about. So I sometimes despair of democracy ever being able to have enough enlightened self-interest—that is, of the people ever having enough enlightened self-interest—to prevent these excesses.

I hope that we might be able to, but certainly our whole history of the past has demonstrated that we are just unable to do it.

Mr. BUFFETT. Well, we have deprived the worker and the producer in this country of a repository of value in which he could have reasonable confidence, have we not?

Mr. ECCLES. Well, we have not deprived him of it. We have never had it. We have never had it in this country or any other country at any time.

Mr. BUFFETT. They have it in Switzerland right now.

Mr. ECCLES. Yes; but I have seen Switzerland when they did not have it, too, when they were on the gold standard.

Mr. BUFFETT. Do you mean that the Swiss peasant who had a small hoard of gold saw that value largely disappear, or be cut in two, and then cut in two again and again?

Mr. ECCLES. Oh, yes; if he wants to sit and hold onto his gold as a means of security, the way matters have turned out, gold has gradually, by devaluation—

Mr. BUFFETT. Wait a minute. He has had the physical gold. You cannot devalue his physical gold holdings.

Mr. ECCLES. That is what I am saying. By the devaluation of gold he has received, in terms of currency, an increase in his money if he wanted to sell that gold. In other words, if the people holding physical gold here could have continued to hold it when this country devalued, instead of having \$20.67 an ounce worth of gold they would have \$35 worth of gold.

Mr. BUFFETT. And their relative position under today's price level would be unchanged.

Mr. ECCLES. Well, they would be better off. The unfortunate thing is that there is not enough gold in the world—I would not say it is unfortunate, but I would say that it is a fact—that there is not enough gold in the world where everybody can hoard gold as a means of protecting the value of their savings. If everybody did it, it possibly

would not be a protective means at all, because there would be such a surfeit of gold that it would possibly lose its value.

Its value has been due, apparently, to its great scarcity, and it was considered to be the most desirable means as a money base.

I recognize that it was expected to control and stop the inflation of the money supply. The Warren theory, of course, was that in the depression the money supply seemed to be inadequate. We had deflation, and Warren had an idea that if you devalued gold and made it \$35 an ounce, that immediately you would inflate the price. Well, the difficulty is that the public did not own the gold, so that when you devalued they would have something to spend. Therefore the experiment of devaluing the price of gold, so far as inflating or increasing the price level was concerned, proved to be entirely worthless, showing that the price level had little or no relationship to gold.

Mr. BUFFETT. Do you mean that the price level in Switzerland has not been more stable than it has been in France?

Mr. ECCLES. I do not think that is because of gold. I do not think that is because of gold at all.

Mr. BUFFETT. What does cause it?

Mr. ECCLES. Well, I am not sufficiently familiar with the Swiss economy, but I know you have had a very stable price level in other countries, such as New Zealand and Australia—just as stable as in Switzerland—and they have had a managed currency. Not only that, but their central bank has been a Government-held bank practically run by the treasury.

Mr. BUFFETT. Do you think this credit curb will prove effective in stopping inflationary trends at this time?

Mr. ECCLES. I doubt it. I doubt it very much.

Mr. BUFFETT. What would be the next move, then?

Mr. ECCLES. Well, as I said this morning, unless you get a balanced budget, or not only a balanced budget but a budgetary surplus to apply against the reduction of the public debt, while through the credit mechanism you are restraining the expansion of the private debt, you are not likely to stop the inflationary tendencies; it can go on just as long as the Government is willing to pump money into the spending stream through deficits, or as long as banks are willing to expand credit to people and corporations who are willing to borrow.

Mr. BUFFETT. What will happen if the public, one of these days, decides that they have been taken for a ride in buying bonds and then seeing the value if those bonds deteriorate, and they begin to cash their bonds on a large scale?

Mr. ECCLES. That would certainly add to the inflation.

I have pointed out the element of danger where the public loses confidence in the purchasing power of their money. I did that as early as 1944 or 1945.

When the public reaches the point where the Government is not going to protect the purchasing power of its savings, then it might decide to quit saving and start to buying things. I think the public, under all circumstances, has behaved very well, and when you consider the potential inflation and the size of the deposit structure, together with the amount of governments that are almost the equivalent of currency, you realize how much more inflation is possible if the public decided to use the money they have and the government they have in order to buy things.

Mr. BUFFETT. That is one of the reasons I was against the Marshall plan, the British loan, UNRRA, and a number of other experiments. However, I am only in a very small minority. Was the Federal Reserve ever instructed by Congress to support the Government bond market at 101?

Mr. ECCLES. It never was.

Mr. BUFFETT. Does that decision on the part of the Federal Reserve Board itself have a very inflationary influence?

Mr. ECCLES. No; it may well have had the opposite. It may well have stabilized the Government bond market and given the people confidence and stopped all this cashing of Government bonds. There may have been a lot of people and a lot of institutions who would have cashed the bonds and gotten the money; and if they had gotten the money they would have been more likely to spend it than if they had held it in the form of Government bonds.

Mr. BUFFETT. Do you think that that action, plus what you are recommending here now, will lick this inflation?

Mr. ECCLES. No; I have said before that I think a budgetary surplus is far more important, and that by no credit mechanism except of the most severe type, namely, that of possibly withdrawing support from the market and denying the banks reserves, could you get at the root of inflation.

Now, let me add this in connection with the root of the inflation, and I am sorry I did not say something about it this morning:

It is better, of course, always, to deal with causes than effects. Everybody recognizes that direct controls deal only with the effects as a stopgap until you can deal with the causes. We have dealt with the effects of an excess supply of money and credit in relation to goods, by the harness of controls but we ceased to deal with the effects of the inflation before we were prepared to deal with the causes. Even at the present time we certainly have not dealt entirely, by any means, with the causes.

More production—and that, of course, is somewhat of a slow process—is absolutely essential. Ultimately, you must have a supply of goods and services equal to the potential demand. There is always a demand, but I am speaking of potential demand backed up by purchasing power. I do not believe everything has been done that possibly could have been done in the field of production. Certainly strikes by labor curbed a certain amount of production; and it was a mistake, when the war ended, to immediately reduce the workweek from 48 hours to 40, when what we needed was not less work and more money, but what we needed was more work. With more work there is more likelihood of getting more goods and services, more work and more savings. That is what was needed.

Those are the basic things you need to get at.

Now, along with that, we should not have provided the easy housing credit, which was particularly bad to the extent that it effectuated a demand for housing in excess of the supply of labor and materials.

So, to get at the causes, we must reduce in any way we can the supply of purchasing power—taxes is the most important element in that particular picture—we must do everything we can to increase the supply of goods and services available; we must keep credit from expanding.

Mr. BUFFETT. How are we going to keep well-informed people from moving steadily into things and real property when the country is exporting a large amount of its production and, by that exportation, constantly raising the replacement cost of merchandise in this country, so that a man who today buys an automobile or a gas stove or almost any kind of durable goods knows that within 2 years or 4 years or 6 years the price of those goods is going to soar simply because of the great funneling-out process of our raw materials in the way of free exports of our goods.

Mr. ECCLES. Of course, he does not know what is going to happen. If he did, of course, what you say would be true.

Mr. BUFFETT. Do you not think there is a movement like that on now?

Mr. ECCLES. No; it has certainly been a slow movement. To-day you even have an excess of certain goods. You have an oversupply, as we know, of certain durable goods and some soft goods. Certainly there is an oversupply of luxury goods, because people have been, as we term it, priced out of the market.

The hopes and expectations of the people are, of course, that prices will not go higher—at least, the prices on things they buy. They would like them to go higher on the things they have to sell. Especially if they have money, or if they have credit and they want to buy, they are hoping that they can get things cheaper later on. That is one reason that the inflation has not been as great as it could be, because there have been a great many people who have deferred the purchase of a car, they have deferred their purchase of a house, and many other things. There have not been enough to do that, however, to reduce inflationary pressures. We may reach a point where enough people will be priced out of the market and will determine that they are just not going to pay inflated prices. If enough of them reach that point so that the supply exceeds the demand, then you will be in for a deflation.

Mr. BUFFETT. What do you think Congress is going to do if that happens?

Mr. ECCLES. Well, of course, if we get into a deflationary period, I think that it is going to run a certain course so as to reduce some of the inflation, but there is a limit to which it can go without wrecking the economy. We found, from 1929 to 1933, that you reach a point where the Government has to intervene on a great scale to save the system. So I would only hope that we would not wait that long. I would hope that if a deflation comes, that we will have a backlog of public housing instead of trying to do it now, and a backlog of private housing, and a backlog demand for public works. We then will have to have some deficit financing, and, whether you like it or not, you will have to reduce taxes, even though it adds to your budgetary deficit, on the great mass of people whose purchasing power would be necessary to sustain your production. We would have to resort to all kinds of crutches. I cannot foresee all of them now, but the further our inflationary situation goes, and the more people get into debt, the more the wealth becomes concentrated again in fewer hands, the greater will be the difficulty of meeting the problem that will develop.

Mr. BUFFETT. Is there any situation more conducive to the real wealth getting into a few hands than a steady deterioration of our

currency that is understood by a small group of people and not understood by the masses?

Mr. ECCLES. Well, I think an inflation certainly helps. There are the speculators who are willing to borrow any amount they can borrow, and take any kind of chances that make the fortunes, and, of course, there have been plenty of fortunes made, which makes anything that ever happened in the past look very insignificant. We were talking about taking all the profits out of war. Of course, we did not do any such thing. There is this difference this time, however: I believe the profit opportunity was much more widely spread than has ever been the case before. The fixed-income groups, white-collar classes, the unorganized workers, have, of course, taken it on the chin, so to speak. The farmers have gotten very much more than their share of the national product, national income, ever since the war started, much more than they were entitled to. That is likewise true of certain business groups. In fact, I would say most business groups have made excessive earnings since the war and particularly since the excess-profits tax was taken off. Certainly some labor groups have profited by the inflation. Their income has gone up substantially more than their increased cost of living.

On the other hand, we also have great groups who have suffered from the inflationary developments.

Mr. BUFFETT. Under our present foreign policy, it seems to me that we have pretty well underwritten the economic wants of the non-Russian world. If that is a correct appraisal, do you think that the present political leaders, and the present Presidential candidates who are pledged with this foreign policy, will come to grips with the roots of inflation?

Mr. ECCLES. Well, there is no question but what the base of our current and expanding inflationary situation is our military and our world-aid program. Without those two programs, we would very soon have a sufficient budgetary surplus, and a sufficient production to meet all of our requirements, all of our demands, and our problem then would more likely be how to prevent a deflation, how to keep purchasing power up.

Mr. BUFFETT. In other words, if it were not for \$575,000,000 or \$600,000,000 worth of goods which we send abroad each month for free, we would be having a surplus and lower price level?

Mr. ECCLES. Well, \$20,000,000,000 of our \$40,000,000,000 budget is in two places, and the reasons for both of those, after all, is the question of the Russians. Until we are realistically willing to face up to that problem, it is pretty difficult to deal with the inflationary picture. Certainly, we cannot continue a preparedness program on a basis of defense that has no terminal point, and continue a foreign-aid program—a global program—that has no terminal point, without ultimately wrecking our economy on the shoals of inflation. We must have a terminal point to both of them, and that terminal point must be brought about through our forcing the conditions of peace before we wreck our economy on the shoals of inflation or on the shoals of a regimentation of controls in an effort to prevent such an inflation. So that means we must find a basis for peace even at the risk of war before it is too late.

Mr. BUFFETT. Do you think we have made any substantial progress in that direction since the end of the war?

Mr. ECCLES. I think the whole world has deteriorated. I think our hopes have come to naught, and I think it is pretty generally recognized that instead of having made the progress that we expected to make when the war ended, there has been a gradual deterioration, and, of course, the whole source of our trouble is Russia. Unless we deal directly and firmly and specifically and soon, with that problem, rather than have an armament race, and then deal with it later on, in a Third World War, it seems to me that this inflationary thing we are talking about is hopeless.

Mr. BUFFETT. It is true, is it not, that in 1945 we were the decisive military, industrial, and political power in the world?

Mr. ECCLES. That is right.

Mr. BUFFETT. Our power in that respect has deteriorated as we have exhausted our strength since that time, and also to the extent that we have diluted the savings of our people by inflation and thus robbed them of the fruits of their labor; that is right?

Mr. ECCLES. That is what happened.

Mr. BUFFETT. I am very much disturbed in this situation in this respect, Mr. Eccles, and I do not see that we are reaching a solution. The longer we temporize with this problem, the longer period of time is provided for those who understand inflation to profit at the expense of the trusting and patriotic citizen who counts on his Government to preserve the value of his savings; is that not correct?

Mr. ECCLES. That is absolutely correct.

Mr. BUFFETT. And if we temporize with this problem, instead of helping him by postponing the climax, we simply add to his ultimate loss?

Mr. ECCLES. That is right.

Mr. BUFFETT. Thank you.

Mr. TALLE. Mr. Buchanan, have you some questions?

Mr. BUCHANAN. No questions.

Mr. TALLE. Mr. Multer.

Mr. MULTER. I agree with you, Mr. Eccles, that our military budget is nonproductive so far as our economy is concerned. You would not, however, reduce that military budget at this time, would you?

Mr. ECCLES. I do not want to get into a discussion of the justification for either the military budget or the world-aid program. I am talking of the economics of the situation, and not the justification. It is a matter that I have some views about, but I do not believe that this is the time or the place to get into the question of our military program or our foreign policy.

Mr. MULTER. I think you might have made some comment about what would happen to the E, F, and G bonds if Government support of the bond market were withdrawn.

Mr. ECCLES. Well, I am glad you mentioned that, because we do have a demand liability in the form of E, F, and G bonds of something like \$53,000,000,000. Certainly any sale of E, F, and G bonds would stop while the long-term interest rate was unsettled and uncertain, and there might be a large cashing in of those securities, because if the interest rate on market securities should go up, which it would if the prices go down, there would be no reason why holders of E, F, and G bonds would not want to either shift to the market bonds—which, of course, in itself, might stabilize the price, except that the Government would have to borrow money to pay off the E, F, and G bonds, in some

form—but the holders of E, F, and G bonds might very well cash in their securities and hold idle cash waiting to see what to do with that money, or they might cash in the bonds and try to spend the money for an automobile or for stocks or any number of things. It would be most unfortunate if the holders of those large savings bonds should start cashing them in on a large scale, which could very well eventuate if you withdrew support from the long-term market bonds.

I am glad you reminded me of that, because that is just another argument supporting the arguments that I have already made for maintaining the present rate of 2½ percent on long-term Government bonds.

Mr. MULTER. Most of those E, F, and G bonds are individually held, are they not?

Mr. ECCLES. Well, there are a lot of the F and G's that are held by corporations and banks and insurance companies.

Mr. MULTER. The surplus you mentioned, the current surplus, for the current year, being the largest the country has ever had, is true from a bookkeeping angle, but if you take into consideration the fact that by legislation this Congress has postponed into 1949 the expenditure of certain moneys already appropriated, the actual surplus would be smaller, would it not? It would be smaller than the 1947 surplus?

Mr. ECCLES. The \$3,000,000,000 that was set aside?

Mr. MULTER. Yes.

Mr. ECCLES. I think the \$7,000,000,000 surplus excludes the \$3,000,000,000. So that if it was not for that, the surplus would have been \$10,000,000,000.

Mr. MULTER. No; I think it would be \$4,000,000,000. If that money which has been appropriated this year—

Mr. ECCLES. In other words, the surplus, from a bookkeeping standpoint, \$4,000,000,000; whereas from a money standpoint it is \$7,000,000,000. So that from an anti-inflation standpoint, it is \$7,000,000,000, although from a bookkeeping standpoint it is \$4,000,000,000.

Mr. MULTER. There was considerable discussion between you and Dr. Smith as to the Federal Reserve System being a governmental agency or an independent agency and whether it is controlled by other agencies. I think the fact is that the Federal Reserve System is the most independent of the governmental agencies in the country, is it not?

Mr. ECCLES. Well, yes; that is certainly true. That is true of the System as a whole, but I would not say that is true of the Board.

Mr. MULTER. You mean the Board submits to outside influence?

Mr. ECCLES. No; I mean that the Board are all appointed by a President.

Mr. MULTER. But their terms of office usually are much longer than the term of office of the appointing official.

Mr. ECCLES. But there are two members whose terms fall due within 4 years, one every 2 years, so you see that is an important political element in the picture. The Chairman and the Vice Chairman are designated by the President, and they, of course, have to meet with and work with all of the other governmental agencies, particularly the Treasury and often, in certain situations, the State Department. The Chairman of the Board is on the National Advis-

ory Council which has to do with the coordination of the foreign economic and credit policies, and so forth. I would not say that they are any more independent than some of the other agencies—that is, the Board. Now, so far as the Federal Reserve banks are concerned, they are. They have maybe too much authority and too much independence. They are elected or appointed by the boards of the banks, the majority of which are elected by the private bankers. And the Board, in Washington, of course, is a supervisory agency, with considerable power to supervise and regulate the operations of those banks. For instance, if Mr. Sproul of the New York bank, comes down—if the Board takes a position in favor of one thing, he can come down and testify, and does right along, against the Board. So you have a degree of independence in the banks that is much greater than in the Board.

Mr. MULTER. The only positive control over the Federal Reserve System is that exercised by congressional legislation?

Mr. ECCLES. That is right. The control, and the responsibility and authority is, in my opinion, too greatly divided and diffused and I am in favor of the study that the Hoover Committee is making on the whole question of reorganization and also the suggested study of the monetary and credit and fiscal problems and organizations of Government as suggested by Mr. Aldrich. I think that we certainly are in great need of reviewing and revamping our present set-up.

Mr. MULTER. One final question: Every time a matter of controls or regulation comes before this committee, we are given the suggestion of socialism and communism. Do you think the Federal Reserve System, in its control of our banking system, smacks of socialism or communism?

Mr. ECCLES. Of course, I can think of a lot of controls which would smack very much more of socialism. I think that any controls that the Federal Reserve System exercises over the system are needed in order to help preserve our private banking and enterprise system. They are necessary to prevent the creation of conditions which might bring on socialism.

Mr. MULTER. Thank you, sir.

Mr. TALLE. Governor Eccles, you have been at work here since 10 o'clock this morning. It is almost 6 o'clock now. We thank you very much. We are very grateful for your testimony.

Mr. ECCLES. Thank you, Mr. Chairman.

Mr. TALLE. The committee will stand adjourned until 10 o'clock tomorrow morning when I understand Secretary of the Treasury Snyder will appear.

(Whereupon, at 5:45 p. m., the committee adjourned, to reconvene at 10 a. m., August 4, 1948.)