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REMARKS OF ALLAN SPROUL,
PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK,
BEFORE THE
NEW YORK STATE CHAMBER OF COMMERCE
THURSDAY, JUNE 12, 1947

Last March you had the pleasure of hearing a talk, "Too Much Money," by your former president, Thomas Parkinson. Some of the newspapers, in reporting the talk, gave it a little more spice, even though it was already pretty hot in spots, and presented it in a way which caused me to ask Peter Grimm for a copy of Mr. Parkinson's remarks. Your president, sensing a debate, I think, asked me if I wouldn't talk to you on the same subject.

I don't want to debate with Mr. Parkinson, -- but I was much interested in his address. He ably set forth a point of view which, I suspect, is shared by many others; and I think it may be helpful to present to you my views of the problem of "too much money," so that you may see wherein we agree and wherein we disagree.

The burden of Mr. Parkinson's argument was, if I may take the risk of summarizing:

1. There has been a tremendous increase in the money supply during and since the war, and the present supply of money bears no proper relation to the volume of production and business.

2. This has been and still is the most important inflationary influence in our economic situation -- it presses prices upward, and is the reason for the increased cost of living and the resultant demands for wage increases.

3. The principal reason for the disproportionate increase in the money supply has been commercial bank purchases of Government securities -- funds used to finance the destruction of war, not the production of goods for peacetime consumption. (Mr. Parkinson indulged in a little hyperbole when he said this was precisely like counterfeit money -- fiat money, perhaps, but surely not counterfeit money.)

4. The supply of money will have to be reduced, or at least prevented from increasing further, if its inflationary effects are to be avoided. This can be done in only two ways -- by achieving a surplus in the Federal budget and paying off debt, or by refinancing bank-held debt with longer term bonds and a higher coupon attractive to permanent non-bank investors.

5. To accomplish this, astute, skillful, patriotic, far-seeing management of the credit supply is needed. This is the job of the Federal Reserve System, but the Federal Reserve System is not doing its job because it has fallen under the control of the Treasury. The redundant money supply forces prices up and interest rates down, and the maintenance of low interest rates especially for Government obligations is the heart of whatever financial policy there is in the administration of the Federal Reserve System today.

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6. This matter is of so much importance to all citizens that the time has come for a re-examination of the whole working of our Federal Reserve System by a monetary commission or some similar committee, created by the Congress to do the same sort of job as was done by the National Monetary Commission which evolved the Federal Reserve System in 1913.

I don't believe I have done violence to Mr. Parkinson's views -- certainly not consciously -- and I think his bill of particulars reads very well as I have set it down. Why, then, do I take up your time and my own in going over the same ground? Only because there were certain simplifications in his remarks which seemed to me to obscure rather than to clarify, because there were certain inferences or implications which I cannot accept, because I do not agree with part of his solution of our immediate problem, and because I think it important that these matters be clearly understood by the business community.

I have another reason, also. It seems to me that it is time that we neighbors of Liberty Street were getting a little better acquainted. A few weeks ago I read in the paper that the Chamber had declared that Regulation W, which relates to consumer credit, had outlived its usefulness and should be eliminated. The Federal Reserve System, including the Federal Reserve Bank of New York, administers Regulation W and yet, so far as I know, no one from the Chamber talked with us about the regulation and heard our point of view. At about the same time, I read that a committee of the Chamber is considering the question of a return to the gold standard. That is a pretty complex question and we central bankers have given it quite a bit of attention -- it might be useful to consult us as well as the gold miners. I am moved to suggest that if your committees which are concerned with monetary and credit problems care to talk with us at any time, they will find good neighbors at 33 Liberty Street.

Now let me address myself to the points of Mr. Parkinson's indictment of present monetary and credit policy. I share fully his concern about our overgrown money supply. It is an actual and a potential menace. Despite the possibility of a decline, or a recession, or a mild readjustment in business this year we still have an explosive situation on our hands. The public's holdings of money -- currency and deposits -- are at the highest point on record in relation to the gross national product, and the velocity of these funds is still low. It may well be that we haven't yet seen the last of the monetary consequences of the war. This swollen money supply did not come into existence, however, solely or even primarily because of the failures of particular men in particular positions of responsibility during the war years. Expansion of the money supply, given our kind of economic system, is an inevitable result of war. No country, and certainly not ours, was ready, willing, and able to finance its recent war expenditures without an increase in the money supply -- without some borrowing from the banks. Despite increases in tax rates which seemed pretty burdensome, only a little more than 40% of our Government's wartime expenditures was met out of tax revenues. Of the remaining 60%, borrowings from non-bank investors accounted for 32%, and borrowing from banks, including savings banks, to 28%. Maybe we could have increased taxes further, but there comes a point where you run the risk of gross inequities and impaired productive effort. Probably we should have sold more Government securities to non-bank investors; certainly some aspects of war-drive financing contributed to the large bank purchases of Government securities. But within the realm of practical possibilities, the overall picture at the end of the war wouldn't have been greatly different.

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If you want to place the primary blame for our now having "too much money," place it on war. If you want to be sure it will never happen again, abolish war.

It is also true that this great volume of money -- of purchasing power -- is an important inflationary influence in our economic situation. But the relationship between the quantity of money and prices is not so direct and causal as is often implied. The volume of production of goods and services and the velocity of money are important parts of the equation. If the volume of money unrestrainedly expressed itself in terms of a static volume of production, we should indeed be in a mess. But the expansion of output was the outstanding economic feature of the war, and the view is widely held among students of money, in other countries as well as ours, that the wartime monetary expansion was an essential contributing factor in the expansion of production. For our present relative well-being, we must give credit also to the horse sense of that part of the American public which has preferred, in some measure, to maintain idle balances rather than to engage in a spending spree which could only bid up prices. We must hope that this good sense will continue to prevail until rising peacetime production -- rising production per unit of capital equipment and per man hour -- comes to help redress the balance and to begin to offset our swollen money supply.

I have already indicated the extent of my agreement with Mr. Parkinson's statement, in so far as it relates to the war period, that the principal reason for our excessive money supply has been commercial bank buying of Government securities. It remains for me to take up what has been happening since. There was a further increase in the total of currency outstanding and of bank deposits belonging to the public during 1946, although the rate of increase was considerably below that of the war years. The significant fact is, however, that this postwar increase was not due to bank buying of Government securities. During the first months of 1946 there was, to be sure, a further "monetization" of the public debt through bank purchases of Government securities from non-bank investors. For the year as a whole, however, such transactions had little net effect on the money supply. Bank purchases of Treasury bonds were offset by sales of short-term securities by the banks to non-bank investors. The principal factor in the growth of the money supply during the past year was the rapid increase in bank loans other than loans on securities. Business loans increased by an amount greater than in any previous year, and there were also substantial increases in consumer loans and loans on real estate. In so far as these loans were necessary to finance expansion of peacetime production, which is essential to a better balance between the supply of and demand for goods, they were desirable, even though they did result in a further increase in the money supply.

It might be argued, however, that the increase in the money supply due to business and commercial lending in 1946 could have been offset, or more than offset, if we were really intent on avoiding the inflationary effects of an excessive money supply inherited from our war financing. That would encompass Mr. Parkinson's next point -- the necessity for reducing or at least preventing a further increase in the money supply. To accomplish this, two methods were suggested: (1) achieving a surplus in the Federal budget and paying off debt; (2) refinancing bank-held debt with longer term bonds and a higher coupon attractive to permanent non-bank investors.

In effect, that is just what was done, so that evidently it is the speed of the operation or the method of its accomplishment which is called into question. I think that most of us realized that the first problem of monetary

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and credit policy in 1946 was to try to keep the enormous supply of purchasing power, which had been created during the war, from increasing further in undesirable ways which would accentuate inflationary pressures. During the year three restraints were put upon the banks by means of credit policy, debt management, and talk -- what has been referred to as an open mouth operation as distinguished from an open market operation. In April and May the Federal Reserve Banks eliminated the preferential discount rate of 1/2 of 1 per cent on borrowing collateraled by Government securities maturing within one year, so that all borrowing thereafter was at the regular discount rate of 1 per cent. That was a small move in itself, but larger in its implications. It carried the very important implication that the pressure for easier credit and lower interest rates was off. We were left, however, with a commitment to support the 7/8 per cent rate on certificates of indebtedness, which tied our hands with respect to any increase in short-term interest rates and, more important, left the availability of Federal Reserve credit largely to be determined by our member banks. Despite this handicap, the volume of Federal Reserve credit outstanding was reduced by approximately $1 billion during the year -- the principal offset being a decline of $900 million in the excess reserves of member banks.

The admitted gap in our defenses was partially plugged by debt management. During the last ten months of 1946 and the first five months of 1947, the Treasury redeemed a substantial amount ($29.9 billion) of its outstanding market securities, first out of balances accumulated during the Victory Loan in December 1945 and, this year, out of budget surpluses. The debt retirement program exerted recurrent pressure on the reserve positions of member banks, as it involved the withdrawal of funds from these banks to redeem securities held by the Federal Reserve Banks. These periodic squeezes on the reserve positions of member banks tended to limit their ability or, rather, restrain their eagerness, to make further purchases of Government securities or to extend credit in other ways. Even such a program can be overdone, however. I should not want to continue a program involving net cash receipts, by the Treasury, at the rate of $6 billion each three months, as was the case during the first quarter of 1947 -- that is too brisk a deflationary pace. But there is, of course, no prospect that the Treasury will continue to have net cash receipts of this magnitude, so that we probably need not worry about excessive deflationary pressure from this source.

In the field of debt management there remains the question of the refinancing of bank-held debt with longer term bonds and a higher coupon attractive to permanent non-bank investors. I think it is too often overlooked that the retirement of bank-held Government debt during 1946 was an operation of this sort. This is not surprising since the cart seemed to be pulling the horse. The fact is, of course, that the Treasury overborrowed very heavily in the Victory Loan drive of December 1945, and that most of the overborrowing was represented by sales of 2 1/2 per cent long-term bonds to insurance companies and other non-bank investors. As Government receipts and expenditures came more nearly into balance, these superfluous funds were used during 1946 to pay off short-term debt, mostly held by the banking system. This was a refunding operation in reverse.

Since further replacement of maturing debt with long rather than short-term issues will result in a higher cost of carrying the debt, such a program must be tested against broad objectives of credit and debt management policy. I think the proposal can meet this test, but care must be taken that we do not merely provide a "safe haven" for institutional and savings funds which should be placed in private investment; that we do not recreate the "rollover racket", and that we do

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not upset the balance in the market for existing long-term Government obligations. These caveats suggest, first, that the issue should not be too attractive; that business and mortgage borrowers should have first call on our savings for investment. They suggest, second, that the new issue should not be a fully marketable issue, and that it should not encourage sales of outstanding issues, in order to obtain funds for its purchase. That sort of rollover was one of the headaches of the war loan drives, and one of the reasons that too many Government securities went into the banking system. Institutional and other investors, in order to pad their subscriptions and to make a profit, sold large amounts of outstanding issues, at a premium, to the banks and subscribed for new issues of long-term securities in amounts in excess of their currently accumulating cash. The result was, and could easily be again, increased rather than reduced monetization of the public debt. Finally, these caveats suggest that to breach the 2 1/2 per cent rate on long-term Government securities, except in the case of a bond of the type of Series E, would have results in terms of prices of outstanding obligations which we have no reason to precipitate, and which private investors, or investing institutions should have no reason to desire.

Finally, in our battle to hold down the supply of money, there was the third restraint I mentioned earlier -- talk -- talk about possible changes in policy which would lead to the defrosting of frozen short-term interest rates on Government securities which would, in turn, narrow the spread in rates between short and long-term securities, and reintroduce some element of uncertainty into the interest rate picture. I think this discussion of the problem had a salutary effect, largely because the action proposed seemed logical and desirable to the business and banking community, and because the discussion gave evidence that the monetary authorities were thinking in terms of shifting the emphasis from maintaining a wartime pattern of rates to preventing an unnecessary expansion of bank credit. The continuance of the debt retirement program, out of net cash receipts of the Treasury, during recent months, and changes in the immediate business outlook, have made action on this front less urgent, but meanwhile steps have been taken to clear the ground for action when the time comes. It would be unprecedented if, after the tremendous dislocations of the war and immediate postwar period, some readjustment in our economy were not necessary to provide a firm basis for an extended period of high level production and employment. It is unlikely that this adjustment can be achieved without temporary curtailment of business activity, and some loss of employment and income in some occupations. I would not want monetary policy or action to accentuate these deflationary tendencies, because while they should be temporary and mild, the increased rigidities in our economic system do enhance the danger of a recession feeding on itself.

Up to now, I have tried to tell you what we in the Federal Reserve System have been doing, in cooperation with the Treasury, to discharge our responsibilities in these postwar months. We have not done all I should like to have done, and we have done some things I would not have done, but I submit that we have done something even though it has not been as "astute, skillful, patriotic and far-seeing" as Mr. Parkinson might have wished. He goes on to say that our failures arise from the fact that we have fallen under the control of the Treasury. That is an opinion that is quite widely held, I know, and to a certain extent it is true. Indeed, properly stated and understood, to a certain extent it should and must be true. But it carries a false connotation -- a connotation that the Federal Reserve System has become a sort of bureau of the Treasury without will or purpose of its own. That is not true. The Federal Reserve System develops its own independent views about credit policy, advocates them strongly, and carries some of

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them through independently, but the fact is that you cannot now discuss credit policy without discussing debt management. That is one of the major facts of our economy growing largely out of the financing of the war. With an interest-bearing Federal debt of approximately $250 billion, with the gross service on that debt totaling $5 billion, or around one-seventh of the Federal budget (more or less), and with commercial banks of the country holding about $68 billion, or 40% of the $170 billion of marketable United States Government securities outstanding, you cannot get very far away from debt management in considering credit policy. It isn't a question of abject subservience of the central banks to the Treasury -- it is part of the economic landscape. What it should mean is that the Treasury and the central banking system have to work together on this problem, with due regard for one another's powers and responsibilities. This has been difficult, at times, but it is not impossible; in my judgment, the difficulties at present are being overcome.

I hope I have made it clear that the questions which were raised by Mr. Parkinson about credit policy and debt management are precisely the questions which have demanded and received the attention of the Treasury and the Federal Reserve System, and I think I have made it clear that we have been moving in the direction in which he would have us go. Evidently, in his view, we have not moved far enough nor fast enough. That is a matter of opinion and judgment. I can only say that his mood might be less uncompromising if he were charged with the fateful decision of determining how much of a decrease in the money supply is compatible with continued high production and high employment, how rapidly it should be attempted, and how it can best be brought about.

These questions, which face us here and now, cannot be solved by the appointment of a national monetary commission such as preceded the establishment of the Federal Reserve System in 1913. That commission took four years to complete its job. Yet I would agree that it is time for a similarly conceived study of the organization and operations of the Federal Reserve System, and of our whole credit mechanism and Government lending machinery. Probably because of the intrusion of two world wars, we have gone too long without a thorough and objective study of our central banking system, and its relations to Government agencies and private business.. Amendments to the original law, sweeping as some of them have been, have not represented an overall appraisal of performance in the light of original conceptions and subsequent developments. It is time we had a new statement from the people, through the Congress, of our responsibilities and of our powers.

And now, having taken up a good deal of your time, I should like to try to bring my remarks into focus. I would not want you to gain the impression that I think monetary and credit policy is controlling in our economic affairs, nor that monetary and credit policy combined with debt management and fiscal policy have given us the power to control economic fluctuations. These weapons can be used for good or ill, but they are at best only part of a well-rounded economic policy. Nor can we find domestic shelter, by whatever policies, in a world swept by unrest and hunger. Repair of the political, social and economic dislocations of war proceeds with maddening slowness. The burdens we must bear are larger and will have to be borne longer than the more sanguine among us anticipated. These matters impinge upon our domestic economy with brutal force, and knock awry the little adjustments we may make in interest rates or in our management of the public debt. It is high time that we again took stock of the world situation and of our position in it, for admittedly the schedules originally set down for the

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postwar period are not being met. It is reassuring to know that the Government has taken cognizance of this problem, and that the Secretary of State has called for a world-wide survey of economic conditions to determine what are the present demands upon the United States for reconstruction aid. In the light of that survey we shall have to determine how those demands can best be met, and what will be the repercussions in our domestic situation. One thing seems obvious -- we cannot be effective everywhere, in the same strength, at the same time. We must decide what are our major objectives and what are minor objectives. We must clear our minds of slogans and redefine our purpose in fighting the war. I think the kernel of the answer can be found in the words of Professor Robert Warren of Princeton, when he said a year and a half ago that the war was primarily a war for the salvation of European integrity, and that until European integrity has been restored and the continued existence of European culture and civilization has been assured, the war is not over. This overriding task to which we put our hand, and to which we sacrificed hundreds of thousands of lives and billions of dollars, cannot now be approached in a niggling spirit. Great generosity and great sacrifice still lie ahead.

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