

GOVERNMENT LOANS

By

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"This article by Governor Strong outlines a simple scheme for accumulating and investing the savings of the people in government securities without causing credit expansion. A complicated "transfer of credits" was necessary in meeting the payments of the first Liberty Loan. This was handled adequately by our Federal Reserve System, but Mr. Strong's suggestions are made with a view to simplifying these operations in the future. He divides bond buyers into four groups, comprising hoarders of cash, capitalists with and without surplus bank balances, and wage earners. Governor Strong lays particular emphasis on cultivating the habit of saving among wage earners, a habit which would facilitate investment without the need of borrowing and placing a strain on the banks.

While this country with its vast material and banking resources has made a notable record in the facility with which large loan operations have been conducted - the largest until recently being the placing of the Anglo French bonds - it has nevertheless been apparent during the past two months that people have not fully grasped the significance of a loan of, say, \$2,000,000,000, the entire proceeds of which must be paid over in a very short period, as we say, "in cash."

Government loans of this magnitude, necessitated by the war, require a thorough examination and understanding of the principles of credit, as otherwise unskillful management of operations of that size are certain to put banking machinery out of order and disordered banking machinery means disturbance of business.

No loan of \$2,000,000,000. can be paid for as we commonly express it "in cash." The amount is too large and payment must be made by complicated bookkeeping operations which can be roughly described as "transfers of credit." To do this successfully, credit must be shifted from the account of one bank depositor to the account of another bank depositor, from one bank to another bank, from one part of the country to another part of the country, and these shiftings of credit involve a temporary shifting of a certain proportion of bank cash or reserve money and therein lies the danger.

If every purchaser of Government bonds could make payment at his own bank and this amount be transferred by that bank to the credit of the Government, then the credit could be disbursed by the Government in the community where the bank is located and no disturbance of credit whatever would arise because no bank reserves would need to be shifted. In a great loan of \$2,000,000,000. subscribed and paid for in varying amounts in all parts of the country, it is inevitable that preliminary withdrawals of bank balances from one part of the country to another will be made in anticipation of payment and again after the funds are placed at the credit of the Government throughout the country; they must be gradually withdrawn to those points where the Government has various bills to pay. The machinery of the reserve banks proved to be adequate to meet the necessity of shifting credits from one part of the country to another. Possibly a correct view of their function would be to say that they were the chief bookkeepers of the transactions and the books being kept in twelve separate places at each of the Reserve banks, the only shifting of reserve money occasioned by the movement of credit is that which takes place between the twelve reserve banks through the normal machinery created for that very purpose.

Look at the problem from the standpoint of the bond buyer. There are in this country, (exclusive of a negligible number of those who own securities of foreign origin which could be resold in foreign countries), only four classes of people who can subscribe for Government bonds.

The first class of buyers comprises those who have hoarded actual cash or currency in their houses or safe deposit vaults, who are induced to buy Government bonds and who produce that cash for the purpose. Purchases of Government bonds by such people (of whom there are few in the United States), have the effect of strengthening the banking position because it brings reserve money, that is, gold, out of hiding and puts it in bank reserves where it serves as the basis of credit. The change occasioned in the nation's general bank account as a result is not simply to add a given amount to the bank deposits, but to also add an equal amount, dollar for dollar, of reserve cash. France, prior to the war held a vast store of gold tucked away in peasant's hiding places and the production of that gold in response to the Government's call has immensely strengthened its banking position.

The second class is composed of the capitalists and corporations with balances in the bank in excess of needs. When bonds are purchased by a member of this class, the owner of the bank balance, Mr. X. Y. Z., sells or transfers that balance to the Government in exchange for a government bond. If the Government leaves the deposit with the bank which holds Mr. X. Y. Z.'s account, it is simply a transfer of the balance of Mr. X. Y. Z. to Mr. U. S. A. No cash reserves shift, no loans would need to be called and no change would take place in the balance sheet of the bank, either of assets or liabilities.

The third class of bond buyers is that which has bank accounts

but has no surplus balances in bank to spare for investment in Government bonds. Having credit at the bank, however, they are induced to buy government bonds and borrow from the bank temporarily in order to pay for them. This is the least desirable buyer of Government bonds, although a necessary one at the commencement of the war when the expected savings of the future must be advanced to the Government. Such a bond buyer pays for his bond out of a bank deposit which is created by making a loan. The deposit so made is transferred to the credit of the United States of America and the bonds are turned over to the bank by the buyer to secure the bank for its loan. By that operation, bank deposits and bank loans are both expanded and the percentage of reserve money held by the bank is correspondingly reduced. Loans of that character cannot be avoided because earnings that are converted into savings become capital and are generally invested very promptly in securities, or property, or improvements to property, so becoming unavailable for Government loans. In a general banking sense, it does the country no good to have its citizens sell one kind of investment in order to make another kind of investment. It produces no new money or credit. All buyers of the class who have engaged themselves to pay loans to their banks, are forced therefore to economize in order to pay off the loans and in that way savings out of future earnings are made available to the Government in advance of the earnings being made.

The fourth class of bond buyers and in some respects the most important in time of war, is the great body of wage earners and salaried people who frequently have no bank account and spend about all that they earn. There are many millions of such in this country whose material

welfare will be improved and whose attitude toward their government will be benefitted if they can be induced to buy bonds. But how can this be brought about? Only by showing them how to cultivate the habit of saving and this kind of saving should be developed in advance of investment so as to avoid the necessity for borrowing also.

Take one industrial organization as an example, employing, say, 20,000 laborers: If these men earn an average of \$1,200. each per annum and can each afford to save \$100. per annum, their employer could enter into agreements with them by which, say \$8. would be deducted from the payroll of each man every month and deposited in bank for future investment. \$50. apiece in six months is \$1,000,000. During the process of setting aside and earmarking these earnings or savings, they could be temporarily invested in short obligations of the Government, convertible at a later date into Government long time bonds. By this process, no permanent bank expansion arises. As rapidly as savings accumulate, they are turned over to the credit of the Government which issues its short notes therefor and these short notes later are converted into long bonds. The bank balance which was originally the bank balance of the employer out of which wages were paid, has through the savings process been transferred to the credit of the Government without disturbance to bank credit.

Assuming that our Government finds it necessary, say every six months, to borrow large sums for war purposes, how readily might this be accomplished if all classes were induced to save in anticipation of such investment in the bonds of their Government? The rich man appropriates so much of his income, the rich corporation so much of its profits, the poor man, so much of his salary or wages. During the period between bond issues, these savings are turned over to the Government in installments in exchange for short notes. When the bond issue comes along, the

short notes are converted into long bonds. The whole operation has been conducted without the use of cash or reserve money but by simply book-keeping entries on the books of banks, which result in a gradual but constant transfer of bank deposits representing the nation's savings to the credit of the Government.

But the question will be asked, "Will not this enormous transfer of bank credit from individuals and corporations to the credit of the Government itself cause expansion?" If will not do so for these credits are not created by bank borrowings but by savings. The Government is spending money as fast as it receives it. The very credit so set aside for Government use must be instantly paid out by the Government for supplies, wages of soldiers and sailors and for the civil establishments. As soon as the credit is inscribed on the books of the bank for the use of the Government, the Government checks against it and turns it back to the very individuals, corporations and wage earners who have produced it. A new credit is not created but existing credit moves faster around this circle from the wage earner and saver to the Government and back to the producer and manufacturer, and through them to the wage earner. The speed with which credit moves in these operations bears a direct relation to the "speeding up" in the production of our farms and forests and mines and our manufacturing establishments.

This country is confronted by a vast problem of finance, but fortunately, with vast resources in gold reserves and credit machinery by which these operations may be handled. In furnishing the Government with the credits required, the primary necessity is for people to save and save in advance of the Government's requirements in order that bond buyers may not be required to make loans to be repaid out of future savings.