

LOOKING BEYOND 1942

Address

by

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There is much significance in the fact that your great association meets here in the neighboring city of a neighboring state. The continent's mightiest river flows between Illinois and Missouri, marking the boundary line. There are many states on many continents of the world where what we are doing today would be impossible. We wouldn't even be holding a convention where a speaker is free to rise and say what he thinks. Far less would we be able to cross a boundary without the slightest inconvenience for a purpose such as this. The hundreds, yes thousands of workers, including our own in the Federal Reserve, who cross the river daily between homes and jobs, wouldn't be able to do that in many lands.

Our organic law made substantial inter-state barriers impossible - a condition largely responsible for our growth as a nation. There is food for thought there. Those 13 strange colonies who founded this nation were farther apart in time and space than are all the lands on this physical globe today. It took Andrew Jackson nearly a month to drive from his Tennessee home to Washington to assume the presidency one short century ago. The early colonies were further apart in their customs and ideas than are many of the democratic nations on the globe today. Looking beyond 1942, it is inevitable that one of the vast frontiers in which we shall adventure as pioneers is that of our international relations in a world drawn so close together, shrunken so small, in the day of airplane, radio, and wire communication.

Our safety and security on this earth in the future depend on the courage, the resourcefulness, and the common sense we show in adjusting ourselves, and soon, to an international union of right-thinking and peace-loving nations. This and the oncoming generation face the challenge to prove whether they possess those qualities in the degree their fore-fathers did. In many ways, the problem which those leaders in the handful of strange jealous seaboard states faced over one hundred and fifty years ago was a tougher one than ours.

The subject given me today is like the Old Mother Hubbard dress - it covers everything, but it doesn't bind. You can put into it whatever you happen to have without feeling forced into any particular line. If what I say seems to deal with this year instead of next year and the years to come, bear in mind that what we do now largely determines what we will have to do then. I want to talk briefly about the banking system's part in financing the war through helping sell government securities and through buying and holding them; about the size of the public debt and its effect on the economy; about the impact of all these developments on the banking system itself; and about the challenge which the future holds for you as bankers and as leaders of public opinion in your communities.

Recent weeks show that we are winning the battle of plant capacity and war goods production. While for good reasons no specific figures on the output of airplanes, tanks, guns, and other materials of war are being released, the total sums currently being spent for war give a clue as to what has been accomplished. During April, war spending was at the rate of nearly \$40 billions annually. For the first part of May, spending has been at the rate of about \$45 billions annually. Last January the President's budget message indicated war expenditures for the fiscal year ending June 30, 1943 would reach \$56 billions. Many thought then that the estimates were physically impossible to attain. Now it appears that the much higher figure of \$70 billions recently announced by the Budget Bureau can be reached.

We are all cheered by these accomplishments in war production, but they also mean that the public debt will be increased much faster than was anticipated. On June 30, 1940, the national debt stood at slightly over \$40 billions. It is now estimated that by June 30, 1943, the debt will increase to over \$125 billions. Notwithstanding the government's effort to cover the cost of the war so far as possible by current tax revenues, the debt may go far beyond that amount before the war is over.

It is only natural that men who have spent their lives in financial service should feel grave concern as to the ultimate size of the public debt. No one likes the prospect, but this isn't a question of likes and dislikes. We are in this war, and the debt has become nearly an inevitable fact. The question is what we are going to do about it.

Americans are not defeatists by nature. On the whole, we have been incurable optimists. This is no time to change. Let us then look at this problem of the public debt with confidence that it does not mean the end of America or of the American way of doing things.

On the favorable side, we note these factors: The bonds will be held by citizens of this country. Service payments raised by taxes from one generation will be paid to the same generation. It will be an internal debt, so we avoid the impossible task of transfer which accompanies large external debt. We will end the war with a high tax structure, capable of yielding enormous revenues if national production and national income are maintained.

The United States, with its Allies, can put in what it takes to win this war with less concern over its financing than can the opposing nations. We have less reason to fear the financial consequences than any other nation. We know confidently that on the day when guns fall silent and we stand victorious, then in spite of what we have put into the war, we will emerge with our soil and our raw materials unimpaired, with the greatest producing plant, and with the greatest army of trained and skilled workers in the world's history. Those, under the genius of management which this nation will not lack, are the elements of real wealth. We shall not have expended them.

It is clear that the banks will be called upon to take a very substantial amount of the government securities sold to finance the war. However, it is

important to keep the amount of financing that must be done by banks down to the smallest amount possible. This is important for the reason that financing through the banking system is the most inflationary of all the ways now being used to meet the costs of the war. It cannot be too often repeated that every dollar borrowed from a commercial bank increases the supply of money just that much. When banks buy government securities they create new deposits which the government pays out to contractors and individuals for war purposes, thus increasing the supply of available purchasing power and aggravating the task of those who are fighting to hold back inflation. Borrowing from individuals or corporations, on the other hand, employs existing funds and does not add to the supply of money. This type of non-bank borrowing absorbs current or future purchasing power and assists in the control of inflation.

On the basis of the present tax and borrowing program it appears that banks may have to buy as much as \$25 billions of government securities during the 14 months ending June 30, 1943. That means the creation of \$25 billions of new purchasing power which, even though it may temporarily be held idle, would still be immediately available any time the holders of deposits attempted to go into the market for goods. In view of these potentialities and other consideration which I shall mention later, I submit that it is good common sense for bankers to push the sale of government securities to other buyers than the commercial banks.

Some bankers have taken issue with me about pushing non-bank sales to corporate depositors. They contend that if their customers withdraw their deposits to buy government securities, the banks will lose funds and may even be forced to liquidate some of their present holdings at a time when the government expects them to absorb a substantial amount of the new financing.

I think these objections overlook the rapidity with which the government

spending program distributes funds throughout the banking system. When government securities are purchased by bank depositors, it does not mean that the banks as a whole lose deposits. The funds that are paid in to the Treasury's account at the Federal Reserve banks are continuously being returned to the banking system just as rapidly as the government expends them to pay its bills for war production. While this is going on, the deposits of all banks will be steadily increasing because of the new deposits created by banks through their own purchases of government securities.

In view of the fact that most of the factories and farms of the country are or soon will be engaged in war production or in providing essential civilian goods and services, there is little likelihood that even the customers of an individual bank will find their incomes long shut off. Because of the interdependence of all units of the economic system, Treasury payments are widely distributed throughout the entire banking system.

Those of you who were in banking business during the World War will remember that your institutions did not lose deposits after the big Liberty Loan drives, but that, on the other hand, your deposits actually increased. I do not believe that the banks need to worry about a loss of deposits if they push the sale of government securities to their customers just as hard as they can.

Furthermore, in considering the objection I have cited, it might be well to go back and consider what it is that fundamentally provides a bank with lending power. The ability of the banking system to add to its loans or its holdings of government securities depends upon the amount of excess reserves. At the present time the banks of the country have somewhat less than \$3 billions of excess reserves. This amount will support roughly \$15 billions of new purchases of government securities or of new loans. The volume of excess reserves can be increased at any time

through open market operations. When we entered the war the Federal Reserve System announced that its policy for the duration of the war would be to maintain adequate reserves so that there would always be adequate funds available for financing the government and essential private activity.

The new Victory Fund Committee organization which was recently announced by the Secretary of the Treasury represents a new effort to channel all available investment funds into financing the war program. These committees will serve to coordinate the efforts of the banking and securities industry in helping to distribute all Treasury securities, except the Series E War Savings bonds. They will work chiefly with the larger investors, including corporations, insurance companies, savings banks, other large institutional investors, trust estates, and wealthy individuals.

The work of the new Victory Fund Committees will not be identical with that performed by the Liberty Loan Organization of the first World War. The Treasury financing program this time aims at providing special types of securities best suited to the needs of particular classes of investors. These new committees will neither supersede nor compete with the nation-wide state and local organizations now charged with the responsibility of attaining the sales quotas for War Savings bonds. Securities dealers and bankers have formed the new committees to push the sale of other types of Treasury securities. For example, the recent Treasury offering of  $2\frac{1}{2}$  per cent registered bonds of 1962-67, which were available to others than commercial banks, and for which the books were left open for ten days, is one kind of security that the Victory Fund committees and their regional organizations would assist in distributing. The Treasury may develop other special securities which will be designed to attract certain types of investment funds that have not yet been tapped. It will be the job of the Victory Fund organization to see that such issues are called to the attention of all investors who might be interested in them.

The banks of Illinois and of the country have done a fine job in providing facilities for issuing War Savings bonds and in encouraging their customers to invest in them. The success of the new campaign will depend in large part upon your cooperation and active participation. In fact, the program itself was established in response to the patriotic offer of the banking and securities industry to be of greater service in helping finance the war. I am sure that bankers can be counted upon to do the job.

Another vital war responsibility for Illinois bankers arises from the fact that Illinois is a key state in the new agriculture that is developing in response to war needs. The cutting off of our supplies of fats and oils from abroad makes it necessary that oil-bearing crops in this country be increased greatly. Illinois leads the country in the production of soy beans. Illinois agriculture is geared to produce the high protein foods such as livestock, dairy products, and eggs so badly needed by the armed forces and the civilian population of this country and our allies. Banks, along with other agricultural credit agencies, have a responsibility to see that no vital agricultural production is impeded by lack of financing. It is also to the immediate interest of the banks that they obtain their full share of this financing now that their loan volume from non-war activity and from consumer credit is declining.

It may be that bankers will have to change some of their usual credit standards if they are going to do this job of financing agriculture. During 1941 the short term agricultural loans of all Illinois banks increased by about 4 per cent. No precise figures are available on the movement of agricultural loans since the end of the year. However, the total loans of Illinois member banks located in the Eighth Federal Reserve District declined by over 6 per cent between the end of last year and April 4. In this same period the loans of the Production Credit Associations in Illinois increased by about one-third. This would indicate that the



increased short term credit needs of Illinois agriculture are being supplied by sources other than banks.

In approaching the soundness of extending credit to agriculture in this war as compared to the experience of the last war, bankers should remember that we have the benefit today of the agricultural program of the past decade. This time we are not going to plow up lands that should never have been put into cultivation. The loan and purchase programs directed by the Department of Agriculture give farmers a protection in undertaking the expansion programs that was not available at the time of the last war. This time the program of increased production will not be the hit or miss affair of the last war, but will be a more intelligent effort, carefully directed, and, I think, followed.

In view of these circumstances, the banks of the country can undertake financing the needs of agriculture with far greater assurance than was ever true before. Whether the banks will meet this opportunity and responsibility in agricultural credit will depend upon whether they are aggressive in seeking and developing the agricultural loan opportunities in their communities, and whether they will grant such credit on fair and equitable terms both from the standpoint of the farmers and of themselves.

It is natural for bankers to feel concerned over the future of their business. They wouldn't be smart business men if they weren't. The trend of recent years, which will be accelerated by the tremendous amount of government securities the banks will be called upon to buy, is toward "riskless banking". At the present time over 50 per cent of total loans and investments of banks is in the form of government direct or guaranteed obligations. Banks also hold a substantial amount of other securities on which the government has at least a moral obligation. Even in the loan portfolios of banks there is a considerable volume of Commodity Credit

Corporation paper and loans guaranteed by the F.H.A.

In my opinion this trend has some long-run implications which may be unfavorable to the maintenance of the private banking system as we have known it in the past. The condition of the banks after the war will be even more closely tied up with the government security market than at present. The prospective, great expansion of deposits will reduce still further the capital-deposit ratio of banks, and will place an increasing premium on riskless investment and lending policies.

In these circumstances also the freedom of action of the Federal Reserve System in adopting national credit policies in light of current monetary and economic conditions may be restricted. More and more weight may be attached to the financing needs of the Treasury, and to protecting the banks' investments in Treasury securities.

The world that emerges after this conflict will differ greatly from the world we have known. How the changes affect the banking system depends in part on how well we meet our new responsibilities, without failing with the old. Banks to survive must continue to lead in providing the essential credit needs of their communities. They must be willing to assume the risks that such financing inevitably involves. They have done a magnificent job for their country in selling War bonds, but they must do still more. It is to the self-interest of the bankers to do everything in their power to see that as much as possible of the government war financing is done outside the banks. Excellence in all these lines is the best insurance against successful future attack.

Now as I approach a conclusion, I want to talk to you, not as bankers, but as leaders of thought and public opinion in your communities. The challenge of the future, if it is met, will be met by "go" men, not by "no" men; by the constructive and not by the obstructive leaders.

This summer is likely to impose severe strains on all of us. The war will be hard, and it may be very long. The democracy of this nation is proving it can rise to the test of war. It remains to be proved how well we can meet the responsibilities that follow the war.

When we were forced to take up arms in this desperate, globe-encircling war, we left unfinished, perhaps even uncharted, the task of domestic rehabilitation. We will have to take it up again and handle it while we carry forward our share of the responsibility for establishing a world society in which peace and freedom have a chance to survive.

Our world responsibilities will not end with the defeat of Hitler and the War lords of Japan. In the post-war world we will have the major battle of reconstruction to fight, at home and abroad. Our battle plan, to win, will have to be based upon the best American tradition and ideals - and that means it must be flexible, imaginative, and daring. This country was built by men who did the things that contemporary judgment said couldn't be done. Washington won his fight in the face of almost hopeless odds. Hamilton brought stability out of a chaos of currency and banking difficulties. Jefferson waged a great battle for human freedom to establish our country as a democracy based on universal suffrage instead of oligarchy. At a later date Lincoln broke with firmly established practices and with respectable opinion, but he abolished slavery and preserved the Union.

All of these great Americans had one thing in common; they did the job that had to be done in their time. To do this job they had to break with precedent. In so doing they were regarded by many of their contemporaries as reckless and revolutionary. Actually, they were trail blazers who saw that new ground had to be broken in order that human progress could continue.

The job ahead of us is as big as theirs. We cannot do it by aping them. Times, conditions, and tools have changed. We will be living in a totally different world from any they knew or we have ever known. The opportunity for leadership, however, faces us just as it faced the great American leaders of the past.

This has been called the people's war. I think that is a good name. If we are going to be successful in establishing a just and lasting peace, it will have to be a people's peace. We will end the war with the finest mechanical plant we have ever known, with our resources intact, and with the largest body of skilled workers in the history of our country. Our problem is how to use them.

The men gathered in this room today have something at stake in this country - something at stake in the world. They have influence far greater than their numbers. Is it too much to hope that they will help provide and will support the leadership this country needs and must have in the trying days ahead? I do not think it is too much.

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