DIRECT PURCHASES OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS

HEARING

BEFORE THE

COMMITTEE ON BANKING AND CURRENCY
HOUSE OF REPRESENTATIVES

EIGHTIETH CONGRESS

FIRST SESSION

ON

H. R. 2233

Superceded by H. R. 2413

AN ACT TO AMEND THE FEDERAL RESERVE ACT, AND FOR OTHER PURPOSES

MARCH 3, 4, AND 5, 1947

Printed for the use of the Committee on Banking and Currency

UNITED STATES
GOVERNMENT PRINTING OFFICE
WASHINGTON : 1947

98702

COMMITTEE ON BANKING AND CURRENCY

JESSE P. WOLCOTT, Michigan, *Chairman*

RALPH A. GAMBLE, New York.
FREDERICK C. SMITH, Ohio
JOHN C. KUNKEL, Pennsylvania
HENRY O. TALLE, Iowa
FRANK L. SUNDSTROM, New Jersey
ROLLA C. McMILLEN, Illinois
CLARENCE E. KILBURN, New York
HOWARD H. BUFFETT, Nebraska
ALBERT M. COLE, Kansas
MERLIN HULL, Wisconsin
WILLIAM G. STRATTON, Illinois
HARDIE SCOTT, Pennsylvania
PARKE M. BANTA, Missouri
CHARLES K. FLETCHER, California
ELLSWORTH B. FOOTE, Connecticut

BRENT SPENCE, Kentucky
PAUL BROWN, Georgia
WRIGHT PATMAN, Texas
A. S. MIKE MONRONEY, Oklahoma
JOHN. H. FOLGER, North Carolina
BROOKS HAYS, Arkansas
JOHN H. RILEY, South Carolina
ALBERT RAINS, Alabama
DONALD L. O'TOOLE, New York
FRANK BUCHANAN, Pennsylvania
HALE BOGGS, Louisiana

WILLIAM J. HALLAHAN, *Clerk*

CONTENTS

DIRECT PURCHASES OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS

MONDAY, MARCH 3, 1947

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met at 10:30 a. m. in the committee room, the Honorable Jesse P. Wolcott, chairman, presiding.

Committee members present were as follows: Messrs. Wolcott, Gamble, Smith, Talle, McMillen, Kilburn, Buffett, Cole, Hull, Stratton, Banta, Fletcher, Foote, Spence, Brown, Patman, Monroney, Folger, Riley, Rains, and Buchanan.

The CHAIRMAN. The committee will come to order.

We have met this morning for consideration of H. R. 2233, a bill to amend the Federal Reserve Act, and for other purposes.

(H. R. 2233 is as follows:)

[H. R. 2233, 80th Cong., 1st sess.]

A BILL To amend the Federal Reserve Act, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the proviso contained in subsection (b) of section 14 of the Federal Reserve Act, as amended (U. S. C., title 12, sec. 355), is hereby amended to read as set forth below, without regard to the provisions of title XV, section 1501, of the Second War Powers Act, 1942, approved March 27, 1942, as amended (U. S. C., title 50, Appendix, sec. 645): "*Provided,* That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities either in the open market or directly from or to the United States; but all such purchases and sales shall be made in accordance with the provisions of section 12A of this Act and the aggregate amount of such obligations acquired directly from the United States which is held at any one time by the twelve Federal Reserve banks shall not exceed $5,000,000,000."

SEC. 2. The ninth paragraph of section 10 of the Federal Reserve Act, as added by the Act of June 3, 1922, and amended by the Act of February 6, 1923 (U. S. C., title 12, sec. 522), prohibiting any Federal Reserve bank from entering into any contract or contracts for the erection of any branch bank building or from authorizing the erection of any such building if the cost of the building proper is in excess of $250,000, is hereby repealed.

The CHAIRMAN. We have with us this morning Mr. Eccles, Chairman of the Board of Governors of the Federal Reserve System, and I assume that Mr. Eccles has a statement which he would like to read without interruption, with the full assurance that all committee members will have an opportunity to question Mr. Eccles when he is through with his statement.

Is that the way you would like to proceed, Mr. Eccles?

Mr. ECCLES. Yes, Mr. Chairman.

The CHAIRMAN. Very well. You may proceed.

Mr. ECCLES. I have a statement that was sent to the clerk of the committee on Friday and possibly some of the members have seen the statement.

The CHAIRMAN. I know they have all had copies of it.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. ECCLES. The proposed bill has two purposes: first, it would make permanent the existing temporary authority under the Second War Powers Act, whereby Federal Reserve banks may purchase up to $5,000,000,000 of Government securities to meet temporary deficiencies in Treasury balances with the Reserve banks. Second, it would remove a limit on amounts that may be expended on construction of Federal Reserve banks' branches.

The first proposal, direct purchase of Government securities, would restore to a limited degree an authority which the Federal Reserve System had from its inception in 1914 until the Banking Act of 1935. A provision was inserted in that act requiring all purchases of Government securities by Federal Reserve banks to be made in the open market, which means purchased chiefly from dealers in Government bonds. Those who inserted this proviso were motivated by the mistaken theory that it would help to prevent deficit financing. According to the theory, Government borrowing should be subject to the "test of the market." The so-called test could only be applied to marketable securities, and the test would be meaningless unless applied to them in an entirely unregulated market. There could be no such market except at the risk of chaotic conditions in the bond market and incalculable added costs to the Government in managing the public debt.

Congress vested in the Federal Reserve authority to create reserves for the banking system primarily by purchases of Government securities in the open market. Purchases as well as sales of Government securities are made by the Open Market Committee, established by Congress for that purpose. Policy governing these operations is determined on the basis of the broad needs of the economy at any given time. Through these operations the Government bond market has been kept relatively stable, notwithstanding the vast increase in the public debt as a result of the war, and the Treasury has had an assured market for new as well as refunding issues at interest rates satisfactory to the Government.

Nothing constructive would be accomplished by the proviso that the Reserve System must purchase Government securities exclusively in the open market. About all that such a ban means is that in making such purchases a commission has to be paid to Government bond dealers. The prohibition would not restrict the total amount of Government financing, nor would it affect the general level of interest rates, and that is the only way in which the "test of the market" could be manifested. Interest rates on Government securities have been and will continue to be determined by the Open Market Committee in consultation with the Treasury. Finally, it is unrealistic to presume, as this theory does, that if Congress votes for expenditures but does not vote for sufficient taxes to cover the expenditures, the money market should erect barriers to discourage the practice.

The purpose for which the direct-purchase authority has always been used in the past and would be used in the future is simply one of meeting temporary needs of the Treasury which, if met in other ways, would entail either needless additional costs in managing the public debt or equally needless fluctuations in the securities and money markets for brief periods. What is involved in the proposed bill is not a question of monetary theory or policy, but simply a question of efficient, economical, and businesslike management of the public debt.

The direct-purchase authority is, in effect, merely an overdraft privilege with the Reserve banks—a line of available credit for use if needed. Without it, the Treasury would feel obliged to carry much larger cash balances, which means that it would have to borrow more and thereby increase the amount and cost of the public debt. In other words, having the overdraft authority, even though there may be no need to use it, enables the Treasury to carry smaller balances than otherwise would be possible and thus reduces interest charges. For every billion dollars of Treasury balance that can be saved in this way, interest costs would be reduced by at least $4,000,000. That would be figuring a rate of three-eighths the bill rate.

As the committee knows, with a huge public debt, much of it in short maturities, frequent, periodic refunding operations are necessary. For example, more than $10,000,000,000 of Treasury bills, certificates, and notes fall due in March, some $8,000,000,000 in April, and so on through the year. The same will hold true for years to come—as long as we have a debt of this magnitude. To have an uncertain or periodically tightened money market in view of this situation would be as impracticable as it is needless.

I append to this statement a table which shows the number of occasions on which the direct purchase authority, granted temporarily in the Second War Powers Act of 1942, has since been used. The table shows that in 1942, 1943, and again in 1945, there were approximately 60 days , all of them falling at periods when the Treasury had to meet large payments, generally for interest or for redemption of maturing debt, a few days before large tax receipts were deposited. In effect, the Treasury had an overdraft with the Federal Reserve banks for these few days when the Treasury balances at the Federal Reserve banks were less than the amounts needed to meet withdrawals. Subsequently these deficiencies were overcome and the Treasury balances at the Reserve banks were built up again as deposits were made to these accounts of tax payments received by Internal Revenue collectors.

The temporary overdrafts did not mean that the Treasury had no funds. It had large deposits in war-loan accounts with commercial banks at all these periods. Sufficient funds could have been transferred from the war loan accounts to the Federal Reserve banks to cover all expenditures. However, transfer of funds from the commercial banks to the Federal Reserve banks for this purpose would have left the Treasury, after the tax receipts had come in, with a much larger balance at the Reserve banks than it needed and this would have unduly reduced bank reserves for an extended period.

If commercial banks are faced at tax periods not only with deposit withdrawals to meet tax payments but also with drains on their war loan accounts, they would have to follow one of four courses: If they had sufficient excess reserves with the Federal Reserve banks, they could reduce their reserve balances to the extent necessary. If they did not have excess reserves—this normally is the case—they would have to sell sufficient securities to obtain the funds, or they could withdraw correspondent balances. That means from the correspondent banks, and those banks in turn would have to sell securities to meet the withdrawals—or they would have to borrow from the Reserve banks. All of these alternatives would tend to tighten money market conditions at a time when taxpayers would be drawing on their bank accounts to make their tax payments. In other words, if the Treasury could not borrow temporarily from the Federal Reserve banks by what is, in effect, an overdraft at these tax payment periods, and in this way avoid withdrawals from its war loan accounts to pay off maturing obligations, money conditions would unduly tighten and tend to unstabilize the money market and the Government securities market.

This can be avoided by the temporary overdraft until the tax payments again build up Treasury accounts at the Reserve banks and provide the Treasury with funds to retire the overdraft. The operation simply stabilizes the market. That is all that happens. The amounts of special certificates to cover overdrafts shown in the table are relatively small compared with the size of the public debt and the recurring maturities. For instance, on June 16, 1942, and for 4 days thereafter, the Treasury had an overdraft varying from 58 to 94 million dollars. The largest overdrafts occurred in the middle of March of 1943, when the highest amount borrowed to cover an overdraft was $1,302,000,000 on March 15. The borrowing was entirely paid off by the end of the month.

As I have indicated, the authority existed for more than 20 years prior to 1935. It is more needed than ever today, because of the size of the debt and the refinancing operations. The fact that tax collections are also very large, currently about $40,000,000,000 a year, means that quarterly withdrawals from the banking system are going to continue to be heavy, so that it will be desirable to have the overdraft authority to help in stabilizing the money market at tax dates.

One suggestion which has been put forth is that the authority should not be a permanent part of the Government financing machinery. However, the need for it is no more temporary than the large public debt and the fiscal operations involved in it. It was used effectively in the 1920's and will continue to be needed as long as we have a huge public debt. Congress could always repeal the power if the need for it ceased to exist, or if Congress felt it was not operating properly. It is better not to place an arbitrary limit of, say, 2 or 3 years on the authority than to have to go to the trouble of renewing it periodically.

The second subject in the bill, has no relationship whatever to the first one, but inasmuch as both matters, from a legislative standpoint, were very small, we thought it advisable to put them in the one bill, or it was suggested that they be put in the one bill.

The second subject is Federal Reserve branch bank buildins. This second point of the bill is not, so far as I know, controversial. The amount of $250,000 on the cost of a Federal Reserve bank branch building was placed in the Federal Reserve Act in 1922 at a time when the System was subjected to a great deal of criticism. Construction costs at that time were such that it was possible to construct buildings needed to house some of the smaller branches at a cost not exceeding $250,000 for the "building proper." In the case of a number of the branches, however, that amount was not adequate, and Congress authorized larger expenditures in accordance with recommendations of the Board. In the light of the greatly increased operations of the Federal Reserve banks and their 24 branches, and in view of the increased costs of construction, the present limitation is entirely unrealistic. Consequently, most of the branches have had to rent outside space, which, in many cases, is unsatisfactory and is uneconomical because of the difficulty of carrying on related operations at different locations. In some cases the working conditions are very unsatisfactory.

In accordance with the established policy of the Board, improvements and additions to Federal Reserve bank and branch buildings have been deferred because of war and postwar conditions resulting from scarcity of materials and labor. It is now necessary, however, in the interest of the efficient conduct of branch operations, which have been greatly expanded to take care of the increased volume of work, partly incident to handling public debt transactions, that a number of branch bank buildings be enlarged and in some cases that new buildings, particularly new or enlarged vault facilities, be constructed. The Federal Reserve banks would use their own funds for such purposes. No appropriations of Government funds would be needed. It is hardly conceivable that removal of the limitation on the cost of branch buildings would lead to any waste of funds, since all new construction has to be approved by the Board of Governors before it is undertaken.

The construction of branch buildings has to be approved in the first instance by the directors of the branch, and then by the directors of the parent Federal Reserve bank. After the Boards of Directors of both the branch and the parent bank have approved the construction of a building, the matter then comes before the Board of Governors for approval. The Board considers the proposal in the light of the needs of the branch, the type of building to be constructed, its cost, availability of materials, and whether the construction at the time would be in keeping with governmental policies with respect to building construction. All such expenditures are reported to Congress by the Board of Governors, and if any question arose regarding the Board's policy in this respect, it could be promptly reviewed by Congress.

The CHAIRMAN. Mr. Eccles, the only new subject in section 1 is that you want this authority made permanent. I understand that now the Board of Governors have to make an annual report to Congress; is that correct?

Mr. ECCLES. That is correct.

The CHAIRMAN. And in that annual report, there is no obligation to make a report of its operations under this authority, is there?

Mr. ECCLES. Well, the Board, in its report, is required to report all matters involving policy. It has always been published in the report as a special thing. The reference has been made to the use of this authority. It would not be considered a routine operation because of the very nature of it. It is not regular or an even amount or routine, and for that reason, I suppose, it could be considered a matter of policy in using this authority. Also, Mr. Chairman, to the extent to which there are any outstanding amounts, it is always given in the statement published by the Federal Reserve at the time. It also appears in the Treasury's statement.

The CHAIRMAN. You have appended to your statement a schedule of the outstanding obligations and purchases. You would not have any objection, I presume, if we wrote into this bill a proviso that you would include this as a part of your annual report?

Mr. ECCLES. That we would? There would be no objection whatever to putting it in the bill. I would not think it was necessary. The hearings now would indicate that the committee wants it, which would be sufficient for the Board, without putting it in the bill.

The CHAIRMAN. I had in mind that that might give Congress assurance that they would have an annual look at these transactions.

Mr. ECCLES. That would be all right.

The CHAIRMAN. Mr. Gamble.

Mr. GAMBLE. Mr. Eccles, when this overdraft occurs, what is the operation of it? To cover that overdraft, do you just buy these short-term certificates from the Treasury? Can you tell us, in a practical way, how it works?

Mr. ECCLES. The Treasury gives to the New York bank a special certificate and the other Federal Reserve banks generally participate in the ownership. That is the way it has been done in the past.

Mr. GAMBLE. Then, it is just a short-term certificate that is temporarily issued to cover this so-called deficit?

Mr. ECCLES. Yes; it is a 1-day certificate, and is renewed each day, because, you see, the amount fluctuates each day.

Mr. GAMBLE. Yes, and it does on a descending scale until it is cleared up?

Mr. ECCLES. Well, the amount of the overdraft in the Treasury's account each day is covered by this certificate, and the amount fluctuates, of course, each day, as funds come in or go out of the Treasury's account. However, the purpose of this legislation is not just to meet the overdraft privilege. As indicated in this statement, with the very large amount of maturing obligations, it is desirable that the Treasury have available a line of credit on which it can call, at a moment's notice. Otherwise, it would likely feel obligated to carry large idle balances instead of one or two billion dollars working balance. It would likely be carrying balances of six or seven billion dollars, as a normal working balance. Due to the fact that it has a $5,000,000,000 overdraft privilege, it considers that equivalent to a balance, and, therefore, it is enabled to carry $5,000,000,000 less public debt, and $5,000,000,000 less idle balances with the banks, which seems to me to be certainly desirable in the public interest. There is no point in the Treasury carrying a larger balance than would be necessary, but, due to the fact that they have these large maturities coming due every month, I am sure they would feel much more comfortable to have this overdraft privilege or this available line of credit. They have never had to use it for any other purpose than as indicated, and they possibly would not have to, but the very fact that they have it, I feel—and I know they feel—relieves them from carrying a much larger balance than they otherwise would carry.

Mr. GAMBLE. Do they pay interest on that?

Mr. ECCLES. On the overdraft?

Mr. GAMBLE. Yes.

Mr. ECCLES. Yes.

Mr. GAMBLE. What is that rate?

Mr. ECCLES. A quarter of 1 percent.

Mr. GAMBLE. If you and the Treasury did not have this privilege, they would have to go out and sell something to cover this overdraft, would they not, or carry the additional reserves?

Mr. ECCLES. Yes, if they did not borrow from the Federal Reserve for the short period, they would have to increase the public debt for that amount, or they would have to draw down their balances with the banks. As indicated in this statement, at the time they have used the overdraft in the past, it has not been when they have had no balances with the banks. They have usually had very substantial balances with the banks. And they could have drawn on those balances to meet the overdraft. That, however, would have come at a time when the banks were losing balances because of tax payments at the same time that they would be losing the war loan deposit accounts, and, inasmuch as the overdrafts are run in anticipation of tax receipts, which are used to pay off the overdraft, it would be undesirable and unstabilizing to the money market to withdraw the war loan accounts for such a very short period of time. It would then build up unnecessary balances in the Reserve banks, and would create a deficiency of reserves in the banks throughout the country, and would compel them to sell securities or to borrow from the Federal Reserve banks.

Mr. GAMBLE. It saves a lot of book work, does it not, being able to do it in this manner?

Mr. ECCLES. It saves a great deal, because to withdraw from the war loan deposit accounts—there are a good many thousand accounts that the Treasury carries with the banks, and every time they make a call, it involves a good many thousand withdrawals from the banks.

Mr. GAMBLE. Instead of doing it in thousands of transactions, you do it in one transaction?

Mr. ECCLES. That is right.

Mr. GAMBLE. Mr. Chairman, it is not in the bill, but I think it would be helpful if the members of the committee could have a copy of that Federal Reserve primer which is available, if they still have some copies down there.

Mr. ECCLES. If we do not, we will get some.

The CHAIRMAN. Can you make those available to the committee, Mr. Eccles?

Mr. ECCLES. Yes; we will be very glad to do that.

The CHAIRMAN. Mr. Spence.

Mr. SPENCE. As I understand, the Federal Reserve's existing authority to purchase Government securities directly from the Treasury is extended by the Second War Powers Act?

Mr. ECCLES. Yes; that is correct.

Mr. SPENCE. You had that authority previous to the Second War Powers Act, did you not?

Mr. ECCLES. Yes.

Mr. SPENCE. When did you acquire that authority?

Mr. ECCLES. When the Federal Reserve Act was originally passed, it provided that authority without limit, and that authority existed until 1935.

Mr. SPENCE. Was that provision repealed in 1935?

Mr. ECCLES. That is right.

Mr. SPENCE. And then in the Second War Powers Act, it was given to you again?

Mr. ECCLES. Yes.

Mr. SPENCE. What is the greatest amount of Treasury bills the Federal Reserve has owned at any one time?

Mr. ECCLES. You mean the overdraft?

Mr. SPENCE. Yes.

Mr. ECCLES. I think $1,302,000,000.

Mr. BROWN. That was just for a few days?

Mr. ECCLES. That is right.

Mr. SPENCE. Those are all very short-term obligations?

Mr. ECCLES. One day. For instance, this was in 1943, and that overdraft started on March 2 at $3,000,000, and it grew each day until on March 15 it reached $1,302,000,000. On March 17, it was down to $981,000,000, and it went down each day until, on March 30, it was all paid off. So, from the 1st of March, it went up from $3,000,000 to the peak, on the 15th; and on March 30, there was $40,000,000, and that was all paid on the next day.

Mr. SPENCE. I assume the reason the authority was repealed in 1935 was because of the existing conditions, then, when there was no reason for the authority: is that correct?

Mr. ECCLES. Well, as I remember the discussion—and I have referred to it in this statement—there was a feeling that this left the door wide open to the Government to borrow directly from the Federal Reserve bank all that was necessary to finance the Government deficit, and that took off any restraint toward getting a balanced budget. Of course, in my opinion, that really had no relationship to budgetary deficits, for the reason that it is the Congress which decides on the deficits or the surpluses, and not the Treasury. If Congress appropriates more money than Congress levies taxes to pay, then, there is naturally a deficit, and the Treasury is obligated to borrow. The fact that they cannot go directly to the Federal Reserve bank to borrow does not mean that they cannot go indirectly to the Federal Reserve bank, for the very reason that there is no limit to the amount that the Federal Reserve System can buy in the market. That is the way the war was financed.

Therefore, if the Treasury has to finance a heavy deficit, the Reserve System creates the condition in the money market to enable the borrowing to be done, so that, in effect, the Reserve System indirectly finances the Treasury through the money market, and that is how the interest rates were stabilized as they were during the war, and as they will have to continue to be in the future.

So it is an illusion to think that to eliminate or to restrict the direct-borrowing privilege reduces the amount of deficit financing. Or that the market controls the interest rate. Neither is true.

Mr. SPENCE. To what extent was this authority used after the First World War?

Mr. ECCLES. It was used in the twenties, all during the twenties, in the same manner, but I imagine the amounts would be considerably less, because Government operations were comparatively very much less. We can get the figures if the committee desires them, showing the extent to which this authority was used during the twenties.

Mr. SPENCE. The reason the authority was repealed, I assume, was because of the changed conditions of the Treasury, and because there was no great need for it in 1935? Is that not true?

Mr. ECCLES. There was very much more need. When the provision was repealed there were deficits, and the public debt was increasing. It was repealed during a period when it really should have been continued. There was greater need for it after it was repealed than there was during the period in which it was in effect.

The Reserve System, or the Government, can operate without this. It did from 1933 to 1942. The Government can operate today without this. It would simply mean a higher public debt, in order to carry larger Treasury balances. It would mean increased interest costs as a result of that. I have indicated here four million for each billion dollars of debt, but that interest cost is, of course, on the basis of the 3/8 bill, which is not a market bill at all. The market takes practically no bills. The Federal Reserve owns practically all of the bills. Of 17 billion, they own over 15½ billion of them. And there is practically no market whatever for the bills, even though there is a buying rate on those bills, so that an owner can turn them into a bank today and buy them tomorrow. We have established a buying rate on bills and a repurchase option, and in spite of that privilege with bills, there is only a total of about a billion and a half dollars of bills carried outside of the Reserve System, and about 500 million dollars of those bills are carried by foreign governments and foreign central banks. So that that rate is really not a market rate at all.

The cost of carrying a larger debt would be substantially more than 4 million dollars per billion dollars, on the basis of the market rate.

Mr. SPENCE. Thank you.

The CHAIRMAN. Dr. Smith.

Mr. SMITH. Mr. Chairman, I suppose we will have plenty of opportunity to interrogate Mr. Eccles. Therefore, for the present I will pass.

The CHAIRMAN. Mr. Brown.

Mr. BROWN. Mr. Eccles, I read your statement with very much interest yesterday. And I think you are correct as to the extension of this law. That was the law from 1914 until 1935. You have made a good case, and I am delighted to state that I agree with you.

But in this bill you have two distinct purposes. One purpose is selling Government securities and the other to build bank buildings. Why put both of them in this bill?

Mr. ECCLES. I recognize that there is no relation whatever between the two subjects, and, in talking to Mr. Wolcott about it, he pointed that out.

The CHAIRMAN. Will you yield, Mr. Eccles?

Mr. ECCLES. Yes.

The CHAIRMAN. I will take full responsibility for it. We had an opportunity to put them both in the same bill at the same time. There is no relation between the two.

Mr. BROWN. Well, I might say there was some good reason for limiting the cost of these bank buildings to $250,000. It looks to me as though $250,000 ought to be enough money to build any kind of a bank building. It belongs to the Government, you know.

Mr. ECCLES. Well, it is not enough to even approach the cost of building today. As a matter of fact, there is no limit to the amount that can be expended on the parent bank, and there was no limit to the amount that could be expended on a branch building until 1922. Then this limitation was put in.

The operations of the branches, since that time, have increased nearly 300 percent. There are three times as many people employed today in the branches as there were in 1922. So that, whereas a $250,000 item might have been sufficient to meet the cost of building a Federal Reserve bank branch when building costs were very substantially less than they are at the present time, and when the operations of the branches were very much less than they are at the present time——

Mr. BROWN. How many branches do you have now?

Mr. ECCLES. Twenty-four.

Mr. BROWN. You are not going to build any more, are you?

Mr. ECCLES. Well, we do not own them all. We have several we rent now. Several of the branches are entirely inadequate. The banks have been pressing us for the last 5 years to get legislation to meet the situation. There is the Pittsburgh branch, the Jacksonville branch, the Detroit branch, the Portland branch—we have been under very heavy pressure to get legislation to cover these various situations, because of their complete inadequacy to deal with the job that has to be done.

You must remember that——

Mr. BROWN. Well, now, now many districts do you have?

Mr. ECCLES. We have 12 districts.

Mr. BROWN. And then you have how many branches?

Mr. ECCLES. Twenty-four branches.

Mr. BROWN. And you have a bank building in each one of those districts?

Mr. ECCLES. That is right.

Mr. BROWN. You call the branch banks the others?

Mr. ECCLES. Well, for instance, in the Boston district, there is no branch. There is just the one bank. That covers New England. Philadelphia has no branches. New York has one branch at Buffalo. Chicago has one branch at Detroit. Cleveland has a branch at Cincinnati and a branch at Pittsburgh. Now, some of the banks have more branches. San Francisco, for instance, has a branch at Los Angeles, Portland, Seattle, and Salt Lake.

Mr. BROWN. Atlanta does not have a branch, does it?

Mr. ECCLES. Atlanta has a branch at Birmingham, and at Jacksonville, and at Nashville, and New Orleans.

Mr. BROWN. That is certainly a fine bank building down there in Atlanta. Are they all that good and that expensive?

Mr. ECCLES. Well, I think the banks——

Mr. BROWN. I am just trying to get at the reason.

Mr. RAINS. Mr. Brown, would you yield a moment?

Mr. BROWN. Yes, sir.

Mr. RAINS. At Birmingham, for instance, you are renting now as much space as you have in the branch bank; is that not true?

Mr. ECCLES. I do not remember particularly.

Mr. RAINS. Well, I have checked and I know that is so.

Mr. ECCLES. I know some branches are renting more space.

Mr. RAINS. I have checked the figures, and you have about 15,000 feet of space in the branch bank at Birmingham and you are renting about 13,000.

Mr. ECCLES. I can get in detail the amount of space that is being rented, if the committee wishes, and what the cost is, the number of people employed now, the number employed before. I can get all the detailed figures covering this, but it seems to me that—of course, if the Congress desires that each time they have these expenditures, they want to have hearings on them and want to treat them separately, that is all right, but it seems to us that the fact that the directors of the branch must first demonstrate the need to the directors at the head office is sufficient——

Mr. Brown. Of course, I am not opposed to the bill because this is in here. But there was some good reason for the limitation. Of course, building costs were cheaper. Then, at this particular time, we want all the scarce material we can get for homes. Of course, if you cannot rent space, you have got to build. But I was hoping we would not start building quite so fast.

I think we ought to be a little cautious about trying to have such costly Government buildings in all these places.

Mr. Spence. Will you yield, Mr. Brown?

Mr. Brown. Yes.

Mr. Spence. The Federal Reserve branch banks acquired the authority to purchase these buildings for a price not to exceed $250,000 in 1922, did you not, Mr. Eccles.

Mr. Eccles. There was no limit before. They put on a limit of $250,000 in 1922.

Mr. Spence. What is the comparable cost in construction between 1922 and the present time? Do you have any figures on that?

Mr. Eccles. Well, that would be a guess. I would say it would be close to a hundred percent higher now, about double.

Mr. Gamble. It is more than that, is it not?

Mr. Eccles. Well, I suppose it would vary according to the type of building and where it is located, but I would say that, on the average, the cost would be double today what it was in 1922.

Mr. Spence. How many Federal Reserve branch banks are in rented buildings now, buildings not owned by the Government?

Mr. Eccles. Three.

Mr. Spence. You do not own the one in Cincinnati, I know.

Mr. Eccles. That is right.

Mr. Spence. Where are the others?

Mr. Eccles. Portland and Seattle, I think.

Mr. Spence. All the others are owned by the Government?

Mr. Eccles. That is right, but they are entirely inadequate, and require, some of them, some every extensive expenditures. There is no limit to the land purchase. The Congress just speaks of the building. In other words, the question of land has not been covered.

Mr. Rains. Mr. Eccles, even where you own the buildings, for instance, as in Birmingham, you must add quite a lot of space, which you are now renting?

Mr. Eccles. Oh, yes; that is true. In practically every bank there is additional space that had to be rented, because, as I say, the volume of business that the Federal Reserve banks have had to undertake, as a result of the war, as a result of the growth in the public debt, as a result of the growth in the volume of currency, growth in the volume of check transactions—in fact, the growth in the total volume of business—is immediately reflected in the Reserve banks as it is reflected in the private banks.

Mr. Rains. The banks have a great many more employees now than they had in 1922, is that not right, and that limitation was pretty closely in keeping with the number of employees?

Mr. ECCLES. I would think so, except that in 1922, I do not believe the 40-hour week was in effect. I think there was possibly a 48-hour week at that time, so it may be that there would be proportionately more due to the shorter workweek.

Mr. SPENCE. What effect does the present rental situation have on the rental properties of the Federal Reserve banks? Have they raised your rents?

Mr. ECCLES. Well, I could not give you the detail on that. I would imagine that, where we do not have leases, that they would have raised the rents. They have raised business rents everywhere, so far as I know, where leases did not protect them.

Mr. FLETCHER. Chairman Eccles, as I understood you, the district banks themselves, such as in San Francisco, there is no limitation on the cost of their buildings?

Mr. ECCLES. That is right.

Mr. FLETCHER. It is only the branches you are talking about?

Mr. ECCLES. That is right.

Mr. FLETCHER. Do I understand also that in these buildings which they have, say, the district banks, do they lease out to others, or rent out to others, in those bank buildings?

Mr. ECCLES. Well, where they have had surplus space, that has been true, but there have been one or two of the banks that had surplus space and did that. At the time they built their buildings, they built buildings to take care of future expansion, and, as a result of that, they built buildings larger than their current needs. For instance, there was the Kansas City bank: They built a large building. The Chicago Building is a large one. But the Chicago bank today is, I understand, renting more space than they rent, and it is a question of their leases expiring, and they will have to take over the entire building and still I think will have inadequate space then.

Mr. FLETCHER. This Cleveland bank, for example, do you occupy that entirely?

Mr. ECCLES. I could not tell you. I would have to check into it. But I know that in most of the banks, the home office banks, they not only occupy them entirely, but they have to rent space. New York, for instance, they not only entirely occupy the building which is a very large building, but they also lease space.

Mr. TALLE. Mr. Chairman.

The CHAIRMAN. Mr. Talle.

Mr. TALLE. Mr. Chairman, I would like to ask a few questions on the monetization of the debt. Would that be appropriate at this time?

The CHAIRMAN. I would think that there was no relation between that and this bill. I think you would be obviously out of order. But you may proceed.

Mr. TALLE. Governor Eccles, my question relates to the report of the Board of last June, which I read with great interest. I gathered from that report that the Board fears further monetization of the public debt by banks. I refer to the possibility that banks might shift from short into longer term maturities, and thereby monetizing the debt on the 6 to 1 ratio, which was referred to in your report. And you have asked for additional powers to limit the amount of maturities and securities which the banks could own, in that report, and I just wanted to know whether you are pushing for legislation along that line at this time.

Mr. ECCLES. Well, I do not believe it is our place to push for legislation. We, as the agent of Congress, reported the situation as we saw it, and we feel the responsibility is then up to Congress. It is not our place to push for it. I do not know where we would push.

Mr. TALLE. Do you recommend?

Mr. ECCLES. Do we recommend?

Mr. TALLE. Yes.

Mr. ECCLES. Oh, yes. We stand on the report.

Mr. TALLE. The Board's annual report forcefully rejected proposals that the Open Market Committee unpeg short-term money rates in order to prevent further monetization of the debt. I read a speech you made in Boston last October in which you were very definitely opposed to any unpegging of short-term interest rates. I have also read a paper by Mr. Allen Sproul, vice chairman of the Open Market Committee, taking exactly the opposite point of view. I understand that Mr. Sproul feels that we should ultimately unfreeze rates in order to prevent further monetization of the debt. I was wondering whether you would choose to express yourself at this time as to your present attitude.

Mr. ECCLES. Yes; I would be very glad to. The purpose of the Board, in filing the report with the Congress a year ago, was to call its attention to the dangers of further monetization of the public debt, which was inherent in the situation that existed.

There has been, since that time, I would say, no further monetization of the public debt due to the Treasury's ability to reduce the public debt substantially out of large balances that it had in its war-loan deposit account.

These balances were acquired as a result of what was known as the Eighth War Loan drive which was carried on after the war and was, I would say, an unnecessary piece of financing.

There were over 25 billion dollars raised in that drive, and those balances, adding to what was already in the Treasury at the time the drive started, created a very large war-loan deposit account which was in excess of the necessity of the Treasury. So the Federal Reserve people strongly advocated that instead of carrying the balances to meet what may be continuing deficits, if they should exist, the balances should be applied on maturing obligations, and that policy was adopted.

Now, the effect of the retirement of the debt through the application of those balances was of a deflationary character. Most of the securities that were retired were Treasury certificates—that is, the 1-year, seven-eighths certificates. These were held largely by the commercial banks and the Federal Reserve banks, having been purchased by the Open Market Committee in order to support the Government bond market and supply needed reserves to the banking system.

Now, the effect of that retirement program, in which, as I say, over $20,000,000,000 of the public debt has been retired, was deflationary and it worked in this manner: The balances were drawn out of the various banks and to the extent that the securities retired were held by the banks it had a neutral effect. The balances were withdrawn, and as the securities were paid the banks got the money back in payment of the securities. So it merely meant that their deposits were that much less, on the one side, and their investment in Government securities or assets was that much less on the other side.

However, a substantial portion of these securities were held by the Federal Reserve banks. Therefore, as the balances were drawn out of the banks and the money used to pay the certificates held by the Reserve banks, the money did not return to the banks and the banks were under pressure to sell securities in order to get reserves because as the balances were drawn out by the Government that left deficient reserves and so the banks were under pressure to sell.

To a lesser degree the money from the retired securities which were held by individuals and corporations—and there were some—went back into the banks to the credit of the individuals and the corporations instead of the Government, but the balances owned by individuals and corporations were subject to reserve requirements—an average of close to 20 percent—whereas the balances held by the Government were not subject to reserve requirements.

Therefore a deposit that was not subject to reserve requirements became a deposit that was subject to reserve requirements, and that put the banks under pressure to sell enough securities to meet the added reserve requirements of the changed deposit. All that put the banks under pressure.

We are getting very close to the end of any substantial debt retirement by the Government. The amount of debt retirement, I would say, after the end of this fiscal year, will be a very small item, comparatively speaking, and I think there is a real possibility that there will be a pressure exerted on interest rates by the banking system—what we call "playing the pattern of rates," that is, selling short-term low-yielding securities for the purpose of buying long-term, high-yielding securities in order to get a higher yield.

So long as the short-term rate is pegged or held at seven-eighths, which is the peg on the 1-year certificate, there is a tendency to pull the entire rate structure down toward that level.

It naturally means, in order to peg or hold that rate, that the Federal Reserve must be prepared to buy Treasury certificates—1-year certificates—at par. That means, of course, that the long-term, high-yielding securities are always selling at a premium.

I agree that without the proposed legislation dealing directly with this question either the short rate will have to go up or the intermediate and long-term rates are likely to come down. They will come down as a result of the banks selling to the Federal Reserve and buying the long-term more profitable securities held outside of the banking system.

We must remember that the Federal Reserve is a fractional reserve system, and that for every dollar of securities sold to the Federal Reserve that gives a reserve to the banking system which they can use to purchase from 6 to 10 times that amount of securities in the market.

The alternative to the proposals of the Board is, I believe, either letting the short-term rate go up or a further monetization of the public debt by the banking system and forcing of the long-term rate down.

Does that answer your question?

Mr. TALLE. Yes; I think it does.

Mr. ECCLES. It is a question of alternatives.

Mr. TALLE. Yes.

Mr. Eccles. I would say this: That I would prefer, I think, to have an unpegged short-term rate and try out to what extent that would go in preventing the long-term rate from coming down, through monetization, in the absence of any legislation to deal with the question.

I would prefer the legislative program. In the absence of that, then I think that some unpegging of the short-term rate may be desirable, as I do not think it desirable to have the long-term savings rate an expression of a monetization of the public debt through the banking system rather than an expression of the amount of savings in relationship to the investment demand.

If the long-term rate was coming down because the volume of savings exceeded the investment demand, that would be one thing—I mean you could not object to that.

But to have the long-term savings rate come down because the volume of bank credit or bank money is expanding through the monetization of the public debt, brought about through the pegging of the short-term rate, it would seem to me that that is not a desirable thing to have develop, especially during a period such as the one we are now going through.

In a dangerous deflationary set-up the situation would be quite a different one. There would be much less concern about the monetization of the public debt under conditions entirely different from those we now have.

Mr. Kilburn. What do you mean by the monetization of the public debt?

Mr. Eccles. I mean the banks creating money by the purchase of Government securities. All money is created by debt—either private or public debt—and to the extent that the banking system creates deposits through the purchase of Government securities or through the lending of money, either way, it is a process of monetization.

You monetize private debt, but there can be no objection to that so long as the debt that is created is increasing production and employment.

There may be such a thing as private debt that is purely speculative, such as the stock market, or real estate or other operations which are creating no employment and creating no production. It certainly is not a very desirable situation to have money created through that form of debt.

Mr. Talle. To go back to the matter we have just discussed, is it fair to say, then, that you and Mr. Sproul are in agreement about the wisdom of unpegging short-term rates?

Mr. Eccles. No, I would not say that. I do not know how Mr. Sproul feels about legislation to deal with debt monetization. I think you might say that there would be no disagreement, insofar as the need of unpegging the short-term rate is concerned, if there is no other alternative or recourse.

I do not know whether Mr. Sproul would say that or not. Mr. Sproul may feel that his preference would be the unpegging of the short-term rate.

Mr. Talle. I have another question. May I ask if you have discovered any tendency on the part of commercial banks to dispose of considerable amounts of Government bonds in order to increase their loans and discounts which may go into too large inventories and which may take a big drop in value in the event of a sharp fall in prices?

Mr. ECCLES. Of course, there are many banks, and a statement could not very well be made that would be applicable to all of them, but it is true that the expansion of private credit by the banking system last year was greater than at any other period in the history of the banking system.

That expansion of private credit was, of course, met out of sale of Government bonds in order to get the reserves to take care of that expansion. However, the amount of Government securities that had to be sold by the banks in order to get reserves to take care of that expansion of credit would possibly not be more than from one-eighth to one-tenth of the amount of credit extended.

We have been making some study of the situation—trying to get such information as we can by some surveys.

There are, without question, some instances where inventories are excessive. I would not say that that was generally true. You have got to look at the inventories today in relation to the increased prices as well as to the increased volume of business. So that, in dollar amounts, by comparison with anything that we have known before the war, they do look excessive. But if you take into account the two factors that I have mentioned, generally speaking I would not not say that they are excessive.

Mr. TALLE. I realize that a situation of that sort would naturally be spotty, certainly under present conditions.

Mr. ECCLES. They would appear to be excessive. If we had a substantial drop in national income——

Mr. TALLE. I yield to Dr. Smith for a question on that point.

Mr. SMITH. I do not want to ask a question. I just want to remark that I had the Commerce Department determine for me, in terms of 1939 dollars, the amount of inventories, and they figure that about 67 percent of the present figure would represent the 1939 figure. That is, you have an inventory of something like 20.2 billions. About two-thirds of that would represent the actual amount of inventory.

Mr. ECCLES. Well, we know there is a great shortage of some inventories. The consumer durable-goods inventories and building materials inventories are very short. Some of the consumer soft-goods inventories are large. So, as I say, it is a very spotty situation.

Mr. TALLE. Is it not true, Mr. Eccles, that if you could get most of the Government bonds into the hands of private investors who would hold them until maturity you would feel very happy about it?

Mr. ECCLES. That is right. But that, of course, is not possible.

Mr. TALLE. And whatever encourages the Government bonds to be centered in the Federal Reserve System will give you some worry, will it not?

Mr. ECCLES. Well, I would not say that it gives us worry. I would say that it is desirable to place in the hands of the public, the savers of the country, as much of the public debt as it is possible to do. I would like to make some exceptions, however, to that general statement.

In the first place, there is a very substantial amount of the public debt which is eligible for the banks to purchase which is not now in the hands of the banks and it would serve no useful purpose to put out a long-term market issue such as is wanted by the large savings institutions and fiduciary institutions because if they could purchase a 2½ percent market bond today—noneligible to banks—they would sell such securities as they hold which are eligible to banks, so that all that the Government would accomplish would be selling securities that would cost it 2½ percent interest, retiring the short-term securities held by the banks merely to have the banks replace those securities by buying other securities from the insurance companies and savings banks and others. So that would in no way decrease the monetization of the public debt and would only substantially increase the interest rate.

Now, to the extent that nonmarket securities can be sold—such as the E, F, and G bonds—to the savers of the country, that is very desirable.

It is desirable first because it gets the debt very widely distributed in the hands of the smaller and the middle income groups. Those types of obligations are nonmarket obligations. They are callable on demand, but the holder only gets the interest rate which bears a relationship to the period for which he holds the security.

The 2½-percent market security, noneligible to the banks, means 2½ percent on a demand liability. It means, further, that you are not only getting 2½ percent on a demand liability, but as long as you are holding the short-term rate down, as the security approaches maturity, the premium on that 2½-percent security increases. So that, in effect, an owner of a 2½-percent security could no doubt carry that security for a time and get the equivalent of 3 percent on his money, and not 2½ percent, by the banks taking it out of the market and furnishing new money for the securities which are eligible to the banks which they do not now own.

You can see that it is a very complicated problem and it is not one that can be radily answered by a "yes" or "no" answer.

There is one other point which I would like to make in connection with the placing of the public debt in the hands of the long-term investor and reducing that portion of it held by the banking system.

If we were in a deflationary period, the opposite would be true. In an inflationary period—in a period such as we have now—it is desirable to get some of the public debt out of the banks and into the hands of the long-term investor.

However, it is not desirable to compete with the need for private investment. If the Government makes its securities too desirable it means, of course, that the investor, and the institutional investor, is less interested in private mortgages, in world bank securities, and in municipal and corporate bond issues.

Therefore, we must give some consideration to the demand for capital by the private market.

To the extent that there is an amount of savings in excess of the need of the private market, it certainly would be desirable to get some of the bank-held debt in the hands of the private individual and institutional savers.

Mr. Talle. Thank you, Mr. Eccles.

The Chairman. Mr. Eccles, the House is in session and we will not be able to proceed further at this time. Would it be convenient for you to come back tomorrow?

Mr. Eccles. Yes, sir.

The Chairman. That will give the rest of the committee an opportunity to interrogate you.

The committee will adjourn until tomorrow morning at 10:30 to continue its consideration of H. R. 2233.

(Whereupon, at 12:30 p. m., the committee adjourned to 10:30 a. m. Tuesday, March 4, 1947.)

DIRECT PURCHASES OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS

TUESDAY, MARCH 4, 1947

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met, pursuant to adjournment, at 10:30 a. m., the Honorable Jesse P. Wolcott, chairman, presiding.

Committee members present were as follows: Messrs. Wolcott, Gamble, Smith, Kunkel, Talle, Sundstrom, McMillen, Kilburn, Buffett, Cole, Hull, Stratton, Scott, Banta, Fletcher, Foote, Spence, Brown, Patman, Folger, Riley, Rains, Buchanan, and Boggs.

The Chairman. The committee will come to order.

Mr. Eccles, who appeared before the committee yesterday, is back this morning.

Mr. Eccles.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE BANKS—Resumed

Mr. Eccles. Mr. Chairman, I wonder if I could make a statement for the record this morning. It is not with reference to the proposed legislation, but has reference to two very important questions that Mr. Talle of Iowa asked me, that had to do with the very important matter ot debt monetization, and the whole question of interest rates.

The Chairman. Yes, Mr. Eccles. Inasmuch as Mr. Talle raised the matter yesterday, I have no objection to Mr. Eccles proceeding out of order for a few minutes to make a statement.

Mr. Eccles. The reason for this is that the Dow-Jones reporting system got it very badly garbled. They related what I said to Mr. Talle to the legislation, when it had no relation whatever to the legislation, and created a lot of confusion. We got a lot of calls. The Journal of Commerce editorial this morn'ng is also very misleading, as is the Wall Street Journal's reporting, and the net result is that a statement from me with reference to the question of interest rates is rather important, because of my position with the Federal Reserve System.

Therefore, I feel that my views should be made very clear with reference to this whole subject. So I worked late yesterday afternoon and this morning in order to get a statement that would clarify this question. Nothing in it is in conflict with anything I said yesterday for the record.

In connection with my statement to the Banking and Currency Committee of the House of Representatives regarding H. R. 2233, I was asked by a member of the committee questions with respect to proposals made in the 1945 Annual Report of the Board of Governors of the Federal Reserve System regarding the problem of monetization of the debt by banks and ways of dealing with that problem. It should be made clear that H. R. 2233 is not designed to deal with this particular problem, which is much broader and more far-reaching in scope than the bill now before the House. The following statement gives in essence my answers to those questions:

First, nature and casue of debt monetization. In connection with financing the war, there was a tremendous increase in holdings of Government securities by commercial banks and by the Federal Reserve banks. To a large extent this increase was necessary in order to facilitate financing of the war and to provide the expanded money supply needed by the wartime economy. These holdings are mostly short-term securities, but banks also hold some longer-term bonds.

To maintain a stable market for Government securities, the Federal Reserve System adopted a policy of maintaining the level of interest rates. The supported rates ranged from 2½ percent on long-term securities, purchased mostly by individuals and savings institutions, down to ⅞ percent on 1-year certificates, generally owned by banks and other holders seeking liquidity. In addition, 90-day Treasury bills, mostly held by Federal Reserve banks, were kept at ⅜ percent.

Although some efforts were made to restrict bank purchases of securities, various aspects of war finance made it attractive for banks to increase their holdings. For example, because of the supported market and the differential in rates, banks increasingly adopted the practice of selling short-term low-rate securities to Federal Reserve banks, thus creating additional reserve funds which were used to purchase longer-term securities in the market. The reserves thus created could provide the basis for an expansion in commercial bank credit of between 6 and 10 times the increase in reserves.

As long as the Reserve System stood ready to purchase short-term securities at the prevailing rates, the short-term rates could not rise. The banks could continue to sell short-term securities and buy longer ones, thus both expanding the amount of bank credit and reducing long-term interest rates. This practice—known as "playing the pattern of rates"—resulted in "monetization of the debt."

Second, the effect of debt-retirement program. During the past year, since the preparation of the Board's 1945 Annual Report, these tendencies have been suspended. The reason for this is that the Treasury, in retiring over $20,000,000,000 of maturing debt out of war loan deposit accounts with commercial banks, accumulated during the Victory loan drive, has put some pressure on the reserve positions of banks. Retirement of securities held by Federal Reserve banks with funds drawn from commercial banks tends to reduce member bank reserves. In order to maintain their reserve positions, banks have had to sell securities to the Federal Reserve. At the same time banks have been increasing their loans to businesses, to consumers, and on real estate, and they needed funds for this purpose. While banks had to sell securities to meet these needs and have had many of their short securities retired, they have not sold additional amounts in order to buy longer-term Government securities.

In other words, they have not been playing the pattern of rates and pressing down on the long-term rates during the past year when this program has been going on.

Next, the problem for the future. First, I have undertaken to give you a picture of what happened during the war, and then what has happened during the Board's annual report, in the past year, and now what appears to be the problem for the future.

With the debt-retirement program approaching an end, there may be in the future a resumption of the tendency on the part of banks to sell short-term securities to the Federal Reserve in order to buy longer-term securities. This would mean a resumption of the practice of creating bank reserves through monetizing the debt and expanding credit by many times the amount sold. It would also mean a resumption of the decline in long-term interest rates. The initiative with regard to this practice rests with the banks, which hold large amounts of Treasury certificates and of Treasury notes and bonds maturing during the next few years. At the same time there are substantial amounts of bonds held by nonbank investors eligible for bank purchase and a number of restricted issues which are also held by nonbank investors, which will become eligible at varying times in the future. The Federal Reserve under present powers and policies could not prevent such a development, that is, the banks selling the short-term securities and buying the longer-term securities, on the basis of selling $1 worth and buying a good many times that many securities, due to the fractional reserve system.

It would be undesirable, particularly in a period of inflationary pressures, to have the long-term interest rates forced down through monetization of the debt. That is the process that I have indicated might take place.

A decline in long-term interest rates resulting from an excess of savings over the demand for investment funds would be desireable, but a decline because of bank credit expansion would be undesirable. Such a development would be an inflationary influence; it would also reduce the return on savings and, therefore, impose a serious burden on individuals and institutions, such as insurance companies, schools, and benevolent agencies, that are dependent on interest returns for their incomes. I might add to that all the pension funds.

Should long-term rates decline much lower, many of the functions performed by these institutions would have to be taken over by Government, thus leading in the direction of socialization of financial institutions.

Next, solutions for the problem.

There are various ways of dealing with this problem, should it develop; those generally suggested are as follows:

(1) The proposals made by the Board in its 1945 annual report would restrict, by one device or another, the ability of banks to shift from short-term securities to long-term securities and thus limit the extent to which banks could monetize the debt.

(2) The Reserve System could lift the present support level for the short-term interest rate and thus permit that rate to rise to a level at which banks would no longer be induced to sell short-term securities to the Reserve System in order to purchase longer-term securities in the market.

(3) It has been suggested that the decline in long-term rates might be checked by issuance of sufficient amounts of long-term securities.

(4) Monetization of the debt could be permitted to continue until long-term interest rates declined to a level at which it would no longer

be attractive for banks to sell short-term and buy longer-term securities.

The Board's proposals would offer a solution striking at the basic cause of the problem, which is the great expansion in bank holdings of Government securities that can be readily converted into bank reserves at the will of the banks. A rise in short-term interest rates would remove another cause of monetization, namely, the differential in interest rates, which encourages shifting short-term securities to the Reserve banks and the buying of longer ones and creates premiums on long-term securities as rates are forced sown. Action to unpeg the short rate would be definitely preferable to the fourth solution of permitting debt monetization and the resulting decline in long-term rates to continue.

As for the third suggestion for checking the decline in long-term rates by issuing more long-term securities, it should be pointed out that if these securities are issues of the conventional market types, even though not eligible for purchase by banks, investors, both institutional and individual, in order to purchase the new securities, will sell existing holdings of eligible issues to banks. Banks, in turn, would sell short-term securities to the Reserve System and be able to purchase many times that amount of longer securities. As a result, monetization of the debt would be encouraged rather than discouraged.

Marketable issues, moreover, with Federal Reserve support, can be readily liquidated at par and thus in effect demand obligations with a high rate of return. That is, if we should issue 2½ percent market bonds, those bonds can be sold on demand, and, therefore, you, in effect, have a demand liability upon which a high rate ot return is paid.

Because of the difference between long- and short-term rates, prices of long-term bonds rise for many years after their issuance and holders of these bonds can sell them at a premium, thus obtaining not only the 2½ percent coupon rate but also an additional amount which may give a return of as high as 3 percent. The use of this solution would raise the interest cost to the Treasury and would encourage debt monetization for years to come by putting out marketable issues which, in the future, could be sold to banks at a premium. This remedy deals with effects, not with causes. A rise in short-term rates would be more effective and less expensive to the Treasury than the third method.

Such long-term bonds as need to be issued to absorb the savings of the public should be in a nonmarketable form, redeemable on demand prior to maturity at a discount so as to give a lower yield if not held until maturity. These bonds would be similar to the present series G savings bonds with broader limits on amounts to be purchased and with substantially longer maturities.

The G bond is the 2½ percent coupon bond limited to a hundred thousand dollars, and, of course, if cashed prior to maturity, it is like the E bond. There is a discount on the bond which figures, on the basis of what the shorter rate would be, if the bond is cashed prior to maturity.

A reasonable rate could thus be paid for genuine long-term savings and thus protect individuals and institutions dependent on savings for their income. Holders would also be safeguarded against loss in case of necessary liquidation before maturity, but would not be guaranteed a high coupon rate of 2½ percent, plus perhaps a premium, on short-term, highly liquid investments.

In summary, my view is that the fundamental solution to the problem of debt monetization rests in some such measure as those proposed by the Board in its annual report. In the absence of legislation toward this end, it would be desirable to permit some rise in short-term interest rates, if necessary, to prevent long rates from declining further as a result of debt monetization by banks. This does not necessarily mean that a rise in short-term rates is imminent. In case there is no resumption of debt monetization and declining long-term rates, then, an increase in short-term rates may not be needed at all. I am pointing out the present situation. We anticipate, however, that it will be needed. But right at the moment, as I say, this does not mean that a rise in short-term rates is imminent in order to prevent a fall in long-term rates.

Additional investment outlets for a long-time savings should be provided in the form of nonmarketable obligation of the series G type, but further issues of long-term marketable securities should be avoided.

I am sorry, Mr. Chairman, to have taken so much time on this, but I wanted to get this statement in the record, because I do think it is very important.

Thank you.

The CHAIRMAN. We are very glad to have you clarify it.

Mr. FLETCHER. Mr. Chairman, may I ask a question?

The CHAIRMAN. Mr. Fletcher.

Mr. FLETCHER. Would you hazard a guess as to the amount of increase in short-term rates which would be necessary to bring about the effect which you are striving for?

Mr. ECCLES. Well, it would be just a guess. If short-term rates were unpegged—that is, if the support of the seven-eighths was discontinued—any increase in rates that was permitted would mean that a peg at another point would have to be carried out. Certainly, I would not expect that the rates would be permitted to go up more than maybe an eighth at a time, testing out what the effect of the increase was. The very fact that short-term rates were permitted to go up, and there was no assurance as to how much they would increase would, of course, put great uncertainty on the banks, because it would mean that the premiums that they have been paying for the intermediate and the longer-term bonds would immediately decline, and if you raised short-term rates enough, it would mean that the premiums that they paid would almost entirely disappear.

As long as the prices of the longer-term bonds which they have bid up—and thus bid down the rates—was declining, there, of course, would be a great hesitancy to shift, and it may well be that a very, very small increase in the short-term rates, due to the uncertainty of when the rate might go up further, would accomplish the result, maybe an eighth, maybe a fourth—certainly not more than a half—that would be my guess.

Mr. FLETCHER. Thank you.

Mr. KUNKEL. Could you tell us how much it would cost the Treasury, Mr. Eccles, if the rate went up, that is, for each one-eighth the short-term rate went up?

Mr. ECCLES. Well, of course, the increase in rate would only apply to the refunding securities, as they were refunded, and that would depend on how many short-term securities were outstanding.

The Federal Reserve System have been favorable to eliminating the completely artificial rate of three-eighths on Treasury bills which is aside from raising or unpegging what we term the short-term market rate, which is the seven-eighths rate on certificates. There are $17,000,000,000 of three-eighths bills outstanding, and the Federal Reserve System owns $15,500,000,000 of those bills.

The bills are not market instruments, although $1,300,000,000 is rolled over every week, presumably in the market. The facts of the matter are that the Federal Reserve System gets practically all of those bills every week, through an arrangement with the Government bond dealers, to put bids in at three-eighths, with complete protection by the Reserve banks to take them off their hands before they even pay for them. That is what we call a hocus-pocus, and we are of the opinion—our lawyers are—that we could exchange directly with the Treasury the bills that mature to pay for the new bills that are offered each week. In other words, in effect, that would be a process of refunding the maturing bills for new bills without going through the market, so long as the bills originally were put through the market.

For instance, in the case of maturing notes, or maturing certificates, we refund directly with the Treasury. The direct purchase operation, covered by the legislation under discussion, is meant to cover new issues, and not refunding issues. We feel that we should be permitted to exchange maturing bills, or use maturing bills to pay for the bills that are issued each week, as a refund of maturing bills.

Now, if the bills were made market bills, that is, if the peg of three-eighth percent were eliminated, and the bills were permitted to rise, approaching the certificate rate, then, there would be a great market interest in the bills, and the bills then would be a market instrument, rather than the kind of instrument they are now. If that happened, it would increase the cost to the Treasury on the bills alone approximately $50,000,000 a year.

However, the Federal Reserve banks——

Mr. KUNKEL. Is the $50,000,000 figure for each?

Mr. ECCLES. No; it is for the entire outstanding $17,000,000,000 of bills.

Mr. KUNKEL. Well, assuming a one-eighth increase.

Mr. ECCLES. Well, I wanted to discuss first the effect of raising the bills up to the seven-eighth, and then I will go on from there, if I may.

Mr. KUNKEL. I beg your pardon.

Mr. ECCLES. So if the three-eighths percent bills become a market instrument, and were sold on the basis of the market, they would likely sell approaching the seven-eighths rate, at least from three-quarters to seven-eighths. That would increase the interest cost about $50,000,000. However, practically all of that income would go into the Federal Reserve banks. If the market took bills, it would sell the certificates. So practically the entire increase in the cost of raising that rate would go into the Federal Reserve banks. And I want to come back to that, if I may, in a moment, with reference to Federal Reserve bank earnings in this picture.

There are $17,000,000,000 worth of bills and $28,000,000,000 of certificates of indebtedness, that is $45,000,000,000 worth of short-term debt which would be affected by a rise in the short-term rate. An increase of 1 percent on $45,000,000,000 is $450,000,000. A half of 1 percent would be $225,000,000. A quarter would be $112,500,000. An eighth would be $66,250,000.

That would be the increase in the cost. But I would like to make this point: During this next 5 years, there is a very large amount of maturities of marketable Treasury bonds and notes outstanding.

For instance, within 1 to 5 years, there are $40,000,000,000 of bonds and notes maturing or callable; and within 5 to 10 years $27,000,000,000 of outstanding bonds are due or callable. Those securities bear rates of substantially more than the bill rates. A great many of them bear a 2-percent rate, some 2½ and 2¾, and on down to 1¼; there are small issues bearing rates of 4¼ and 3⅛ percent.

So that, as these securities which are largely held by the banks, fall due, and if they were refunded at 1¼, we will say, assuming that the rate of the short-term outstanding securities, that is, of bills and securities amounting to $45,000,000,000, increased, the decrease in the refunding of the higher rate securities would save the Treasury interest costs. At the increased rate on the short-term securities, if the rate was permitted to rise, there would be less interest added than would be taken off by the retirement of the longer-term securities with their present high rates. Do I make my point clear?

Mr. KUNKEL. In other words, in the over-all operation there would not be a loss?

Mr. ECCLES. Well, what I am indicating is that if you did not let the short-term rate go up, there would be very substantial savings in the refunding of the maturing securities. If you did let the short-term rate go up, then the saving in the securities that mature, as they were refunded, would be largely offset, depending on how far the short-term rate was permitted to rise, by the increase in the short-term rate. But the over-all cost to the Treasury, of course, based on what it is at present, certainly would not increase.

Mr. KUNKEL. Could you handle your seven-eighths differently than you do the three-eighths bills? Or would you have to unpeg all the way along the line?

Mr. ECCLES. Yes; I think so. I think that you should unpeg—or what you really do, in a sense, is move the peg without the market knowing at what point the peg has moved to. They do not know at what point you are going to support the market. That creates the uncertainty. But, of course, you would have to support it. If not at seven-eighths it would have to be supported at some other point. But the uncertainty as to when you are going to change the rate would have a very powerful effect in stopping the banks from going out and bidding for the securities in a market that might decline.

Mr. KUNKEL. But I think that last question I asked you was: Could you handle that 17½ billion dollars worth of bills differently from the certificates and notes that are pegged approximately at seven-eighths now?

Mr. ECCLES. I do not think they should be.

Mr. KUNKEL. You do not think they should be?

Mr. ECCLES. No, I do not think so. I think they should be made market instruments. They were created during the war, as a war measure, and we do not feel that they should continue as a special instrument; that they should be converted into a market instrument.

Mr. KUNKEL. And you are in favor of doing that to the 17½ billion dollars now? The Board has taken that position?

Mr. ECCLES. We would be in favor of exchanging, certainly directly the three-eighths bills for the three-eighths bills, but ultimately we would like to permit the bill rate to go up to approaching a market relationship to the certificate rate.

Mr. KUNKEL. That would amount to unpegging, in the long run, the bill rate?

Mr. ECCLES. That is right. While unpegging the bill rate may have some psychological effect in the market, but it would actually only affect the income of the Reserve banks.

Mr. KUNKEL. Thank you very much.

Mr. TALLE. Mr. Chairman.

The CHAIRMAN. Mr. Patman started out yesterday, and he may continue. We would like to get back to the consideration of H. R. 2233.

Mr. PATMAN. Mr. Eccles, I would like the committee to get our definitions straight in the beginning, and for that purpose I will ask you a few questions for the record. I believe the Federal Reserve Act became law about 2 days before Christmas in 1913. I believe it was December 23, 1913. Under that act you have 12 Federal Reserve banks, and 24 branches; that is correct, is it not?

Mr. ECCLES. That is right.

Mr. PATMAN. And each bank has its own officers and directors. And the bank's connection with the Federal Reserve Board, which is set up by Congress as an agency of Congress, is composed of whom?

Mr. ECCLES. I am sorry. I did not get your question.

Mr. PATMAN. The Federal Reserve Board here in Washington, having some supervisory control over the Federal Reserve banks——

Mr. ECCLES. General supervision, as the statute says.

Mr. PATMAN. Is composed of whom?

Mr. ECCLES. The law provides that there should be a Board of Governors made up of 7 members appointed for terms of 14 years and not more than 1 member shall come from any 1 of the 12 Federal Reserve districts; that they shall be representative of commerce, finance, and agriculture and industry; and that 1 of the members of the Board shall be designated as the Chairman by the President to serve for a fixed term of 4 years, and 1 shall be designated by the President to serve as Vice Chairman for a similar term. Each Board member must be appointed by the President and confirmed by the Senate.

A Board member's term expires every 2 years.

Mr. PATMAN. You mean one of the Board members, not all of them?

Mr. ECCLES. That is right.

Mr. PATMAN. And you are Chairman of that Board. When does your term expire, Mr. Eccles?

Mr. ECCLES. My term as member expires in 1958.

Mr. PATMAN. 1958?

Mr. ECCLES. Yes, sir.

Mr. PATMAN. Now, the Federal Reserve banks, as set up, required all national banks to become members of the Federal Reserve System?

Mr. ECCLES. That is correct.

Mr. PATMAN. It permitted State banks, if they met certain requirements, to become members of the Federal Reserve System?

Mr. ECCLES. That is correct.

Mr. PATMAN. Now, in the United States today, we have how many national banks? About 7,000?

Mr. ECCLES. I think it is about 5,000.

Mr. PATMAN. At any rate, there are about 14,000 commercial banks in all; is that correct?

Mr. ECCLES. Yes, including the uninsured banks—there are about a thousand, as I recall, uninsured banks——

Mr. PATMAN. I was under the impression that there are about 14,500 banks in all, including the banks that are not members of the FDIC.

Mr. ECCLES. Well, perhaps you are right.

Mr. PATMAN. At any rate, there is a ratio there of about 5½ to 9 national banks to the State banks. If you have the correct information, would you put it in the record?

Mr. ECCLES. It is the commercial banks rather than the savings banks that you are speaking of—the commercial banks?

Mr. PATMAN. Yes, sir.

Mr. ECCLES. That is right. There was a total of 16,000 in 1934, all banks, but that has gone down to 14,586 banks. Of course, a good many banks became branches. There are now 14,000 incorporated commercial banks. There are 5,007 national banks, 1,893 State member banks, which makes a total of 6,900 member banks; 7,148 nonmember banks. These numbers are shown in the table.

Number of banking offices in the United States

[Figures for last date shown are preliminary]

	All banks	Commercial banks							Mutual savings banks	
		Total	Member banks			Nonmember banks				
			Total	National	State member	Total	Insured	Noninsured	Insured	Noninsured
BANKS (HEAD OFFICES)										
Dec. 31, 1933	15,029	14,450	6,011	5,154	857	8,439	8,439		579	
Dec. 31, 1934	16,063	15,484	6,442	5,462	980	9,042	7,699	1,343	68	511
Dec. 31, 1941	14,825	14,277	6,619	5,117	1,502	7,661	6,810	851	52	496
Dec. 31, 1942	14,682	14,136	6,679	5,081	1,598	7,460	6,667	793	56	490
Dec. 31, 1943	14,579	14,034	6,738	5,040	1,698	7,299	6,535	764	184	361
Dec. 31, 1944	14,535	13,992	6,814	5,025	1,789	7,181	6,452	729	192	351
Dec. 31, 1945	14,553	14,011	6,884	5,017	1,867	7,130	6,416	714	192	350
Dec. 31, 1946	14,586	14,045	6,900	5,007	1,893	7,148	6,457	691	191	350
BRANCHES AND ADDITIONAL OFFICES										
Dec. 31, 1933	2,911	2,786	2,081	1,121	960	705	705		125	
Dec. 31, 1934	3,133	3,007	2,224	1,243	981	783	783		126	
Dec. 31, 1941	3,699	3,564	2,580	1,565	1,015	984	932	52	32	103
Dec. 31, 1942	3,739	3,602	2,615	1,592	1,023	987	935	52	35	102
Dec. 31, 1943	3,933	3,797	2,793	1,741	1,052	1,004	952	52	95	41
Dec. 31, 1944	4,064	3,924	2,892	1,813	1,079	1,032	978	54	99	41
Dec. 31, 1945	4,090	3,947	2,909	1,811	1,098	1,038	981	57	101	42
Dec. 31, 1946	4,138	3,980	2,913	1,781	1,132	1,067	1,005	62	115	43

Mr. PATMAN. Of course, they are State banks?

Mr. ECCLES. That is right; and so are the State members, of course.

Mr. PATMAN. I understand. That is the 1,800 State members, approximately?

Mr. ECCLES. Yes.

Mr. PATMAN. Now, under the original act, each bank was required, in order to become a member—and, of course, all national banks were required to become members—to deposit a certain amount of their capital and surplus as stock in the Federal Reserve bank in the district in which the bank was located; is that correct?

Mr. ECCLES. That is right.

Mr. PATMAN. That was originally 6 percent; was it not?

Mr. ECCLES. I think that they were required to subscribe 6 percent, and half of it has been called.

Mr. PATMAN. That is right. The law required them to subscribe 6 percent, to be a part of the capital stock of the Federal Reserve bank in that district, but the Board only required them to pay 3 percent, which was at the discretion of the Board, and they have never been required to pay more than the 3 percent; is that correct?

Mr. ECCLES. That is correct.

Mr. PATMAN. Now, what is the total amount of the capital stock of the 12 Federal Reserve banks at this time?

Mr. ECCLES. I will have to look that up; $188,000,000.

Mr. PATMAN. It has increased considerably in the last 3 or 4 or 5 years; has it not?

Mr. ECCLES. Well, as you see, as the capital of the banks increased, they are required to pay 3 percent of that increased capital.

Mr. PATMAN. That is right. And the banks having increased their capital, that would necessarily increase their payments to the Federal Reserve banks?

Mr. ECCLES. That is right.

Mr. PATMAN. So you have $188,000,000 capital stock; that is, in all the 12 Federal Reserve banks?

Mr. ECCLES. That is right; yes, sir.

Mr. PATMAN. What were your earnings last year, Mr. Eccles?

Mr. ECCLES. $93,000,000 after expenses.

Mr. PATMAN. $93,000 000 after expenses?

Mr. ECCLES. That is right.

Mr. PATMAN. Now, the original Federal Reserve Act had a sliding scale, as I remember it, so that when a certain amount had been set aside for a surplus——

Mr. ECCLES. I would like to correct that statement. That $93,000,000 was before dividends. That is, before dividends were paid to the member banks on their stock.

Mr. PATMAN. They get 6 percent on their stock; do they not?

Mr. ECCLES. That is right. The amount that was available to surplus after that was $81,000,000 and not $93,000,000.

Mr. PATMAN. They get 6 percent interest or dividend on the stock that they have actually invested with the Federal Reserve bank in the district?

Mr. ECCLES. That is right; they were paid $10,962,000 in dividends last year on the stock.

Mr. PATMAN. On $188,000,000, or whatever it was?

Mr. ECCLES. Yes.

Mr. PATMAN. Now, this $81,000,000: What became of that money? Where is it now?

Mr. ECCLES. That money is added to the surplus of the Federal Reserve banks.

Mr. PATMAN. The 12 of them?

Mr. ECCLES. That is right.

Mr. PATMAN. Under the original act, there was a sliding scale, so that when a bank's surplus was increased to a certain amount, any additional earnings—net earnings—would flow over into the United States Treasury; is that not right?

Mr. ECCLES. That is correct.

Mr. PATMAN. That was what was known as a franchise tax?

Mr. ECCLES. That is correct.

Mr. PATMAN. Based upon the theory that these 12 Federal Reserve banks were using the Government's credit, the credit of the Nation, and, for the use of that credit, this franchise tax would be paid, and all above a certain amount would be paid into the Treasury?

Mr. ECCLES. That is correct.

Mr. PATMAN. When was that franchise tax repealed?

Mr. ECCLES. In 1933.

Mr. PATMAN. Well, in view of the great earnings of these 12 Federal Reserve banks, do you not think that that law should be restored, Mr. Eccles, and that provision placed back in the Federal Reserve Act?

Mr. ECCLES. I would like to acquaint the committee with a little of the history behind that, if I may. It was repealed in 1933 at the time the Congress took from the surplus of the Federal Reserve banks 139 million dollars for the purpose of providing part of the capital for the Federal Deposit Insurance Corporation, as it was set up. And, therefore, it was repealed.

The idea, no doubt, being to permit the Reserve banks to earn back, in their surplus account, the amount that was taken away.

For quite a number of years, in fact, up until the time of the war, the earnings of the Federal Reserve banks were negligible. They were just about making enough for their expenses during the greater period from 1935 to 1940, and it is only since the war, and with the war financing, that they have greatly increased their income, and have finally succeeded in building back the surplus. Therefore, this problem of Federal Reserve bank earnings only now—certainly within the year—really becomes the problem that Congressman Patman has referred to. The earnings of the System are such that they have recovered completely the $139,000,000, and some in addition to that. The Federal Reserve Board has discussed this question several times, and we have felt that it was necessary to either ask the Congress to reinstate the franchise tax, which provides that nine-tenths of the earnings of the Reserve System above expense be turned in to the Treasury, or the Federal Reserve Board could impose immediately on the Federal Reserve banks, under the provisions of section 16 of the Federal Reserve Act, paragraph (4), what is known as a tax on Federal Reserve notes.

Mr. PATMAN. You are not referring to the Federal Reserve bank notes, are you?

Mr. ECCLES. Yes.

Mr. Patman. Well, there is a difference there, is there not, Mr. Eccles, between Federal Reserve notes and Federal Reserve bank notes?

Mr. Eccles. There are no Federal Reserve bank notes out. The Federal Reserve bank notes were——

Mr. Patman. You are pulling them in as fast as you can and putting them out of circulation?

Mr. Eccles. There were a very few issued at the time of the bank holiday.

Mr. Patman. But you are referring to the Federal Reserve notes?

Mr. Eccles. Yes, I am referring to Federal Reserve notes, and the law gives the Board authority to impose an interest charge—and the law refers to it as an interest charge, not as a tax, so I want to correct myself in that regard—the Federal Reserve notes, which are not covered, that is, in excess of the amount of the gold coverage.

Now, there is a very large amount of Federal Reserve notes which are not secured by gold certificates but are secured by Government bonds.

Mr. Patman. And would be subject to that tax?

Mr. Eccles. And under the law we can impose an interest rate on that circulation which could immediately get into the Treasury without legislation, all of the earnings of the Federal Reserve banks. Although the authority in the original act to charge a rate of interest on note circulation that was unsecured by gold was not meant for that particular purpose, our lawyers advise us that the Board could use that authority—I have a memorandum here from one of our lawyers on that question.

Mr. Patman. In other words, Mr. Eccles, to shorten it, you have an alternative, you could really do the same thing under section 16 of the Federal Reserve Act?

Mr. Eccles. Immediately.

Mr. Patman. And you would not have to wait for a change in the law?

Mr. Eccles. Well, I was going to say that the Board—in fact, we just discussed this last week with the Reserve bank presidents at their conference, with the idea that we could immediately impose it, and if Congress at any time wanted to substitute a franchise tax for that, of course, they could do so.

Mr. Patman. What is the surplus of these 12 banks now, Mr. Eccles?

Mr. Eccles. $439,000,000.

Mr. Patman. $439,000,000?

Mr. Eccles. Yes, sir.

Mr. Patman. What would you consider to be a fair surplus; about $200,000,000?

Mr. Eccles. Well; no; I would not think that the present surplus, considering the size of the operations, is excessive. Certainly, in dealing with the kind of figures we deal with today——

Mr. Patman. I know, but you certainly would not feel that $439,000,000 would be much security——

Mr. Eccles. Well, $439,000,000 is really a lesser surplus than the banks had at the time of the bank holiday in proportion to the size of the deposits and the size of the circulation.

Mr. PATMAN. But in the original act, Mr. Eccles, it was contemplated that when the surplus reached the amount equal to the capital stock, the additional amount would go, nine-tenths of it, into the Treasury. Was that not contemplated?

Mr. ECCLES. Yes; I think it was when it reached that point.

Mr. PATMAN. So according to that, there would be something like $150,000,000 available now that could go to the Treasury and be used to pay the national debt; is that not right?

Mr. ECCLES. Of course, it was contemplated also that 6 percent of the capital would likely be used, in which case the capital would be double what it is, and the surplus would not be excessive in relation to the capital.

Mr. PATMAN. Now, in order to get our definitions straight a little further, our economy is based upon debt; our bank system and our money are based on debt; that is right, is it not?

Mr. ECCLES. Money is created by bank credit.

Mr. PATMAN. Yes.

Mr. ECCLES. That is right. And the bank reserves are created by the central bank.

Mr. PATMAN. With some exceptions, if all the people were to pay their debts to the banks and the United States Government should pay its debts, there would not be any money to do business with, would there, except just a little, like Civil War money, and coins, and things like that, probably about four or five billion dollars; is that not right?

Mr. ECCLES. That is right. That is what happened after 1929. With debt contraction—we have never had a period of prosperity when there has not been an expansion of debt on balance, by either the Government or by the private individuals or corporations, or by both. Whenever debt has contracted on balance, you have had a depression. From 1929 to 1933 I think there was a total debt contraction, as I recall, of something like $30,000,000,000. This was bank debt and also private debt..

Mr. PATMAN. Well, is the reason not obvious, that since our money is based upon debt, and our bank system also, and money is created through the bank system by debt, that we can only be prosperous if we go into debt, and if we pay our debts, why, we are in a depression; is that not right?

Mr. ECCLES. You have got to distinguish between bank debt and debt outside of the bank. The expansion of debt to the banks creates deposits and deposits, of course, are always available to be withdrawn as currency. In other words, the growth of debts to banks, whether in the form of public debt, such as the ownership of Government bonds, municipal debt, or private debt, creates deposits. That is where the great growth of bank deposits has come from, largely through the growth of debt, and largely Government debt. And that, of course, is responsible for our very large, what we term, money supply.

Mr. PATMAN. I want to get into that later, if you will permit me to.

Mr. ECCLES. I just wanted to add this one further point: That debts outside of the banks merely mean the velocity of the circulation of money. In other words, a person draws a deposit out of the bank to pay an insurance company his premium, and the insurance company puts it back into the bank, and there is no more money. The insurance company lends that to somebody to build a house and it goes back in the bank, and, as it is spent to pay the various trades people, it circulates. But when debt from one to another, outside of the banks, is incurred, it does not create money, it puts money into circulation.

Mr. PATMAN. In order to get our definitions straight further, these 12 banks can issue what are known as Federal Reserve notes under the direction of the Federal Reserve Board; is that correct?

Mr. ECCLES. That is correct.

Mr. PATMAN. Although these banks are owned by private banks, every penny of stock is owned by commercial banks, the 14,000 commercial banks?

Mr. ECCLES. No; it is owned by the 7,000 member banks.

Mr. PATMAN. I am not trying to get into an argument as to who controls them, and I can see that the Federal Reserve Board, to a large extent, controls the 12 Federal Reserve banks, but the fact remains that although these 12 banks are owned by private banks, they issue Federal Reserve notes which are not obligations of the 12 Federal Reserve banks at all; they are obligations of the United States Government, are they not?

Mr. ECCLES. That is correct. They are both. They are obligations of both the bank and the Government.

Mr. PATMAN. I know, but the amount of the obligations of the banks would just be practically nothing compared to the obligations of the Government; that is right, is it not?

Mr. ECCLES. Well, the fact that they are secured by Government bonds, and the fact that they are secured by gold which the Government buys, means, of course, that indirectly they are secured by the Government's guaranty.

Mr. PATMAN. How much money do we have outstanding now; about 25 or 26 billion dollars?

Mr. ECCLES. Well, there is a total of more than $28,000,000,000. But there is a substantial portion of that, other than Federal Reserve notes. Silver certificates is a very large item.

Mr. PATMAN. Just a minute. You say a substantial portion in addition to the Federal Reserve notes.

Mr. ECCLES. Well, the majority are Federal Reserve notes.

Mr. PATMAN. Certainly. It is bound to be.

Mr. ECCLES. And the growth is in Federal Reserve notes. If it were not for the silver policy, the issuance of silver certificates and payment for newly mined silver, of course, there would be that many more Federal Reserve notes.

Mr PATMAN. Would it not be at least 75 percent of that $28,000,000,000 in Federal Reserve notes?

Mr. ECCLES. $24,000,000,000.

The CHAIRMAN. Mr. Patman, if you have no objection, it might be well at this point to put in the record a break-down of the $28,000,000,000.

Mr. PAMAN. Yes; I wish you would, Mr. Eccles.

Mr. ECCLES. I can give it to you right now, if you want it.

Mr. PATMAN. No; just put it in the record at this point.

(The document above referred to is as follows:)

United States money in circulation, Jan. 31, 1947

[In millions of dollars]

Federal Reserve notes	24, 116
Treasury currency:	
Standard silver dollars	147
Silver certificates and Treasury notes of 1890	1, 917
Subsidiary silver coin	864
Minor coin	327
United States notes	308
Federal Reserve bank notes	429
National bank notes	110
Total Treasury currency	4, 100
Total money in circulation	28, 265

NOTE.—Federal Reserve notes are obligations of the United States and a first lien on all the assets of the issuing Federal Reserve bank. Federal Reserve notes are secured by the deposit with Federal Reserve agents of a like amount of gold certificates or of gold certificates and such discounted or purchased paper as is elibible under the terms of the Federal Reserve Act, or of direct obligations of the United States. Federal Reserve banks must maintain a reserve in gold certificates of at least 25 percent, including the redemption fund which must be deposited with the Treasurer of the United States, against Federal Reserve notes in actual circulation; gold certificates pledged as collateral may be counted as reserves.

Federal Reserve bank notes and national bank notes are in process of retirement; since funds have been deposited with the Treasury for their retirement they are now obligations of the Treasury and not of the issuing banks.

Mr. PATMAN. Mr. Chairman, before I forget it, I want to ask unanimous consent to extend my remarks in the record and to insert anything that I believe is germane to this inquiry.

The CHAIRMAN. Without objection, it is so ordered.

(See p. 42 for extension of Mr. Patman's remarks.)

Mr. PATMAN. Mr. Eccles, on this particular bill, Mr. Wolcott, the chairman, has very properly called our attention to the fact that we should get back to the bill, H. R. 2233, This bill is to permit the 12 Federal Reserve banks to buy directly from the Treasury, Government bonds and securities up to $5,000,000,000 at any one time.

Mr. ECCLES. That is correct.

Mr. PATMAN. In other words, may hold that much at any one time, but no more?

Mr. ECCLES. That is correct.

Mr. PATMAN. The original act as passed in 1913, up until about 1935, gave the Federal Reserve banks that power; is that right?

Mr. ECCLES. Without limit.

Mr. PATMAN. Without limit; but there was no reason to use it, and it was not used?

Mr. ECCLES. Except to take care of the overdrafts at tax-payment dates.

Mr. PATMAN. Yes; now, since 1935, in order for the Federal Reserve banks to buy Government bonds, they had to go through a middleman, is that correct?

Mr. ECCLES. That is correct.

Mr. PATMAN. In other words, the Treasury would sell them outside to some individual or corporation and then the 12 Federal Reserve banks acted, through the Open Market Committee, and would purchase those bonds or bills or certificates from this middleman. That is the only way you could acquire them, from 1935 up until the Second War Powers Act was passed by Congress during the war; is that correct?

Mr. ECCLES. And then we could purchase directly $5,000,000,000; that is correct.

Mr. PATMAN. Under the Second War Powers Act, you could purchase up to $5,000,000,000, since 1942?

Mr. ECCLES. That is correct.

Mr. PATMAN. Yes.

Mr. ECCLES. Prior to that, we could buy them only in what was known as the open market, which, of course, meant buying from the dealers in Government securities.

Mr. PATMAN. From the brokers, you had to pay a brokerage commission?

Mr. ECCLES. Yes, sir; well, I suppose the seller of the securities paid the commission.

Mr. PATMAN. Instead of the Treasury sending over to the Federal Reserve Bank Building, for distribution to the 12 Federal Reserve banks, these securities offered by the Treasury, they had to sell them to some third party, some broker, and then, they would be purchased by the Open Market Committee for the Federal Reserve bank, by the 12 banks; that is the way it was done, was it not?

Mr. ECCLES. Yes; as a matter of fact, the initiative is not taken by the Open Market Committee. The initiative for the sale of securities, is, of course, taken by the market. To the extent that securities are purchased by people dealing in securities, and they are unable to dispose of the securities to the market, without depressing the prices, the Open Market Committee stood ready to support the prices. Otherwise, of course, the interest rates for Government financing would have gone up, and the market for securities would have gone down.

Mr. PATMAN. That is what you meant in your supplemental statement this morning by supporting the market?

Mr. ECCLES. That is right.

Mr. PATMAN. Preventing bonds from going below par?

Mr. ECCLES. Yes.

Mr. PATMAN. Yes; I expect to cover that later.

The $5,000,000,000, of course, is used for the purposes which you pointed out yesterday, and, of course, they are very worthy and deserving purposes. But suppose we were to decide, in the committee, to recommend—I do not know whether the committee would or not, I am merely suggesting it for consideration—that we divide this public debt, and that we set aside, say, 50 or 75 or 100 billion dollars, that we are willing to have remain outstanding for the insurance companies, and the private investors, or the public, and to a certain extent the commercial banks, but the others, say, $160,000,000,000, we want to handle through the Federal Reserve System, and pay interest on the bonds all right, but let that interest flow over into the Treasury, and, in effect, save interest on those bonds, if we set aside that $160,000,000,000, and say we are going to pay 2½ percent each year, which would, in effect, retire those bonds in 40 years, and the other hundred million dollars permit to go ahead normally as now and pay such amounts on them as we want to, what do you think about a plan like that? And, of course, we would have to give you the power to change the reserve requirements of banks, otherwise we would have a ruinous inflation.

Mr. ECCLES. Of course, to the extent that the holdings of Government bonds by the Reserve System increased, just to that extent, you would, of course, add reserves to the commercial banks, and if you purchased the securities from the Treasury directly—that is, new financing, new securities, you would add to the deposits, because, as you purchased from the Treasury the Government securities, and the Treasury, in turn, spent that money that was created by that purchase, that money would go back into the commercial banking system and would show up as deposits of individuals and corporations on the one side of the balance sheet, and would show up as idle or excess reserves in the Federal Reserve banks on the other side, and, of course, would be a perfect instrument of inflation.

Mr. PATMAN. But consider the reserve requirements, Mr. Eccles. I suggested that the Board have the power to change the reserve requirements to correct that.

Mr. ECCLES. Well, to the extent, of course, that the Reserve System could increase the reserve requirements by the amount of excess reserves that were created through this process it would mean, I think, that you would bankrupt the commercial banks, and for this reason: The commercial banks would have the expansion of deposits, such as they do now, through the expansion of the public debt; they would have that great growth of deposits, which would be held by the public, to handle. And on the other side of their ledger they would have their cash, which is the offset to it, locked up in the reserve banks, through the increase in reserves. So that the commercial banks would not have earning assets to offset these deposit liabilities. They would have assets, in the form of balances of the Reserve banks, to meet withdrawals, but they would not have earning assets to offset the deposits and the cost of doing business.

Their only return, of course, would come from such loans and investments as they had, and, under this plan, they would have no Government securities to offset the deposits.

The record of bank earnings, of course, would indicate that on that sort of a plan they would be unable to survive.

Mr. PATMAN. In other words, Mr. Eccles, that is an argument in favor of the Government selling bonds to the commercial banks and permitting them to pay for them by a bookkeeping transaction and receive interest on them in order to pay the cost of carrying their accounts with individuals and corporations; is that correct?

Mr. ECCLES. That is right.

Mr. PATMAN. In other words, it is a subsidy, is it not?

Mr. ECCLES. Well, I would not say that it is a subsidy. I think that if they must handle, as they do, the deposits that are created as a result of the Government financing program, then they should be entitled to invest those funds at a sufficient rate—at a rate that would make their operations safe and profitable.

I would say that to the extent that their earnings are excessive, then you might say that the excessive portion of the earnings was a subsidy. I would not want to call——

Mr. PATMAN. All earnings a subsidy?

Mr. ECCLES. All earnings from that source a subsidy.

Mr. PATMAN. But you would admit that where the earnings were excessive that would be a subsidy? Now, Mr. Eccles, I do not want to do anything to harm the commercial banks. I want to help them. I think we have the strongest banking system we ever had. I want to help them. I do not want to harm them in the least. But, at the same time, it occurs to me that it is better for the people who get the service directly from the banks to pay for the cost of this service rather than do it through the taxpayers, as you recommend.

Mr. ECCLES. The effect of Government financing in holding the interest rate low, of course, tends to reduce the rate that the banks are able to get on private lending, and the competition in the credit field, or the effect of Government action in the private credit field, of course, has also tended to reduce interest rates. And of course that, in turn, has greatly reduced private banking income, which, in turn, has made it necessary for the banks to rely more upon their return on Government securities than would be the case if the rates on private lending were not as exceedingly low as they have been, reflecting, of course, the low rate that we have provided for Government financing.

And the fact that the banks can sell to the Reserve banks their short-term Governments and create reserves with which to make loans has tended, of course, to create a competitive situation in the lending field, and we have seen rates for not only short-term commercial papers but also for term loans and for private credit at the lowest rates that have existed for—well, I think, on record.

For instance, 10-year term loans were made to industry, for a time, at as low as 1¾ percent. And loans to brokers—loans secured by Governments—were made frequently at 1 percent or lower.

Commercial paper or what we call commercial loans were made at from 1¼ to 1½ percent.

So that the low rate that banks have charged on private financing brought about by monetary policy necessary to finance the war has greatly affected bank earnings from private credit.

Mr. PATMAN. I think the banks did a fine job during the war. They were very helpful. In fact, I do not see how we could have carried on this war, at least the financing of it, without the fine spirit of cooperation demonstrated by the commercial banks.

But now, Mr. Eccles, if a bank wants to increase its earnings, what about selling a million dollars worth of three-eighths certificates and getting a million dollars worth of credit, or reserve, and then buying from 6 to 10 million dollars worth of bonds paying 1 percent or more?

Mr. ECCLES. That is correct, as far as the banking system as a whole is concerned.

Mr. PATMAN. That is right. But it affects the individual banks, too, profitwise.

Mr. ECCLES. Well, the individual bank could sell the short-term paper and buy a like amount of long-term paper with higher yields. However——

Mr. PATMAN. A like amount? They could buy several times that amount.

Mr. ECCLES. The banking system as a whole could, but that particular bank could not.

Mr. PATMAN. But, at the same time, the particular bank profits by it.

Mr. ECCLES. It profits by the difference between the lower yield and the higher yield.

Mr. PATMAN. Yes.

Mr. ECCLES. And it creates, of course, a reserve which it uses for the purpose of buying the security. But that reserve becomes a deposit in another bank with which that bank, likewise purchases. And then, as that bank purchases, it creates a reserve in another, and it has the multiple effect of enabling the banking system as a whole to purchase from 6 to 10 times as many Governments as was originally sold. That is the effect of it.

Mr. PATMAN. That is the point I was trying to bring out.

Now, what is the amount of Government bonds, bills, and certificates—all Government securities—held by commercial banks at this time?

Mr. ECCLES. Falling due within 1 year, the commercial banks have $16,700,000,000——

Mr. PATMAN. I do not want it in detail. Will you give us the total amount?

Mr. ECCLES. The total amount that the banks have—of all maturities?

Mr. PATMAN. Yes, sir.

Mr. ECCLES. It is estimated at $66,484,000,000 of market issues on December 31, 1946.

Mr. PATMAN. What is the annual interest rate on those bonds?

Mr. ECCLES. The average rate that banks earned on Government securities in 1946 was probably a little over 1.5 percent.

Mr. PATMAN. What would be the exact figure?

Mr. Eccles. About 1.3 billion dollars.

Mr. PATMAN. That is the aggregate amount collected by the commercial banks from the Government for interest on Government securities? Now, how much is the capital stock of those banks?

Mr. ECCLES. I do not——

Mr. BUFFETT. I believe there is a contradiction in these figures, Mr. Patman.

Mr. ECCLES. Yes; I do not think that figure is right.

Mr. PATMAN. Anyway, the only difference is between 1.4 percent and 1.5 percent. We can straighten that out.

Mr. ECCLES. Well, the average rate of return is 1.5 percent. Now, the amount that the banks would get on that—of course, you have got to take it over the year. These figures that I gave you of the holdings of the banks were at the end of the year, and the earnings that the banks received are, of course, for the entire year. And during the year there was a great reduction in the securities held by the banks, so that you cannot take one and a half times what they held at the end of the year. That does not give you their earnings during the year.

Mr. BUFFETT. On $66,000,000,000?

Mr. ECCLES. Yes; that is correct. But here is the estimated amount that I had put together this morning. This is for the member banks, and the member banks represent, I would say, 85 percent of the total—that is, the assets of the member banks represent about 85 percent of the assets of all banks. And their estimated earnings, in 1946, were nearly $1,100,000,000 from interest on Government securities.

Mr. PATMAN. Let me shorten this by asking you to place a statement in the record on that matter, Mr. Eccles.

Mr. ECCLES. Very well.

Mr. PATMAN. That is, as to the total amount of earnings, based upon the assumption that you have described and that you have discussed.

(The statement referred to is as follows:)

Holdings of public debt and interest on public debt, Dec. 31, 1946

[Amounts in millions of dollars]

	Outstanding par value	Estimated interest [1]	Interest as percentage of outstanding par value
Total interest-bearing public debt	257,980	5,304	2.06
Holdings of:			
Commercial banks [2]	73,700	1,307	[3] 1.77
Federal Reserve banks	23,350	144	.62

[1] Estimated amount of annual interest on amounts outstanding as of Dec. 31, 1946.
[2] Total holdings of all commercial banks at par value estimated on basis of figures reported in Treasury survey for a sample of banks.
[3] The actual return on the book value of holdings after amortization of premiums on bonds bought above par would be around 1.6 percent.

Mr. PATMAN. What is the capital stock of the banks?

Mr. ECCLES. $9,000,000,000 for all insured and commercial banks.

Mr. PATMAN. Oh, no; that cannot be.

Mr. ECCLES. That is capital and surplus.

Mr. PATMAN. I did not ask you for that. I asked you for the capital stock.

Mr. ECCLES. I do not have that.

Mr. PATMAN. That includes undivided profits, surplus and everything else?

Mr. ECCLES. That is right.

Mr. PATMAN. Well, will you please place in the record a statement showing the amount of capital stock of these banks, the amount of surplus and the amount of undivided profit? Then it will make up the total that you suggested. But what I asked for was the capital stock as distinguished from the others.

Mr. ECCLES. Very well.

(The document referred to is as follows:)

All insured commercial banks—assets and liabilities June 29, 1946

[In millions of dollars]

ASSETS

U. S. Government obligations	82,998
Treasury bills	1,220
Certificates of indebtedness	17,642
Treasury notes	12,207
Treasury bonds	50,911
United States savings bonds	1,195
Guaranteed obligations	24
Other securities, total	7,644
Loans	26,796
Total loans and investments	117,438

All insured commercial banks—assets and liabilities June 29, 1946—Continued

[In millions of dollars]

ASSETS—continned	
Cash, balances with other banks, and cash collection items	31, 853
Bank premises and other assets	1, 452
Total assets	150, 743
LIABILITIES	
Total deposits	140, 649
Miscellaneous liabilities	1, 025
Capital accounts, total	9, 070
Capital stock, notes and debentures	3, 071
Surplus	3, 933
Undivided profits	1, 485
Reserves	581
Total liabilities	150, 743

Mr. PATMAN. Now, Mr. Eccles, we have a $260,000,000,000 debt. In view of our ability to pay—and, after all, I consider that our Government bonds are backed principally by the ability and willingness of the people to pay taxes—how much do you think we ought to reduce that debt this year, and next year?

Mr. ECCLES. That, of course, is very difficult for me to say. It depends entirely upon the degree of inflationary development. As long as you have inflationary pressures, the most effective way to reduce those pressures is through taxes.

Mr. PATMAN. Siphoning of purchasing power?

Mr. ECCLES. That is right. To the extent that you reduce taxes you of course increase, and not reduce, the inflationary pressures.

However, let me put it this way, merely to keep taxes up and spend the money from those taxes, rather than apply it against the debt, of course does not bring about any antiinflation measure. You must not only siphon the money off, but the money must then be used to apply against the debt, which, of course, is the most effective means of dealing with an inflationary problem.

So the extent to which payment should be made upon the public debt would depend, in a large measure, on the extent to which inflationary measures are continued.

If you had a deflationary situation, then to collect a sufficient amount of taxes to make substantial payments on the public debt would only add to the deflationary pressures.

The opposite is true, of course, in an inflationary situation.

Now, I have stated a principle here. As to the amounts that should be applied against the public debt, I would think that it could not be very substantial under present circumstances. Something certainly should be applied against the public debt.

Mr. PATMAN. Well, would you advocate tax reduction to any extent, or would you advocate paying all of that money on the public debt?

Mr. ECCLES. Well, I have not studied the problem enough to be able to give other than what may be considered a horseback opinion.

I have felt, with the inflationary pressures that we still have, that it would be premature to reduce taxes and that we should cut expenses as far as possible and apply as much as possible on the public debt under the present economic situation.

There is, I recognize, a real problem on the part of the small-income people which make up the majority, I suppose, of our workers. The unorganized workers have not received increases in pay, generally speaking, commensurate with their increased living costs and are pretty much out of balance with what I term the organized-workers groups. So you still have a great many people who are receiving 50, 60, or 70 cents an hour for their work. And I am in great sympathy with those millions of people, and certainly would feel that any reduction in taxes should go, pretty largely, to that group of people as a matter of equity.

Of course that group of people is not the one that is likely to purchase consumer durable goods and goods in short supply so much as they are likely to use that increased income to buy food and other necessities which have increased so greatly in cost.

Mr. PATMAN. But the practical effect of more take-home pay—and I am not discussing the sympathetic side—would be that the more money they have to take home, the more they will be in competition with other people for the scarce goods and for whatever supply of foodstuffs there are.

Mr. ECCLES. There is no question but that to the extent that you have inflationary pressures, any reduction is likely to add to those pressures.

Mr. PATMAN. Yes.

Mr. ECCLES. When I made this other point, it was with reference to what seems to me to be the pressures of equity for some tax relief due to the increased cost of living.

Mr. PATMAN. I thoroughly agree with you on that, Mr. Eccles, but at the same time I think that while we have the money to pay our debts we should pay off as much as possible.

Mr. ECCLES. If we do not do it under the conditions that exist at the present time, when the national income and the national production exceed that of any year in our history, including any war year, and when there is a shortage of a great many goods—if we cannot make substantial applications against the public debt under these conditions, then I do not know when we can do so.

Mr. PATMAN. That is right.

Mr. ECCLES. We cannot do it in a deflationary period.

Mr. PATMAN. That is correct. Now, ordinarily, the bankers generally would be in favor of paying as much on the public debt, I would think, as possible, because bankers know how runious inflation can be.

I wonder what stand they have taken on the question of making payments on the public debt now? Do you know what they have decided in their conventions?

Mr. ECCLES. I do not know of any official stand taken by them. I think you are right, though, in speaking of bankers generally, I think that the great majority of them are not in favor of tax reductions. I think the great majority of bankers are favorable to a reduction of expenses and applying as much as possible, as an anti-inflationary measure, on the public debt.

Mr. PATMAN. I know that when the proposal was made to reduce taxes by 20 percent across the board that attracted a lot of people, especially those in the high-income brackets, who would profit the most. Naturally it would. I guess the private enterprise and personal initiative system is a little selfish. But now that sentiment seems to be crystallized to the point that whatever income-tax reduction there will be, will be in the lower income brackets, I wonder whether the enthusiasm of these people in the higher brackets has cooled off a bit.

Mr. ECCLES. I think that might be a logical conclusion.

Mr. PATMAN. How large are the hockus-pocus operations in the case of the Treasury selling securities at, say, three-eighths of 1 percent to brokers? I suppose those are the only ones the operations would apply to.

Mr. ECCLES. Every week there are $1,300,000,000 of Treasury bills which fall due. Every week the Treasury offers, in the market, that many bills to be sold to the highset bidder. As a matter of fact, there is practically one bidder. The bills that mature each week are held almost entirely by the Federal Reserve system.

There are, in the process of replacing those maturing bills, arrangements with the dealers to put in bids for them at three-eighths of 1 percent.

Mr. PATMAN. You mean the Federal Reserve arranges with this bidder, you might say?

Mr. ECCLES. That is right. We do it for the Treasury, really, because we have got to assure it that this $1,300,000,000 is going to be taken care of.

Mr. PATMAN. That is right.

Mr. ECCLES. So that, as ours fall due, we see to it that they are taken care of. And the way we do that is to see that bids are put in.

Now, as I say, it would be much better—and the Federal Reserve System have felt, and so advised the Treasury—that a much more direct way of handling it to recognize the fact that this really was not a market operation and that we do directly what we do indirectly—and that is to accept the bills that are maturing, each week, in payment of the new bills that are offered.

Mr. PATMAN. How much would that save each week?

Mr. ECCLES. The cost is very nominal. It is a very small item or fee. At one time it was very substantial.

Mr. PATMAN. Well, tell us about how small it is.

Mr. ECCLES. We cut them down to a very, very small amount. I do not know for sure. We can get it.

Mr. PATMAN. Suppose you put that in the record.

Mr. BUFFET. Are those 30 or 60 days?

Mr. ECCLES. All 90-day bills, and it takes $1,300,000,000 a week to reach the $17,000,000,000 in 90 days.

Mr. PATMAN. Will you put them in since the first of the year, Mr. Eccles, please—each week since the beginning of the year. That will be about 8 weeks.

Mr. ECCLES. Put in what?

Mr. PATMAN. The amount of service charges in connection with it.

Mr. ECCLES. Yes.

(The document referred to is as follows:)

DEALERS FEES ON TREASURY BILLS BOUGHT FOR FEDERAL RESERVE ACCOUNT

In connection with the weekly turn-over of Treasury bills in the Federal Reserve System open market account, dealers in Government securities subscribe to bills and sell them to the System account and charge no commission fee for this service. The dealers obtain a nominal profit because they purchase the bills at $99.905 per $100 face value and sell them at a price of $99.905208. The small profit arises because the Treasury accepts bids only to three decimal places, whereas the Federal Reserve buys bills at a discount of 0.375 percent per annum, which gives the purchase price indicated. This profit to the dealers amounts to $2.08 for each $1,000,000 of bills bought and sold. Since, as shown in the following table, these transactions average about $750,000,000 per week, the amount of profits received by dealers is about $1,500 per week.

This small profit also accrues to banks and others who tender for new issues of Treasury bills at $99.905 and resell them to the Federal Reserve banks at the latters' three-eighths of 1 percent buying rate.

Purchases of new Treasury bills for System account

[In thousands of dollars]

Jan. 2	314, 065	Feb. 6	807, 715
9	655, 135	13	775, 405
16	775, 284	20	786, 075
23	818, 485	27	775, 305
30	775, 105	Total	3, 144, 500
Total	3, 338, 074	Total January and February 1947	6, 482, 574

Mr. Patman. Mr. Chairman, I will not ask any further questions. Thank you very much.

The Chairman. The House is in session, Mr. Eccles. Is it going to be convenient for you to come back tomorrow, with the thought that we might be able to finish tomorrow?

Mr. Eccles. I will be glad to be back, Mr. Chairman.

GOVERNMENT CAN SAVE BILLIONS IN INTEREST OF THE NATIONAL DEBT

Mr. Patman. Mr. Chairman, permission having been granted, I am inserting herewith my testimony and the testimony of former United States Senator Robert L. Owen on the question I have been interrogating Mr. Eccles about:

DEBT LIMIT OF THE UNITED STATES

House of Representatives,
Committee on Ways and Means,
Washington, D. C., Saturday, February 13, 1943.

The committee met at 10 a. m., Hon. Robert L. Doughton (chairman) presiding.

The Chairman. The committee will be in order. The first witness this morning is Representative Patman.

Statement of Hon. Wright Patman, a Representative in Congress From the State of Texas

Mr. Patman. My name is Wright Patman, Member of Congress from the First Congressional District, Texas.

In the beginning I want to express my appreciation to this committee for giving consideration to this subject. I know it is a controversial subject, but I have studied it for 25 years, 10 years before I ever made any public declaration on it. I was very anxious to seek the best advice from the best experts in this Nation before I ever made any public declaration on this subject.

Our public debt by the end of the next fiscal year will be about $210,000,000,000. A large part of this debt, if present plans are not changed, will be owned by the 14,000 commercial banks in the Nation. The interest burden on this debt will be between four and five billion dollars per annum. The interest burden this fiscal year will be $3,000,000,000, which is provided for in the Budget message submitted by the President at the beginning of this session of Congress.

The net increase in the public debt for the year ending June 30, 1944, will be $75,500,000,000.

HOW LARGE PART OF INTEREST CAN BE SAVED

The occasion of my appearance before this committee is to make a suggestion about how billions of dollars a year can be saved by the Government on this huge national debt. Our interest burden after the next fiscal year will be much larger than the entire expenditures of our Government in 1933 and more than four times as large as the total expenditures of our Government in 1914. The question of interest, therefore, becomes one of our major problems. If a substantial part of this interest can be saved it will be of great help to the already over-burdened taxpayers. If the plan had been in effect in the past our Government would would have been saved at least one-half the interest burden, which would have amounted, over a period of years, to billions of dollars.

It is my considered opinion that not only can a large part—in fact, the greater part—of this interest burden be saved but the method pursued in saving it will enable our Government to pay the entire national debt in 40 years even if it should reach $300,000,000,000 before this war is over. In addition, the plan proposed will retire a definite amount of the debt each year, thereby reducing annually any inflationary condition that has been brought about because of the war, and more effectively retard inflation than the present system.

Inflation is our greatest danger. Monetary controls cannot stop it; only adequate price control can retard or prevent it. It must be prevented or our country will suffer a shock almost equal to losing the war to the dictators.

My plan is no different from present plans and methods except that no interest will be paid by the Government for a large part of its credit used to finance the war.

I am opposed to the Government owning the commercial banks. Those banks render a good service and are entitled to a fair profit. My advocacy of this proposal is in favor of the private banks and to help them remain private. This is no fight against bankers. They are doing a splendid, patriotic job in the war effort and they are among the finest and best citizens in every community. If it is necessary for the Government to assist the private banks in order to keep them performing efficiently, I am in favor of it.

For the first 125 years of our country's existence the question of interest paid by our Government was of only minor importance. For the past 25 years, however, our Government's interest burden has exceeded on an average more than a billion dollars a year.

Anyone is entitled to pay for hire of his money. When people dug gold and silver out of the earth, it was right, if they loaned it to the Government to get interest on it.

ROAD TO RUIN

We should not permit the war burden to be doubled and trebled through the payment of unnecessary interest. It will be traveling the road to ruin.

The Treasury is spending monthly:[1]

Currently: $6,000,000,000 for a war, a half billion for other purposes.

End of 1943: $8,000,000,000 for a war, a half billion for other purposes.

Fiscal yearly total spending:[1]

Ending June 30, 1943: $74,000,000,000 for war, $6,500,000,000 for other purposes.

Ending June 30, 1944: $97,000,000,000 for war, $7,000,000,000 for other purposes.

Gross public debt[1]

Dec. 31, 1941	$57, 900, 000, 000
Dec. 31, 1942	108, 200, 000, 000
June 30, 1943	134, 800, 000, 000
June 30, 1944	210, 500, 000, 000

[1] Information from Banking, Journal of the American Bankers Association for February 1943, p. 24.

Possible banking-system balance—sheet as of June 30, 1944 [1]

Resources:	
Cash and reserves	$20, 000, 000
Government securities, direct and guaranteed	112, 000, 000, 000
Other investments	8, 000, 000, 000
War loans	8, 000, 000, 000
Other loans	12, 000, 000, 000
Total	160, 000, 000, 000
Liabilities:	
Deposits	152, 000, 000, 000
Capital	8, 000, 000, 000
Total	160, 000, 000, 000

[1] Information from Banking, Journal of the American Bankers Association for February 1943, p. 24.

It will be noticed that the banks are expecting to hold $112,000,000,000 of the Government's securities by the end of 1944, which will be more than one-half of the entire public debt. The annual interest on this amount, which must be paid by the taxpayer, will be approximately $2,500,000,000. The Stevens Hotel in Chicago was purchased by the Government because the annual rent to be paid would soon equal the purchased price.

In connection with the question of how much of the increased debt for this year will have to be purchased by the banks, I desire to quote the chairman of the board of directors of the Chase National Bank of New York, Winthrop W. Aldrich, in a speech he made Thursday, January 21, 1943, in which he stated:

"Through 1943, it is estimated that the commercial banking system, that is, all commercial banks plus the 12 Federal Reserve banks, may have to absorb $40,000,000,000 of Government obligations, an amount equal to about 60 percent of the estimated increase in the total Federal debt."

BANKS IN VULNERABLE ATTITUDE

The Bank of America statement of condition, December 31, 1942, discloses that it owns $1,043,000,000 of the United States Government's securities and has a capital stock of $50,000,000. In other words, this bank will collect as much in interest on these bonds in 2 years as the amount of the entire capital stock of the bank.

The statement of one bank of New York for December 31, 1942, discloses that it had in its portfolio Government obligations amounting to $1,988,096,539.18. The capital stock of this bank is $77,500,000. The interest received on the Government obligations in 2 years would be much more than the capital stock of the bank.

The statement of another New York bank for December 31, 1942, discloses that it had in Government obligations at that time $1,692,372,867.88. The capital stock of the bank is $90,000,000.

ONE-HALF ALL FEDERAL SOCIAL SECURITY BENEFITS

January 9, 1943, it was reported that the 12 largest banks in New York City, as of December 31, 1942, held $11,182,594,000 worth of United States Government interest-bearing securities. These 12 New York banks will therefore collect approximately a quarter of a billion dollars a year interest each year from the Government on these securities. This amount is equal to about half of the Federal Government's total expenditures for social security—10 times as much as the cost of the legislative department of our Government in a year.

It was reported January 20, 1943, that the 20 largest banks in the United States, 12 of them being in New York City, held Government bonds at the end of 1942 amounting to $16,407,197,000. The interest that the Government will pay to these 20 banks will be between three hundred and four hundred million dollars per year.

The total capital stock of all the commercial banks amounts to $3,500,000,000, although their surpluses and undivided profits amount to about $5,000,000,000 more. When these banks own enough Government bonds to entitle them to $3,500,000,000 a year, what do you think will happen?

ALL RIGHT TO PAY INTEREST ON ACTUAL MONEY HIRED

In the beginning, may I make it plain that I am not opposed to interest being paid by individuals or corporations for the use of other people's money that they have hired. Neither am I opposed to the payment of interest by States, counties, and political subdivisions for money that they hire. I am opposed to the United States Government, which possesses the sovereign and exclusive privilege of creating money, paying private bankers for the use of its own money. These private bankers do not hire their own money to the Government; they hire only the Government's money to the Government, and collect an interest charge annually.

What I am telling you I can prove by the highest authorities in the world. Over a period of years I have interrogated Mr. Eccles, Mr. Morgenthau, Mr. Bell, and the biggest bankers in this country and I know what their claims and contentions are, and what I say is there is no dispute or contention about it, or controversy; it is admitted. And, furthermore, I have, I believe, the best authority in the world on financial matters to support this statement. I don't want to take too much time, because I want you to hear from him. There are more words of Senator Robert L. Owen in the Federal Reserve Bank Act than the words of any other person, living or dead. Senator Owen is one of the most highly cultured men in the world. I feel like he knows more about this problem than any other person living. I know he is a modest man; he has not tried to put himself forward, but I feel, because of his attitude back in 1913, when the Federal Reserve Act was being written, his attitude was not favorable to certain powerful interests and it is the same today as it was then, and by reason of that unfavorable attitude on the part of some of the biggest fellows in the country they have submerged the part this great man had in the writing of that history-making legislation. Few men in the world have had the ripe experience and the successful experience that Senator Owen has had. He is a successful national banker himself. He organized in 1890, owns a substantial part of the stock, was president for a long time, has been an official or director ever since, and he knows what this is all about.

Incidentally, it is a coincidence that Senator Owen, who was chiarman of the Banking and Currency Committee in the Senate at the time of the passage of the Federal Reserve Act, and Senator Glass, who was chairman of the Committee on Banking and Currency in the House, when the Federal Reserve Act was passed, were both born about the same time within two blocks of each other, in Lynchburg, Va.

The CHAIRMAN. May I interrupt to ask a question there?

Mr. PATMAN. Yes, sir.

The CHAIRMAN. You know that Senator Owen and Senator Glass were the authors of the Federal Reserve System?

Mr. PATMAN. Yes, sir.

The CHAIRMAN. Both played a conspicuous part in the writing of that act.

Mr. PATMAN. Yes.

The CHAIRMAN. Did you get Senator Glass' reaction to this proposal?

Mr. PATMAN. I only know how Senator Glass stood when the Federal Reserve Act passed, and his views were contrary, in many substantial respects, to Senator Owen's. I know his views since that time, and I would consider he would definitely be very much against it.

The CHAIRMAN. He would?

Mr. PATMAN. Yes, sir. I know his views. I am not arguing with him, or criticizing him or condemning him. I am just telling you I believe that would be his views. I know how he stood in the past on these difficult questions.

INTEREST CAN BE SAVED ON PART OF WAR DEBT

Furthermore, in this emergency it is necessary that we sell all the interest-bearing bonds that we can to the public, including corporations who have the money to buy them. This is necessary to retard inflation and it is very helpful to that end. I favor the levying and collection of all the taxes it is possible for the people to pay in order to reduce the national debt as much as possible each year. After the Government has collected all the taxes it can collect and has sold all the bonds to the public that can be sold, there will remain 50 percent or more of the funds to be raised which must be obtained from the Federal Reserve banks or the privately owned 14,000 commercial banks of the country, that accept deposits, or from both.

It is this money that must be obtained from the Federal Reserve banks and the commercial banks that I insist can be secured by the Government without an annual interest charge.

Mr. Disney. Congressman, if you will restate your proposal in just a word, it would help me.

Mr. Patman. The point is this; we want to sell all the bonds we can to the public and corporations that have the money to buy them. And I am not opopsed to that. We want to collect all the taxes we can to pay on this war. But after we do that, we will still have to have a large sum of money each year, and that money must be obtained through creation; it has got to be created. And my point is that the money, if it has got to be created on the Government's credit, that the people should not have to pay interest on that money that is so created. That is it in a nutshell, Mr. Disney.

H. R. 1 GERMANE TO BILL TO RAISE DEBT LIMIT—THAT IT PROVIDES

I have before this Congress the bill H. R. 1. It is germane in the consideration of this bill to raise the debt limit to $210,000,000,000. The bill provides for the issuance of non-interest-bearing, non-negotiable bonds by the 12 Federal Reserve banks to finance the part of the war that would otherwise be financed by the commercial banks and the 12 Federal Reserve banks on interest-bearing bonds.

The bill would prohibit the Treasury from issuing any further interest-bearing bonds to the banks receiving deposits, and would restrict the amount of United States bonds held by any bank to the amount held by such bank on December 31, 1941. The date is an arbitrary one. Any other fair date or fair adjustment of the amount of bonds any bank could hold would be satisfactory.

FEDERAL RESERVE BANKS DISTINGUISHED FROM COMMERCIAL BANKS

First, let us get our definition straight as to the kind of banks that I speak of. The 12 Federal Reserve banks are owned by the private commercial banks of the country. Not one penny of stock in these 12 banks is owned by the United States Government or by the people. The total stock in these 12 banks is about $150,000,000.

The 14,000 commercial banks include not only the national banks and the State banks that belong to the Federal Reserve System, but also the other banks which accept deposits which are State banks and do not belong to the Federal Reserve System, but practically all of them are insured by the Federal Deposit Insurance Corporation.

NO INTEREST SHOULD BE PAID ON LARGE PART

The money that must be secured by our Government after all the bonds have been sold to the public that can be sold, and all the taxes have been paid that can be collected without injuring our domestic economy, can be secured without an interest charge through the use of the 12 Federal Reserve banks. It is right that the Government use the banks for this purpose, because these 12 banks, although privately owned, operate exclusively upon Government credit. These 12 banks have the power to create the money that is placed in circulation and used by the people. Congress has farmed out to them this great privilege. It is the most valuable privilege any government on earth ever delegated or conveyed to an individual group or corporation.

POWER NOT DISPUTED

The sovereign power of Congress to authorize the program that is proposed in the bill I am discussing is beyond question. No one questions the power of Congress to do what I propose.

SIMPLICITY AND SOUNDNESS OF PLAN

In order to demonstrate the simplicity, desirability, and soundness of the plan, I desire to first analyze the status of the present national debt. It will not be my purpose to quote exact figures since exactness is not required for the purpose of this illustration. Let us assume that the national debt now is a round number—$100,000,000,000—which is very close to the actual amount. One-half of the amount is held by individuals and corporations, including mutual-savings banks and life-insurance companies which had the money to lend to the Government in exchange for interest-bearing bonds. The other $50,000,000,000 is held as follows:

Forty-four billion by the private commercial banks which created the money by a flick of the pen to purchase interest-bearing bonds from the Government and which they now hold.

Six billion has been purchased by the 12 Federal Reserve banks by creating it by a flick of the pen, and is now held by these 12 Federal Reserve banks, and the Government will continue to pay interest on it just the same as if the bonds had not been purchased through the use of the Government's credit.

CREATING MONEY IS ACKNOWLEDGED

For fear that someone will think that I am using a very radical and unorthodox word when I say "create" in connection with the banks' creating money with which to buy Government bonds, I want you to know that the highest and best authorities in our Government and in the United States agree that the commercial banks and the Federal Reserve banks actually create money on the Government's credit in order to buy United States Government bonds. There is no dispute about that question. The Honorable Henry Morgenthau, Secretary of the Treasury, admits it. So does the Honorable Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, and all other informed people.

Therefore, the main point for consideration by this committee is whether or not the 12 Federal Reserve banks and the private commercial banks that create money on the Government's credit, should continue this policy and thereby cause the taxpayers to pay interest on it for generations to come.

HOW GOVERNMENT OBTAINS MONEY NOW

Under the present system if the Government desires more money and it is necessary to borrow the money from the banks, the following procedure is adopted:

First. If it desires, the Treasury can deliver bonds to the 12 Federal Reserve banks directly and receive credit for the amount of the bonds on the books of the 12 Federal Reserve banks. Then as the Treasury pays its debts, checks are given on these 12 Federal Reserve banks and the funds are transferred from the Treasury to the ones receiving the checks. In this way the Government is paying interest to the Federal Reserve banks just the same as it pays interest to the private banks and to individuals, although the Federal Reserve banks operate on the Government's credit. If the receiver of a Treasury check in a case like this desires the money instead of credit in his local bank, he is given Federal Reserve notes. These notes are not obligations of the Federal Reserve banks, they are obligations of the United States Government. Therefore, the Government and Congress, particularly, finds itself in the idiotic position of permitting the Treasury to deliver one form of Government obligation—interest-bearing notes—to the privately owned Federal Reserve banks and receiving credit therefor, and then when the Federal Reserve banks are called upon for the money they issue another form of Government obligation, Federal Reserve notes, to satisfy the demand. In each case Government obligations ure used. The net result is that the taxpayers are paying for the use of their own credit.

This power of selling bonds directly to the Federal Reserve banks by the Treasury is authorized by the Second War Powers Act which became a law March 27, 1942, and can only be used to the extent of $5,000,000,000. The question is, if it is good money up to $5,000,000,000 why is it not good money up to $100,000,000,000? However, this does not stop the Federal Reserve banks from buying $100,000,000,000 or $200,000,000,000 of Government bonds in the open market through the Open Market Committee in New York. The restriction of $5,000,000,000 is only on a direct sale from the Treasury to the Federal Reserve banks.

Second. The other way the Treasury would obtain the money would be to sell interest-bearing bonds of the Government to the 14,000 commercial banks. In a sale of that kind a commercial bank receives the Government bond and gives the Treasury credit upon its books for the amount of the bond. Then when the Government pays its bills it gives checks upon this fund in the local commercial bank. The money has been created by a bookkeeping transaction and it is seldom that the one receiving a check from the Government wants the actual money but desires instead credit at the bank. In that way the money is created on the books of the bank but the actual money is not paid out except to a very limited extent. If the one receiving the check, however, desires the actual money and the local bank does not have the money to pay the check, the local bank can obtain it from the nearest Federal Reserve bank by depositing Government bonds as collateral security. The bank will pay the Federal Reserve bank one-half of 1 percent interest on this money. The Federal Reserve bank will pay the Government 30 cents per $1,000 for the money. The net result is that the Government has not gotten anything for the sale of bonds to the public and the collection of taxes, that the United States Treasury deliver to the Federal Reserve banks non-interest-bearing, nonnegotiable Government securities or certificates of indebtedness and obtain from the 12 Federal Reserve banks credit for the amount of the bonds or certificates. Then as the Treasury pays its debts checks will be given on these 12 Federal Reserve banks in the same way and manner as if the bonds were interest-bearing. The ones receiving the checks will receive their money and the same kind of money and in the same way and manner as if the bonds were interest-bearing. The result will be, however, that the Government will be saved interest. In this way the Government can pay each year 2½ percent to the Federal Reserve banks on these bonds or certificates and in 40 years the entire debt will be liquidated, whereas under the present plan our Government can pay 2½ percent each year for 40 years as interest and none of the principal of the debt will be paid but all of the debt will still be due at the end of the 40 years.

Mr. DEWEY. May I query the witness at that point on just that use of currency?

The CHAIRMAN. Yes; go ahead.

Mr. DEWEY. Why did not the Government do that in 1907 and 1912, when there was a money panic, before the organization of the Federal Reserve System, and the country went to clearing-house certificates and there wasn't any currency to go around? They had to go to the only thing that existed at that time, which was the clearing house, and they issued real fiat money to take care of the requirements of trade and industry. As the result of that we put in a system known as the Federal Reserve System, which would supply cash and take it off the market when not needed. The Bureau of Engraving and Printing was in existence then. Why didn't the Government go to the Bureau and buy some of this 30-cents-a-thousand currency and just put it out in the country?

Mr. PATMAN. Of course, the gentleman would not seriously insist that I attempt to answer that question. I was only 14 years old at that time.

Mr. DEWEY. Well, that is what you want to have done now, Mr. Patman.

Mr. PATMAN. I don't know what was in the minds of the people who were in charge of our Government at that time. Of course, I know about the clearing-house certificates from reading the history of the 1907 panic, and I well remember it, because it hit us awfully hard in Texas, and we all suffered from the depression down there. I know they used the certificates, but as to why they didn't resort to other means—there are other means that could have been resorted to. This would not be the only one.

Mr. DEWEY. They did resort to other means, by organizing the Federal Reserve System.

Mr. PATMAN. And remember this, Mr. Dewey, that up until 1917 we had never paid any interest hardly on our national debt, only two or three million a year over a period of 125 years.

Mr. DEWEY. We didn't have any national debt.

Mr. PATMAN. Our interest burden has really not been sufficient to attract our attention except during the last 25 years, and for that reason only should a plan like this be considered.

Mr. DEWEY. We didn't have any national debt.

Mr. PATMAN. That is right; we didn't have any national debt. It was very small. But I cannot answer the question as to why people, 35 years ago, did not do so and so, because I have no way of determining it. But I know one thing; their failure to do it is not sufficient to justify us in ignoring it. I am not willing to ignore a good proposition now because it was not adopted 35 years ago.

The CHAIRMAN. One question right there. You mentioned this money that the Bureau of Engraving and Printing gets out, and all the Government gets for it is the cost of the printing.

Mr. PATMAN. Yes, sir.

The CHAIRMAN. You say the Government get nothing for its credit. The Government isn't out anything.

Mr. PATMAN. It is out its credit. It signed a mortgage; it is behind it. It has pledged all the resources of this Nation to back it up.

The CHAIRMAN. Doesn't it give what Senator Owen and Senator Glass were after, a sound system of banking?

Mr. PATMAN. Certainly.

The CHAIRMAN. That is getting something.

Mr. PATMAN. Certainly; it is a sound system of banklng.

The CHAIRMAN. It is put on a national basis.

Mr. PATMAN. That is right.

The CHAIRMAN. And, of course, that was the trouble before. The banks could not get the money. There was no Federal agency, and no means by which they could get money. This provides a sound system of banking; isn't that right?

Mr. PATMAN. Sure; it is a very fine system. I am not opposed to it; I am for it, but in an unusual case like this, why should we burden the taxpayers on a $300,000,000,000 debt, when we know they will never be able to pay more than just the interest on it? That means a perpetual debt of $300,000,000,000. That means that any inflation that we have in that $300,000,000,000 will remain indefinitely, whereas if you adopt a plan of saving the interest on a substantial part of that money, you can reduce it each year by as much as least as you would pay in interest, and then you reduce the inflationary condition each year instead of having it remain the same each year.

The CHAIRMAN. I haven't any disposition to argue with you. I may agree with you when you get through; I don't know. But if the banks were not to get any interest on this money that the Government borrows, how would you get the banks to lend the money? They say, "It is the money of our depositors; we are responsible for it, and if we don't get anything for the use of it we will just not buy the bonds."

Mr. PATMAN. I don't think that question is involved in this at all.

The CHAIRMAN. I don't know why it wouldn't be involved. They won't furnish the money if they're not going to get any interest on it.

Mr. PATMAN. I am not proposing that. I am proposing that the 12 Federal Reserve banks furnish it, not the commercial banks.

The CHAIRMAN. Suppose the Federal Reserve banks balk?

Mr. PATMAN. They can't balk. They are an agency of the Congress. They have to do what Congress says.

The CHAIRMAN. These bonds can't all be held by the Federal Reserve banks; they have to be scattered throughout the country.

Mr. PATMAN. I am afraid we are talking about different things. I am afraid you are talking about the usual industrial or commercial transaction, and I am talking about the Government finances.

The CHAIRMAN. I beg your pardon. I am sorry; I didn't follow you.

Mr. DISNEY. As I understand it, these banks are heavily loaded with Government bonds, so heavily loaded that a sharp decrease in the value of Government bonds would wipe out their capital stock.

Mr. PATMAN. Two or three points decrease would wipe out their capital stock, but there is no danger of that.

Mr. DISNEY. Suppose there was a sharp decrease in the value of Government bonds, that would have a tendency to wipe out a part of the capital stock of the banks, or some of them, and if any sizeable number of them should get in that position, they would be liable to be in trouble and go broke and take the rest of the banks with them. How could we prevent that?

Mr. PATMAN. That is already provided for, Mr. Disney. The Open Markets Committee, which, by the way, has been moved from Washington to New York, has already arranged that any bank in distress can get a hundred cents on the dollar on its bonds any time. There is where the Government's credit comes into play again. They just issue more Federal Reserve notes to buy those bonds, and they are not going to let the banks suffer. They have already told them they will not let them suffer. There is no danger of that at all.

Mr. DISNEY. No danger of Government bonds——

Mr. PATMAN. Declining; absolutely not. It is, in effect, guaranteed by the United States, and there is no danger in the world. In fact, I think it is a good thing, although it is the Government's credit being used again, free. It is perfectly all right.

Mr. KNUTSON. Right at that point, why did Government bonds drop to 82, along in the fall of 1921?

Mr. PATMAN. Because of a situation you gentlemen had vission enough to guard against when this war started. In 1914, when the war started in Europe, and in 1917, when we became engaged in the war, we did not make any provision to protect the people who bought United States Government bonds. They had to sell them in the open market. Consequently, when the war was over, and everyone wanted to sell their bonds, naturally the market went down and down, and some of them sold as low as 75 cents on the dollar. It was the crime of the age to permit that to be done. Men in the armed services had paid for their bonds a few dollars a month over a period of time. And when they came out of the service they saw these bond manipulators force the price down to 75. It was absolutely a crime. But you gentlemen provided—and if you will remember, I appeared before this committee in connection with that and invited your attention to it, and asked you, for God's sake, to prevent any such thing happening in the future. Not necessarily because of my testimony did you do it, but you provided, anyway, that now they can get their money 100 cents on the dollar, and the people of this Nation should appreciate what this committee did to initiate that type of legislation which will protect them against that awful crime that happened after the other war.

There is one objection to this plan. Mr. Chairman, not a serious objection, not one that you cannot correct, but it is, I am afraid, an objection.

The CHAIRMAN. Which plan are you talking about?

Mr. PATMAN. This plan I am proposing now.

OBJECTION WORTHY OF CONSIDERATION

One objection is urged against this plan which I think is worthy of the greatest consideration. It is that if the commercial banks buy the bonds a part of the excess reserves of the bank will be used in the transaction, but if the Federal Reserve banks buy the bonds and the money is paid out into the country, it is deposited in the local banks and the excess reserves of the local banks are increased by that much, which will be more inflationary than the sale of the bonds to the local banks.

This objection can be overcome completely by permitting the Board of Governors of the Federal Reserve banks to change the reserve requirements of the local banks. In other words, use the same system to contract the reserves of the local banks that is now being used to expand the reserves of the local banks. Mr. Eccles has testified that the objection can be cured that way.

That is the only real objection that has ever been urged to this plan and upon analysis it becomes an excuse rather than a reason for not approving the plan that will save the taxpayers such enormous sums of money annually.

The CHAIRMAN. Where would the banks get the additional reserve? They can't call in their loans very well. If they did, they would wreck the country. It would embarrass the parties to whom they made loans. Where would they get this extra reserve? I am not trying to argue. If they have to increase their reserves, where would they get the increase?

Mr. PATMAN. I will be glad to answer the gentleman's question. If this plan is adopted and we sell a million dollars' worth of bonds, it will require the Federal Reserve to take a million dollars of bonds that are not interest bearing, and nobody doubts the power of Congress to do that. They all admit it. Raleigh, I guess, is your Federal Reserve bank, is it not?

The CHAIRMAN. No; Charlotte.

Mr. PATMAN. All right; at Charlotte there is a credit of $1,000,000. When they pay the Postmaster and the rural carriers and the Honorable Bob Doughton their salaries, they will take their checks to the local bank, a commercial bank, and deposit them, and the local commercial bank can use those deposits as excess reserves and purchase any kind of paper, 5, 8, or 10 times as much as that, depending on what the reserve requirements are at that time. I will admit that that will cause an inflationary condition, but you can correct it by changing the reserve requirements of that bank so that it could not lend more than 2 to 1, or 3 to 1, or more than $1 for one—100 percent reserves. Mr. Eccles suggested that before the Banking and Currency Committee. That would completely stop the inflationary condition and save interest.

The CHAIRMAN. Do you think a bank could live and pay its stockholders any dividends if it were forced to keep such large reserves? They couldn't make any money.

Mr. PATMAN. Oh, they would make money. I provide in this bill that they shall be allowed to take and hold a reasonable amount of bonds. Let them have enough bonds to live and render the fine service they are now rendering, but not let them have unlimited bonds on the Government credit in an unusual critical situation like we are in now, where the war debt must be increased by hundreds of billions. That is just going too far. But I provide in this bill, Mr. Doughton, that they may have as many bonds as they had December 31, 1941, and they had a pretty good supply of bonds.

The CHAIRMAN. How would they get those bonds?

Mr. PATMAN. They could buy them in the open market, or directly from the Treasury.

The CHAIRMAN. Wouldn't they have to draw on their reserves to buy them?

Mr. PATMAN. That would be all right.

The CHAIRMAN. Wouldn't that cut their reserves down? How could you go on the market and buy bonds, and at the same time hold up your reserves?

Mr. PATMAN. I respectfully submit that is no problem in this plan.

The CHAIRMAN. That is not the question I asked. You say they have to have a reserve, and they go into the open market and buy bonds. I say they can't go into the market without reserves.

Mr. PATMAN. They have the money.

The CHAIRMAN. They can't have the bonds and the reserves both. You know that.

Mr. PATMAN. They have plenty of reserves, Mr. Doughton, and I would be in favor of having plenty of reserves. If they want more reserves, they could sell a million dollars' worth of bonds to the open-market committee and get a million dollars in Federal Reserve notes, and then buy $10,000,000 of United States Government bonds. They will have no trouble in getting reserves.

The CHAIRMAN. Would they be interest-bearing or non-interest-bearing?

Mr. PATMAN. They would be interest-bearing. There is no trouble about reserves. That could be changed up or down, and I am presenting in my testimony here, which I will not take the time to read, evidence along that line.

The CHAIRMAN. Let me see if I understand it. The bonds that the Federal Reserve banks hold would bear no interest, but the bonds that the commercial banks hold would bear interest.

Mr. PATMAN. Yes; you see the commercial banks are entitled to a profit.

The CHAIRMAN. What percentage of the total loan now outstanding would the Federal Reserve have and what percentage would the commercial banks have?

Mr. PATMAN. That depends on how much we spend in the war and on how much the public will buy and the insurance companies and other corporations that have money to buy the bonds with; and, in addition, how much money can be collected in taxes to retire part of it.

The CHAIRMAN. If they bought them all, then you wouldn't have to get any loans from the Federal Reserve?

Mr. PATMAN. I would love to see it that way. If the public and the life-insurance companies and the other people having money would buy it, that is the way to do it. But it will not work, Mr. Chairman; we know it will not work. They don't have the money. It has to be created; so, since it has to be created, should we always pay interest on that part?

The CHAIRMAN. How much do you save—say on $200,000,000,000, how much do you estimate the Federal Reserve banks would hold on which there would be no interest paid?

Mr. PATMAN. I estimate 50 billion, something like that.

The CHAIRMAN. That is one-quarter.

Mr. PATMAN. Yes; but if you save a quarter of $4,000,000,000 a year and you have saved $1,000,000,000, and after this war is over, my dear sir, and when we have industrial activity then the banks will want to unload these bonds, individuals will want to sell their bonds, and money will have to be created in order to take care of them. Then the Federal Reserve could save more money—I am not trying to hurt the commercial banks, but the chairman of this committee knows——

The CHAIRMAN. How would this money to take up all these bonds be created?

Mr. PATMAN. In the same way and manner it is now created, by just a flick of the pen, if you want to call it that. That is the power of the Federal Reserve banks, to create money. They are doing it to the amount of $5,000,000,000 now by direct purchases.

The CHAIRMAN. Would it be logical to just create money that way now?

Mr. PATMAN. No, because you would have unlimited inflation, ruinous inflation. I don't want to do that. I would love to sell all the bonds to the public and the corporations having the money to buy, but we cannot sell the bonds that way. The people do not have the money and we have go to create it. I don't want the taxpayers of this Nation to pay interest for the next two or three hundred years. That is the point I am trying to make—just the part that must be created anyway, on the credit of the Government.

The CHAIRMAN. Why not create that independent of the Federal Reserve banks; just leave them entirely out of it?

Mr. PATMAN. Well, that is the best way to do it, I think. You wouldn't have any control otherwise. You have got to have a simple, desirable plan that is sound. I think that is the soundest way to buy them. But it is impossible to sell enough bonds to the public.

Mr. DISNEY. You mean through the Federal Reserve?

Mr. PATMAN. The Federal Reserve. All the bankers tell you that they shouldn't buy these bonds. They know it is highly inflationary. The bankers are patriotic people; they spend their own money to get the public to buy them and they are doing their best to get the public to buy them. But it is impossible to sell enough bonds to the public to finance this war, and a large part of it must be created, and I say the part that must be created on the Government's credit, the Government should not pay interest on.

Let me read you just a few questions and answers, from Mr. Eccles's testimony in 1941, before the Banking and Currency Committee. I am interrogating:

"Mr. PATMAN. The stock is less than $140,000,000 and you do several hundred billions dollars' worth of business a year sometimes, and furthermore, when you actually hold and claim now over $2,000,000,000 in Government securities which you claim you bought. How did you get the money to buy those $2,000-000,000 of Government securities?

"Mr. ECCLES. We created it.

"Mr. PATMAN. Out of what?

"Mr. ECCLES. Out of the right to issue credit, money.

"Mr. PATMAN. And there is nothing behind it, is there, except the Government's credit?

"Mr. ECCLES. We have the Government bonds.

"Mr. PATMAN. That's right, the Government's credit.

"Mr. ECCLES. That is what your money system is."

There is the highest authority in the Federal Reserve bank. There is no question about this, gentlemen. There is no dispute about what I am saying. You will not find a witness who will deny what I say. It is undisputed. There is no controversy about it.

Mr. KNUTSON. Does Mr. Eccles endorse your plan?

Mr. PATMAN. Oh, I am sure he wouldn't because he believes there should be interest paid on all Government bonds. He is opposed to starting any other system. He don't want a change. Ordinarily, that may be right, but when you have such an unusual condition, when our national debt will be 10 times as high as it has ever been in the history of our country, don't you think we should consider any plan that might save the taxpayers money?

Mr. DEWEY. Mr. Patman, you want to create some more money, or funds for the Government in these wartimes. We have been hearing a great deal about this inflationary gap.

Mr. PATMAN. Yes, sir.

Mr. DEWEY. Which is the excess funds in the hands of the public which may come into competition for a large amount of commodities?

Mr. PATMAN. Yes, sir.

Mr. DEWEY. For that reason we are considering increasing the tax bill and enforced savings.

Mr. PATMAN. That is right.

Mr. DEWEY. You want to create more.

Mr. PATMAN. No.

Mr. DEWEY. Why not exhaust that excess spending power of the public before creating new money?

Mr. PATMAN. That is perfectly all right, my dear sir. If you could get the money to finance this war by selling bonds to the public who have the money to buy them, and through the collection of taxes, such as you propose, or in any other way, I am for it. But——

Mr. DEWEY (interposing). It is understood——

Mr. PATMAN. Let me finish. But we have demonstrated we cannot sell enough bonds to the public, we cannot levy enough taxes to balance our expenditures in this war and the difference, my dear sir, has got to be created money on the Government's credit, and my point is what we create on the Government's credit we should not pay interest on for the next two or three hundred years.

Mr. DEWEY. What percentage of the debt was carried by the banks during the last war?

Mr. PATMAN. I don't know, but the last war was merely a fist fight compared to this one, so far as expenditures are concerned.

Mr. DEWEY. In proportion to the national income, the Government bonds sold in the last war was a very small percentage. We sold most of the bonds to the public and I don't see why we couldn't do it this time.

Mr. PATMAN. Well, we can't do it, because the Government knows the people do not have the money.

Mr. DEWEY. We just agreed that the public is in possession of that inflationary gap. That has been brought out by every person that has testified here, from Treasury officials on down.

Mr. PATMAN. Let me read a little more of the testimony of Mr. Eccles, in answer to questions asked him by Mr. Dewey. I have had an awful time getting these things, Mr. Chairman. The witnesses have shown irritation, sometimes, in being compelled to answer questions, but over a period of years I have gotten the Secretary of the Treasury, Mr. Morgenthau, the Under Secretary, Mr. Bell, and Mr. Eccles and other high officials of the Government to prove every statement that I make concerning this. I mean not my own opinions or conclusions, but statements of fact. I have other testimony to prove it. Let me read Mr. Eccles' testimony when he was interrogated by Mr. Dewey on June 17, 1942 (reading):

"Mr. ECCLES. No; the Federal Reserve would buy in the open market. If the Federal Reserve then bought a billion dollars of securities in the open market that would be new Treasury issues. The banks would still hold them, and the Federal Reserve would put into the banks another billion of excess reserves. If they used that billion they could buy 5 billion more of Governments, and you could keep the price up. For every billion of the Federal Reserve banks put in the open market operations, the private banks could buy 5 billion.

"Mr. DEWEY. That comes pretty close to some other ideas I have heard.

"Mr. ECCLES. I mean they could buy 10 billion. I mean the Federal Reserve when it carries out an open market operation, that is, if it purchases Government securities in the open market, it puts new money into the banks which creates idle deposits.

"Mr. DEWEY. There are no excess reserves to use for this purpose.

"Mr. ECCLES. Whenever the Federal Reserve System buys Government securities in the open market or buys them direct from the Treasury, either one, that is what it does——

"Mr. DEWEY. What are you going to use to buy them with?

"Mr. ECCLES. What is who going to use?

"Mr. DEWEY. The Federal Reserve to make these purchases.

"Mr. ECCLES. What do they always use?

"Mr. DEWEY. You are going to create credit?

"Mr. ECCLES. That is all we have ever done. That is the way the Federal Reserve System operates. The Federal Reserve System creates money. It is a bank of issue."

What better evidence do you want than that, gentlemen? There is no dispute about what I say, and I insist it is absolutely wrong for this committee to permit this condition to continue and saddle the taxpayers of this Nation with a burden of debt that they will not be able to liquidate in a hundred years or two hundred years.

Do you know that we are carrying a million dollars' worth of bonds that were issued during the War between the States and we have paid 4 billions in interest for every $1 that was borrowed? We are still paying on them and still owe them. Do you know that on the Panama Canal convertible 3's, we have already paid more than $50,000,000 in interest and we will soon have paid $75,000,000 in interest and still owe the $50,000,000 principal on those bonds? If you judge the future by the past, the people will be compelled to pay a dollar, $2, and $5 in interest for every $1 they borrow. Does any man, then, say that we shouldn't seriously consider any plan that will enable the taxpayers of this Nation to make that payment on the principal of the debt and not on the interest? Two and a half million each year, and in 40 years liquidating the entire debt, and removing that inflationary condition that we will have by reason of the expenditures during this war.

W. L. Hemingway, president of the American Bankers' Association and of the Mercantile-Commerce Bank & Trust Co., St. Louis, in a speech on our national debt before the Chamber of Commerce of the State of New York, in New York City, said:

"The war must and will be financed. It can be done in one of three ways—first, by printing paper money, Uncle Sam's demand I O U's. Fortunately this generation has seen the evils of that route and will have none of it. The second is by borrowing from the Federal Reserve banks directly, but that is but little removed from the paper money way because the Reserve banks would issue the money against the Government's notes or give credit on their books to the Government, which would pay it out for war purposes. It would then flow into the commercial banks increasing their legal reserves, thus inviting further inflation. So we come to the third and least objectionable way, and that is by borrowing from the public and the banks.

"Both the Treasury and the banks want to see the banks buy as small a part of the succeeding issues as possible, because both understand that when the banks buy the bonds new bank credit or money is created and remains in circulation until their bonds are paid or taken by the public—an inflationary act to be avoided as much as possible. The banks should be only underwriters and distributors and not permanent investors."

I invite your attention to the following with reference to Mr. Hemingway's statement:

First, he says that banks should not be permanent investors of United States Government bonds.

Second, that it is highly inflationary for banks to buy United States Government bonds.

Third, in the second way, he says the war can be financed by borrowing from the Federal Reserve banks directly, he also says that is but little removed from the paper-money way because the Reserve banks would issue money against the Government's notes or give credit on their books to the Government, which would pay it out for war purposes. He could have very well added that the sale of Government bonds to commercial banks is no further removed from paper money than the sale to Federal Reserve banks if the excess reserves of banks are properly handled.

Reasons why commercial banks should not purchase bonds are contained in a statement of the Secretary of the Treasury issued April 25, 1942. It is as follows:

"If the Government is compelled to go to the commercial banks for the bulk of these funds, the result will be to increase inflationary tendencies which are already serious. This is true because when commercial banks buy Government bonds they do not pay for them with actual cash taken from their vaults, but by placing on their books newly created deposits to the credit of their Government. When the Government draws upon those deposits to pay for the goods and services it buys, the purchasing power of those to whom these payments are made is increased without any decrease in the purchasing power of those from whom the money is borrowed."

When Mr. Eccles, Chairman of the Board of Governors of the Federal Reserve System was before the Banking and Currency Committee, September 30, 1941, I interrogated him at length about the banks creating money on the Government's credit.

When Mr. Morgenthau, Secretary of the Treasury, and Mr. Bell, his Under Secretary, were before the Banking and Currency Committee on September 24, 1941, testifying on the price-control bill, I interrogated Mr. Morgenthau about banks creating money. He suggested that Mr. Bell, his Under Secretary, answer the questions. Mr. Bell was sitting by Mr. Morgenthau's side and the following questions were asked and the following answers were given, as disclosed on page 1132, volume 2, of the printed hearings on that bill:

"Mr. PATMAN. In other words, when you sell a Government bond to a commercial bank, you allow the bank then to create the money.

"Under Secretary BELL. That is right. We want to avoid that, as far as we can.

"Mr. PATMAN. By a bookkeeping transaction?

"Under Secretary BELL. Yes, sir; in the first instance.

"Mr. PATMAN. And that increases the supply of money, just as much as if the country issued greenbacks directly?

"Under Secretary BELL. It increases the supply of money, but I would not say it has the same effect.

"Mr. PATMAN. It increases the supply of money to exactly the same amount as if the Government issued the credit directly?

"Under Secretary BELL. That is probably right."

I doubt that anyone would want any higher authority on the question of commercial banks creating money to buy Government bonds than the testimony just quoted.

When Mr. Marriner S. Eccles, Chairman of the Board of Governors of the Federal Reserve System, testified before the Banking and Currency Committee of the House, June 24, 1941, the following questions were asked and the following answers given, at page 68 of the printed hearings on S. 1471, a bill to amend the Federal Reserve Act.

"Mr. PATMAN. Going back to this issue as to the Government's credit, is it a fact that the $20,000,000,000 that the commercial banks of the country hold today in United States Government bonds were purchased with created money?

"Mr. ECCLES. Is it not a fact that what?

"Mr. PATMAN. The $20,000,000,000 of Government bonds, approximately, that they purchased these bonds with created money.

"Mr. ECCLES. What 20 billion of bonds?

"Mr. PATMAN. That the banks hold today; approximately—between 19 and 20 billion dollars.

"Mr. ECCLES. I do not know excatly what the banks hold."

"Mr. PATMAN. Well, that is not the main point. In other words, the bonds that the banks hold today—they created the money to buy those bonds, did they not?

"Mr. ECCLES. The banking system as a whole creates and extinguishes the deposits as they make loans and investments, whether they buy Government bonds or whether they buy utility bonds, or whether they make farmers' loans.

"Mr. PATMAN. I am thoroughly in accord with what you say, Governor, but the fact remains that they created the money, did they not?

"Mr. ECCLES. Well, the banks create money when they make loans and investments.

"Mr. PATMAN. All right; and these Government bonds were one of the investments.

"Mr. ECCLES. That is correct.

"Mr. PATMAN. Now we are back to where we were. The banks created the money to buy $20,000,000,000 or whatever it was in Government bonds. Therefore it has increased the available money supply by $20,000,000,000 did it not?

"Mr. ECCLES. Yes: that is true, if those are the figures representing the increase in commercial banks. I think those figures are excessive.

"Mr. PATMAN. It is over 19 billion, anyway?

"Mr. ECCLES. I think those figures represent a large investment of savings funds.

"Mr. PATMAN. I believe they do. Anyway, the commercial banks when they buy bonds or anything else, create the money, so to speak, to buy them with?

"Mr. ECCLES. That is right."

Mr. Eccles testified before the Banking and Currency Committee June 17, 1942, on a bill to amend the Federal Reserve Act. His testimony which appears at page 15 of the hearings, discloses that commercial banks can buy all the bonds they desire to buy and if they are called on for money to pay their depositors the nearest Federal Reserve bank can always furnish them the money they need. His testimony is as follows:

"Mr. PATMAN. Is it not a fact that you did send out letters to the banks which made the statement that the Federal Open Market Committee was ready to buy all the bonds at par?

"Mr. ECCLES. No, sir; not buy, but we adopted a policy, each bank did, that would loan par on them.

"Mr. PATMAN. That would loan par on Government securities?

"Mr. ECCLES. Yes.

"Mr. PATMAN. Do you charge the interest rate that is effective in that particular Federal Reserve district?

"Mr. ECCLES. One percent.

"Mr. PATMAN. One percent?

"Mr. ECCLES. Yes.

"Mr. PATMAN. Have you ever told all the banks that you stand ready to make loans at par at a 1 percent interest rate?

"Mr. ECCLES. Each Federal Reserve bank has done that."

Since Mr. Eccles testified, the interest rate has been reduced to one-half of 1 percent. It is doubtful that the banks will need the money, but if they do the Government, through the Bureau of Engraving and Printing, will furnish it to them. The Federal Reserve banks will pay 30 cents per $1,000 approximately, for the currency, and the commercial banks will pay $50 per $1,000 interest per year, but will continue to receive interest on the bonds that they deposit with the Federal Reserve banks to obtain the money at one-half of 1 percent.

Mr. Eccles' testimony before the Banking and Currency Committee, June 17, 1942, commencing at page 16, of the hearings on the bill to amend the Federal Reserve Act, is as follows:

"Mr. PATMAN. What are the excess reserves on the money market at the present time?

"Mr. ECCLES. They are running around two billion five hundred million.

"Mr. PATMAN. How much could they buy in Government bonds if they were to use the excess reserves to the limit?

"Mr. ECCLES. About $12,000,000,000.

"Mr. PATMAN. $12,000,000,000?

"Mr. ECCLES. Yes, sir; that is, assuming that the deposit structure and the present structure does not change.

"Mr. PATMAN. It would be about $12,000,000,000.

"Mr. ECCLES. Yes; you see, the Federal Reserve requirement is about 20 percent.

"Mr. PATMAN. Yes, sir.

"Mr. ECCLES. For the country it is 14, and for central Reserve cities it is 20, and for the Reserve cities it is 26, so that we figure in about a 20-percent reserve requirement, so that on the basis of $2,250,000,000, if that were all fully utilized on the fractional reserve basis, I would estimate that they could buy about $12,000,000,000 worth of Governments, that is, if it were utilized fully and completely through the entire reserve, all the banks.

"Mr. PATMAN. Suppose today they bought those $12,000,000,000 of bonds, what would they have back of those bonds to support them in addition to what they have now? In other words, what increased assets would the bank have except the Government bonds?

"Mr. ECCLES. They would have the Government bonds themselves, which would be an asset, and they would have a liability, however, in the form of a deposit.

"Mr. PATMAN. That is right."

Then further:

"Mr. PATMAN. Let us suppose that the banks are called upon to buy $12,000,000,000 of Government bonds today. That consumes all their excess reserves. If you wanted to increase their excess reserves in order to buy another $12,000,000,000 of Government bonds, how would you do that, through the Federal Open Market Committee?

"Mr. ECCLES. We might decrease the reserve requirements.

"Mr. PATMAN. How would you decrease them?

"Mr. ECCLES. I think it runs between $5,000,000,000 and $6,000,000,000.

"Mr. PATMAN. Between $5,000,000,000 and $6,000,000,000?

"Mr. ECCLES. Yes; somewhere between $5,000,000,000 and $6,000,000,000.

"Mr. PATMAN. If it were decreased as you suggest, that would enable you to buy how many bonds?

"Mr. ECCLES. If we decreased it to the full amount, then the reserve requirements are 10 percent instead of 20 percent, and you can buy about 10 to 1.

"Mr. KEAN. What does change it from 5 to 1 to 10 to 1? Would you explain that again?

"Mr. ECCLES. As it is, the requirements of the Federal Reserve Bank System of the country as a whole are about 20 percent. If we changed the reserve requirements to the full amount we could then say the reserve requirements are only 10 percent instead of 20 percent, and you can get about 10 to 1, and that would be about $50,000,000,000.

"Mr. PATMAN. After you have already reduced the reserve requirements of the banks and have bought these $50,000,000,000 in bonds, if you need to buy still more, how would you handle the others? Suppose you wanted to call upon them to buy $25,000,000,000 more in bonds?

"Mr. ECCLES. We would carry it on then, if it were necessary, by an open-market operation.

"Mr. PATMAN. In other words, you would buy a billion dollars' worth of bonds. What would be the effect of that billion dollars on the banks?

"Mr. ECCLES. If they could get a billion dollars they could buy up about $10,000,000 in bonds."

June 19, 1942, Mr. Eccles testified before the Banking and Currency Committee of the House on the amount of Government bonds that any bank could purchase. His testimony is as follows, at page 41 of the hearings on the bill to amend the Federal Reserve Act.

"Mr. PATMAN. In the bill we passed here a few days ago, creating the Smaller War Plants Corporation, there was an amendment offered by the gentlewoman from Illinois, which was adopted and it is now a part of the law, providing that there should be no limitation on the amount of a loan to any person or corporation by any bank, providing, of course, that the loan is guaranteed by the Government, or some agency of the Government.

"Have you given consideration to that amendment, Mr. Eccles?

"Mr. ECCLES. Are you referring to the technical aspects of it?

"Mr. PATMAN. No; I am talking about—suppose a bank had a capital stock of $250,000, should they, under this amendment, negotiate a loan for say $5,000,000 if it is guaranteed by the Government or some agency of the Government?

"Mr. Eccles. It would take the limit off. There is no limit to the amount of Government bonds, for instance, that a bank can buy. Its only limit is its supply of funds.

"Mr. Patman. You mean there is no limit now?

"Mr. Eccles. That is right.

"Mr. Patman. This amendment did not cause that—it was already that way.

"Mr. Eccles. No; the difference is—there has been no question about direct obligations of Governments. This was simply a case of recognizing the loans which were guaranteed as having the same status as a direct Government obligation."

On the same day Mr. Eccles testified, at page 25 of the hearings:

"Mr. Patman. Mr. Eccles, the day before yesterday I had gotten down to the point where, if we needed more money, one way to give the banks extra reserves to purchase Government bonds would be for the Open Market Committee to buy Government bonds in the open market, and I suggested if you bought for the Federal Reserve bank one billion dollars' worth of bonds, that would automatically create a billion dollars of reserves in the banks, and, after the reserves had been reduced to 50 percent, the maximum that would enable the banks to purchase $50,000,000,000 worth of bonds. Now, let us assume that has happened——

"Mr. Eccles. $10,000,000,000 worth by the purchase of a billion dollars' worth of bonds in the market?

"Mr. Patman. I got the two mixed up. The purchase of a billion dollars' worth of bonds in the market, after the excess reserves had been reduced, will enable the banks to buy ten billion?

"Mr. Eccles. That is right.

"Mr. Patman. Where the fifty billion came in was if you would automatically reduce the reserves now, which you have a right to do, that would give them $5,000,000,000 of excess reserves, which they could use to purchase $50,000,000,000 worth of bonds.

"Mr. Eccles. That is right.

"Mr. Patman. Now let us assume that we not increase the reserves in the banks, and you go into the market and buy a billion dollars' worth of bonds; you buy them with Federal Reserve money, do you not?

"Mr. Eccles. Well, we buy them with Federal Reserve credit.

"Mr. Patman. I know; but suppose the banks call for the money, you issue Federal Reserve notes, do you not?

"Mr. Eccles. What we do, if we purchase Government securities in the market, is we credit the account of the bank that turns them in. They usually come through the banks.

"Mr. Patman. That is right.

"Mr. Eccles. Even though they may be individuals who are selling the securities; and we debit the bond purchase account, showing that the Federal Reserve has a liability to the banks to the extent of $1,000,000,000, which represents their reserves on the one hand, and that they own $1,000,000,000 of bonds in what we call the portfolio, on the other hand.

"Mr. Patman. I know in practice that is exactly the way it is done, Mr. Eccles, but suppose the banks want the billion dollars in currency, you would pay it in Federal Reserve notes, would you not?

"Mr. Eccles. That is right.

"Mr. Patman. Those Federal Reserve notes, as we have often discussed, are obligations of the United States Government?

"Mr. Eccles. That is right.

"Mr. Patman. Then you use those Government obligations to buy interest-bearing Government obligations and you place them with the Federal Reserve banks—12 of them?

"Mr. Eccles. That is right.

"Mr. Patman. And they would continue to receive interest on those Government obligations as long as they were outstanding?

"Mr. Eccles. That is right."

On June 17, before the same committee, at page 21 of the hearings on the bill to amend the Federal Reserve Act, Mr. Eccles testified:

"Mr. Eccles. No; the Federal Reserve would buy in the open market. If the Federal Reserve then bought a billion dollars of securities in the open market that would be new Treasury issues. The banks would still hold them, and the Federal Reserve would put into the banks another billion of excess reserves. If they used that billion they could buy five billion more of Governments, and you could keep the price up. For every billion of the Federal Reserve banks put in the open market operations, the private banks could buy five billion.

"Mr. Dewey. That comes pretty close to some other ideas I have heard.

"Mr. Eccles. I mean they could buy ten billion. I mean the Federal Reserve when it carries out an open-market operation, that is, if it purchases Government securities in the open market it puts new money into the banks which creates idle deposits.

"Mr. Dewey. There are no excess reserves to use for this purpose.

"Mr. Eccles. Whenever the Federal Reserve System buys Government securities in the open market or buys them direct from the Treasury, either one, that is what it does——

"Mr. Dewey. What are you going to use to buy them with?

"Mr. Eccles. What is who going to use?

"Mr. Dewey. The Federal Reserve bank to make these purchases.

"Mr. Eccles. What do they always use?

"Mr. Dewey. You are going to create credit?

"Mr. Eccles. That is all we have ever done. That is the way the Federal Reserve System operates. The Federal Reserve System creates money. It is a bank of issue."

Mr. Allan Sproul is president of the New York Federal Reserve Bank, which is manager of the open-market system for the Federal Reserve System. On January 18, 1943, he addressed the bankers of the State of New York and stated:

"Reserve banks are backing the commercial banks in investing to the limit in war financing."

Further it was said in his speech:

"President of New York bank tells bankers of New York State that the Federals are here to save them from embarrassment if withdrawals reduce reserves."

In other words, the Federal Reserve System will continue to furnish all the money that the private banks need to pay their depositors in the event that it is needed and then they can purchase all the bonds they want to purchase with the assurance that the Government printing presses will protect them.

The Federal Reserve Bank of New York is acting as the manager of the Federal Reserve's open market system. This system is the most powerful factor in the money market in the United States. Washington authorities often do not know of important rules and regulations that the New York bank has put into effect until long afterward.

In connection with the question of how excess reserves are manipulated in order to permit commercial banks to buy additional bonds, the following is quoted from the bulletin published by the National City Bank of New York, October 1942.

"In order to provide the additional funds required, the Federal Reserve banks have bought over $1,000,000,000 of Government securities in the open market since April, and have twice reduced the percentages of required reserve against deposits of member banks in the central reserve cities of New York and Chicago. The latter action followed enactment of legislation in July authorizing the Reserve Board to reduce reserve requirements for the rest of the country; and the reductions were confined to New York and Chicago by reason of the drain imposed upon these centers by the steady flow of funds to areas where war industries are located.

"The first reduction, from 26 to 24 percent against net demand deposits, came on August 20, and released approximately $345,000,000 of reserves in New York City and $70,000,000 in Chicago. Within less than a month—on September 14—the second reduction, from 24 to 22 percent, was ordered, adding about the same amounts to excess reserves, on September 23, the "excess" totals in the two main financial centers were again approaching their earlier lows, while the total of slightly over $2,000,000,000 reported for all member banks was the lowest since 1938."

When Dr. E. A. Goldenweiser, Director of Research and Statistics for the Board of Governors of the Federal Reserve System, testified before the Banking and Currency Committee of the House on October 1, on the price-control bill, the following questions were asked and the following answers give, page 1538, volume 2, of the hearings.

"Dr. Goldenweiser. The total reserves of the Federal Reserve are about 20½ billion, not 23 billion.

"Mr. PATMAN. I am talking about the total gold supply that is either owned by the United States Government or claimed by the Federal Reserve banks through the——

"Dr. GOLDENWEISER. The amount of the stabilization fund is not available to the Federal Reserve.

"Mr. PATMAN. No; but I am presuming that it will be available. That will be 23 billions?

"Dr. GOLDENWEISER. All right.

"Mr. PATMAN. That leaves 16 billions unattached?

"Dr. GOLDENWEISER. Yes.

"Mr. PATMAN. How much bonds could the Federal Reserve Open Market Committee buy in the United States, Government bonds, based upon that?

"Dr. GOLDENWEISER. It depends on how much of it will be in deposits and how much in notes. But, roughly speaking, about three to three and a half times.

"Mr. PATMAN. Three and a half times?

"Dr. GOLDENWEISER. No; not three and a half times. From two and a half to three times.

"Mr. PATMAN. That would be about $40,000,000,000?

"Dr. GOLDENWEISER. That is right.

"Mr. PATMAN. When that money is paid out, suppose they pay it to the commercial banks, they could expand about five to seven to one on that, couldn't they?

"Dr. GOLDENWEISER. If they paid that much assessment.

"Mr. PATMAN. Yes; they would have the power to under the existing law?

"Dr. GOLDENWEISER. That is right.

"Mr. PATMAN. That means that, say, an average of six times—that is about right now, isn't it—about six?

"Dr. GOLDENWEISER. Approximately.

"Mr. PATMAN. That means that they could inflate about $240,000,000,000 more?

"Dr. GOLDENWEISER. That is right."

It will be noted that the Federal Reserve banks and the commercial banks could expand their deposits sufficiently to purchase $240,000,000,000 worth of Government bonds at the time Dr. Goldenweiser testified. When the reserves are reduced to the limit that they can be reduced, these banks may purchase as much as $480,000,000,000 of Government bonds without having any more capital stock or assets than they now have except, of course, as Mr. Eccles always adds, that they will have the Government bonds.

The taxpayers have paid at least $4 for every dollar that was borrowed on the $1,000,000 now outstanding on the debt created during the War between the States. It is possible that the taxpayers will pay several dollars for each dollar borrowed before the debt is fully liquidated.

In the hearings on the price control bill, in 1941, volume 2, commencing on page 1354, the following testimony appears:

"Mr. Chairman, I desire to insert in the record two question that I have submitted to Mr. Morgenthau, under date of February 4, 1941, and his answers under date of February 15, 1941.

"The CHAIRMAN. They will be incorporated in the record.

"Mr. PATMAN. I asked Secretary Morgenthau the following question:

" 'Your annual report for the year ending June 30, 1940, on page 730 discloses that there are outstanding now $758,945,800 in Treasury bonds that were issued October 16, 1922, and bearing 4½ percent interest. Please advise how much interest the Government will have paid on these bonds by October 15, 1947, and also by October 15, 1952.'

"Mr. Morgenthau's answer was as follows:

" 'The annual interest charge on the 759.9 million dollars of 4½ percent Treasury bonds of 1947–52 outstanding on June 30, 1940, is 32.3 million dollars. For the 25-year period from their date of issue to their first call date, October 15, 1947, the total interest payments with respect to the amount of bonds outstanding on June 30, 1940, would be about 806.4 million dollars; and for the 30-year period from date of issue to final maturity on October 15, 1952, would be about 967.7 million dollars.'

"Mr. PATMAN. Then I asked this question:

" 'On the same page of the same report it is disclosed that there are $49,800,000 of Panama Canal loan bonds outstanding, which were issued June 1, 1911, and are redeemable or payable June 1, 1961, with a rate of interest of 3 percent.

Please advise how much interest has been paid on these bonds to date and how much will have been paid by June 1, 1961.'

"And his answer was:

" 'The annual interest charge on these 49.8 million dollars of 3 percent Panama Canal bonds of 1961 outstanding on June 30, 1940, is about 1.5 million dollars. For the 29½-year period from their date of issue to December 1, 1940, the total interest payments with respect to the amount of bonds outstanding on June 30, 1940, would be about $44,000,000; and for the 50-year period from date of issue to maturity on June 1, 1961, would be about $75,000,000.' "

It will be noticed that in each of the cases inquired about the interest charges will be considerably in excess of the principal amount borrowed. This is typical of long-term bonds. Almost invariably the taxpayers are compelled to pay more interest than the amount of the principal on all long-term bonds, not only Federal, but also States and cities. In the case of the Panama Canal bonds, the taxpayers will be required to pay $75,000,000,000 in interest by the time the bonds are due and will then still owe the $49,800,000 originally borrowed. Other similar instances could be cited.

Mr. ROBERTSON. Mr. Chairman, I would like to ask a question. Mr. Patman, as you probably know, some have been unkind enough to refer to your plan as the issuance of printing-press money. Now, in order to get the difference between your plan and printing-press money, will you give us a plain and concise definition of printing-press money?

Mr. PATMAN. That depends on which plan you are talking about. You know, you couldn't have any more printing-press money than you are using today. If you think we are slipping into greenbackism, you can say we have already slipped, because that is what we are using now for money. It is just one of those obnoxious terms that people are wont to use against any plan they do not favor.

Mr. KNUTSON. Mr. Patman, I have heard it charged—I don't know but what I have heard you say it, that up to 1862 some similar plan to what you propose was before the Treasury Department in this country.

Mr. PATMAN. No, I don't think so, Mr. Knutson, but I will say this, that in 1861–65 there were $356,000,000 of money issued, and on a 5-percent annual-interest basis, more than $11,000,000,000 of interest on that money has been saved and the money is still outstanding, and that is just an example of what can be saved if you adopt this plan instead of committing the taxpayers to forever paying interest on this debt.

Mr. KNUTSON. I am asking for information. What was the market history of that money?

Mr. PATMAN. You mean the United States notes?

Mr. KNUTSON. Yes; the greenbacks.

Mr. PATMAN. Well, they went down when they had no support behind them at all, and when they could be used only for a limited purpose.

Mr. KNUTSON. How far down did they go?

Mr. PATMAN. I don't know. They went down——

Mr. KNUTSON. Thirty-five cents?

Mr. PATMAN. Then the Government made them good for all purposes and placed some gold behind them. Of course, there is no danger on earth of any money outstanding. Take Federal Reserve notes, there is some criticism about those. There is no danger of those notes going below par. They will always be worth a hundred cents on the dollar. Those notes happened to be issued because they had them printed over there—I am giving you my opinion only. They may have had a different reason for it—and it is true they are obligations of the Federal Reserve banks. The Government permits the Federal Reserve banks to issue notes on the Government credit to the extent of tens of billions of dollars, so why should the Federal Reserve banks object to these notes being in circulation, which are obligations of the Federal Reserve banks to the extent of two-thirds of a billion dollars?

Mr. KNUTSON. It is my recollection those notes went down to thirty-five cents, around 1864.

Mr. PATMAN. I am sure they went down.

Mr. KNUTSON. Between 1864 and 1867.

Mr. PATMAN. There was nothing to keep them from it, when they were only good for a limited purpose.

Mr. KNUTSON. What was the limited purpose?

Mr. PATMAN. I don't know, it has been so long since I read their history, but I know they were restricted in use, and they went down. Senator Owen could tell you.

Mr. KNUTSON. They were currency. The greenbacks that were issued during the War between the States were currency and circulated as such. I don't think there was any restriction on its use, how the money could be used.

Mr. PATMAN. Well, I hope the gentleman would not want to use that as a reason why this plan should not be adopted.

Mr. KNUTSON. The only reason I inquire is that I was in Germany immediately following the war, and I will never forget that I had to pay 1,250,000 marks, that had a normal value of one-quarter in dollars, which would be about $300,000, for a breakfast consisting of half an orange, a very small piece of ham, one egg, dry toast, and a cup of coffee that I couldn't drink. I thought it was a little bit excessive. I don't need to argue with you that we all want to get out of this debt as easily as we can. I am not saying you haven't got a plan, because I don't know enough about it. It is my understanding, or at least I have read somewhere, that Germany went into this war with about $28,000,000,000 gold reserves; is that correct?

Mr. PATMAN. It couldn't have had that much gold reserves; there isn't that much in the world, 28 billion.

Mr. KNUTSON. Twenty-eight million, I meant.

Mr. PATMAN. Excuse me, I thought you said billion. I wouldn't be surprised. They had a small gold reserve.

Mr. KNUTSON. If that be true, and they financed the war through taxing resources to the utmost, as against wealthy nations like America, Great Britain, Russia, and China, it does look to me as though we should be able to find a way of working out of this thing without placing too great a strain upon our economy. I can't say you haven't got a good plan, Mr. Patman, because I don't know. I have been listening to you with a great deal of interest, and I am sure I represent every member of this committee when I say we want to finance this war in the very easiest way possible.

Mr. PATMAN. I join you in that hope.

Mr. KNUTSON. And we appreciate your taking the time to come before us this morning and explain your plan.

Mr. PATMAN. May I suggest about this German money; Germany doesn't have any gold reserve, hardly. Gold reserve is not so important now as the integrity of the nation and the taxing power and the ability of the people to pay taxes and debts. That means more than any metallic substance that may be behind any government obligation. When the war was over, Germany was a conquered country. We don't have to go to Germany to find out about money or currency. Go to the Confederate States of America, after the War between the States, and you will find currency just as worthless.

Mr. KNUTSON. Germany isn't a comparable country——

Mr. PATMAN. No; but Germany is financing her debt without gold by only the credit of the Nation. That is all that is behind money, the integrity of the nation, the ability of the people to pay taxes.

Mr. ROBERTSON. Doctor Hanson, of Harvard, agrees with that theory. He said Germany financed its war without money, but added that it took over the manpower and resources of the nation.

Mr. PATMAN. Manpower would have no connection with this, I will say to the gentleman from Virginia.

Mr. ROBERTSON. That is the way Germany proposed to finance its war without money, and some economists say we could do it.

Mr. PATMAN. We are fortunate in that we can finance it in a way just as convenient and not take over the manpower, as Germany did. We can get all of the benefits, without any of the liabilities.

(The following matter was submitted for the record by Mr. Patman.)

"EDISON'S VIEWS ON THIS SUBJECT

"About 20 years ago Mr. Thomas A. Edison was inspecting Muscle Shoals. He remarked that the Government should operate that great project in the interest of the people. He was asked if he favored the Government borrowing the $30,000,000 necessary to make repairs. His answer substantially was: 'No; why should the Government borrow its own credit? If it issues tax-exempt interest-bearing bonds and sells the bonds to Wall Street bankers to get the money, by the time the bonds are paid the bankers will have collected as much in interest as the Government received on the bonds. In other words, the bankers, who will not furnish an ounce of material or a lick of labor, will get as much out of it as the men who do the work and furnish the material.' Mr. Edison also said at the same time: 'Any government that can issue a dollar bond, interest bearing, that is good can issue a dollar bill, noninterest bearing, that is good; the only difference is the bill is easier to redeem because it does not draw interest.' No one can answer Mr. Edison's argument. This same argument can consistently be made on our preparedness program.

"ECCLES AGAIN QUOTED ON MONEY CREATION

"Chairman Marriner S. Eccles, the top authority of the Federal Reserve Board here in Washington, testified before the Banking and Currency Committee of the House during the hearings on the Banking Act of 1935, on private banks creating deposits and thereby becoming virtually private individual mints, as follows:

" 'In purchasing offerings of Government bonds, the banking system as a whole creates new money or bank deposits. When the banks buy a billion dollars of Government bonds as they are offered—and you have to consider the banking system as a whole, as a unit—the banks credit the deposit account of the Treasury with a billion dollars. They debit their Government-bond account a billion dollars, or they actually create, by a bookkeeping entry, a billion dollars.'

"By a sort of magic the money is created.

"CONSTITUTIONAL MANDATE

"The framers of the United States Constitution, in article I, section 8, very wisely said:

" 'Congress shall have the power to coin money and regulate the value thereof.'

"This provision of the Constitution is mandatory. All Members of Congress are sworn to uphold the Constitution. Why has this provision never been carried out? The answer is simple. In the early days of our national existence the people were deceived into believing that the subject of money was so mysterious and intricate that only a few of the financiers understood the subject and therefore the great privilege of issuing and distributing money should be farmed out to them. This was done, and it has never been changed, except to give them more power and authority. The strange part of it all is that the ones who are the beneficiaries of this great privilege are not even charged with the duty of furnishing the people a sufficient circulating medium.

"LEON HENDERSON'S TESTIMONY ON NO DEBTS, NO MONEY

"In the hearings before the House Banking and Currency Committee on the price-control bill, the following questions were asked by me and the following answers given by Mr. Leon Henderson (pp. 981–982):

" 'Mr. PATMAN. * * * You stated yesterday that everybody should take advantage of this period of rising prices to pay their debts. You really don't believe everybody should pay their debts, do you? If you mean that, what would we do for money, since our money is based on debt?

" 'Mr. HENDERSON. I have been through that, the same as you have, and I don't believe our economy would come to a halt if people paid their debts.

" 'Mr. PATMAN. If everybody paid their debts?

" 'Mr. HENDERSON. If you are going to say that I have discounted the trade acceptances which the Federal Reserve has created by a couple of bookkeepers, that is not the connotation debt has for me.

" 'Mr. PATMAN. You had in mind individual debts, personal debts?

" 'Mr. HENDERSON. Yes.

" 'Mr. PATMAN. And if the policy is good for individuals, why isn't it good for corporations?

" 'Mr. HENDERSON. I think it is.

" 'Mr. PATMAN. All right. If everybody paid their debts, where would you get money to carry on business?

" 'Mr. HENDERSON. You would get into debt and come out again. I assume the healthy process of credit is that you do liquidate debt as you do the trade acceptances.'

"Mr. Speaker, Mr. Henderson's very clever reply was, in effect, that it is all right to pay the debts, but you should get right back into debt again in order for the country to have this circulating medium.

"CHAIRMAN MARRINER S. ECCLES' TESTIMONY ON NO DEBTS, NO MONEY, IN HIS TESTIMONY ON THE PRICE-CONTROL BILL BEFORE THE BANKING AND CURRENCY COMMITTEE

"Chairman Eccles, of the Federal Reserve Board, testified as follows, page 1338 of the hearings, September 30, 1941:

" 'Mr. PATMAN. * * * You made the statement that people should get out of debt instead of spending their money. You recall that statement, I presume?

" 'Mr. ECCLES. That was in connection with installment credit.

" 'Mr. PATMAN. Do you believe that people should pay their debts generally, when they can?

" 'Mr. ECCLES. I think that depends a good deal upon the individual; but, of course, if there were no debt in our money system——

" 'Mr. PATMAN. That is the point I wanted to ask you about.

" 'Mr. ECCLES. There wouldn't be any money.

" 'Mr. PATMAN. Suppose everybody paid their debts, would we have any money to do business on?

" 'Mr. ECCLES. That is correct.

" 'Mr. PATMAN. In other words, our system is based entirely on debt.'

"Mr. Speaker, there can be no dispute about the statement that our system is based entirely upon debt, and if a person and corporation paid their debts we would not have sufficient money to do business on.

"If we were to change that system the Government would pay its own money into circulation, and the people would be saved billions of dollars a year in interest.

"The Federal Reserve Banking System is privately owned. Not $1 of the stock is owned by the Government or by the people; it is owned by private banking corporations. It is a corporation owned by corporations. Many people believe that the Federal Reserve Banking System is owned by the Government because it is named Federal, but of course this is not true.

"CREATE MONEY, BUY BONDS, AND COLLECT INTEREST

"When the Honorable Marriner S. Eccles, Chairman of the Federal Reserve Board, was before the Banking and Currency Committee of the House, of which I am a member, on Tuesday, September 30, 1941, I interrogated him about how he obtained for the 12 Federal Reserve banks the $2,000,000,000 in Government bonds, which the System is now holding and charging the Government interest thereon. The questions and answers appear in the printed testimony, volume 2, page 1342, and is as follows:

" 'Mr. PATMAN. * * * How did you get the money to buy those $2,000,000,000 of Government securities?

" 'Mr. ECCLES. We created it.

" 'Mr. PATMAN. Out of what?

" 'Mr. ECCLES. Out of the right to issue credit, money.

" 'Mr. PATMAN. And there is nothing behind it, is there, except the Government's credit?

" 'Mr. ECCLES. We have the Government bonds.

" 'Mr. PATMAN. That's right; the Government's credit.'

"Mr. Speaker, the Government is now paying between forty and fifty million dollars a year to the Federal Reserve Banking System as interest on these bonds. The expenses, dividends, and profits of the System are paid in that way. It would be just as reasonable for each department of our Government to be allowed to purchase enough Government bonds to pay their expenses the same way. It would be just as reasonable for the Government to set aside enough interest-bearing bonds to each Federal employee to pay the Federal employee interest sufficient to pay his salary as it is for the Federal Reserve Banking System to get their expenses paid in that way.

"Under our present system the Federal Reserve banks can purchase twenty-five or fifty billion, a hundred billion, or an unlimited amount of Government bonds the same way they purchased and then held the $2,000,000,000. The System now owns about $6,000,000,000 in United States securities acquired the same way. Officials of the Federal Reserve System are paid salaries up to $50,000 a year.

"Commercial banks that obtain a large part of their earnings from United States bonds bought with created money paid their officials up to $175,000 a year."

(Article from the Congressional Record submitted by Mr. Patman follows:)

"WAR DEBT CAN BE PAID IN 40 YEARS WITHOUT UNBEARABLE BURDEN ON TAXPAYERS BY CONGRESS USING THE GOVERNMENT'S CREDIT AND IDLE GOLD INSTEAD OF CONTINUING TO FARM IT OUT TO SPECIAL PRIVATE CORPORATE INTERESTS

" '[H. R. 1, 78th Cong., 1st sess., Jan. 6, 1943]

" 'A BILL Providing for the issuance of nonnegotiable United States bonds to Federal Reserve banks and terminating the authority of the Treasury to issue other interest-bearing obligations of the United States to commercial banks, and for other purposes

" '*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That the Secretary of the Treasury, with the approval of the President, is authorized to issue from time to time United States bonds, the proceeds of which shall be available to meet any public expenditures authorized by law and to retire any outstanding obligations of the United States bearing interest or issued on a discount or on a combination interest-bearing and discount basis. Such bonds shall be issued in such form or forms and in such denominations, and mature at such times (not in excess of 40 years from the date of issue) as the Secretary of the Treasury may prescribe. Such bonds shall not bear interest or be issued on a discount basis and shall not be negotiable or transferable.

" 'SEC. 2. Bonds issued under the provisions of this act shall be issued solely to Federal Reserve banks and shall be subscribed for by the various Federal Reserve banks in such proportions of the entire issue as may be agreed upon by the Secretary of the Treasury and the Board of Governors of the Federal Reserve System. The Secretary of the Treasury shall pay, out of any funds hereafter appropriated for such purpose, to each Federal Reserve bank subscribing to bonds issued under this act, such amounts as he deems necessary to reimburse such bank for any expenses incurred by it in connection with such bonds.

" 'SEC. 3. The authority of the Secretary of the Treasury to issue any interest-bearing obligations of the United States (including obligations issued on a discount basis or on a combination discount and interest-bearing basis) under any other provisions of law is hereby terminated insofar as the issuance of United States bonds to any bank receiving demand deposits is authorized hereby. Except in accordance with such regulations as the Secretary of the Treasury may prescribe in order to provide for the orderly disposition of United States bonds held by any bank receiving demand deposits on the date of the enactment of this act, no such bank shall at any time hold any amount of United States bonds in excess of the amount held by it on December 31, 1941.

" 'SEC. 4. The first two paragraphs of section 7 of the Federal Reserve Act, as amended, are amended to read as follows:

" ' "SEC. 7. After all necessary expenses of a Federal Reserve bank have been paid or provided for and a surplus equal to the paid-in capital stock of such bank accumulated, the annual net earnings of such bank shall be paid into the general fund of the Treasury.

" ' "Should a Federal Reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts and the par value of all stock, shall be paid to and become the property of the United States.' "

"WILL STOP FARMING OUT GOVERNMENT CREDIT AND USE OF IDLE GOLD FREE TO BOND BUYERS

"Section 1 of the bill will permit the Secretary of the Treasury, instead of selling Government interest-bearing bonds, to receive the money necessary to meet any public expenditure by issuing and depositing with the 12 Federal Reserve banks bonds that provide for no interest. These bonds will not be sold to the public, as the public generally would probably not be interested in buying them since they will not draw interest, but the Federal Reserve banks can keep them, and each year the Government can make a payment on the bonds to the Federal Reserve banks.

"Under our present system the Treasury, when it needs money, sells bonds that provide for interest through the Federal Reserve banks, and in that way the Treasury receives credit at the Federal Reserve banks, which is checked upon in order to pay the debts of the Government. This proposal will permit the Treasury to receive the same amount of credit as on interest-bearing bonds and the Treasury may check upon this credit in the same manner that it is checked upon today when interest-bearing bonds are sold. In other words, when this proposal is enacted, the Treasury will give the same kind of checks to the same people for the same service, or in payment of the same debts. The people receiving these checks under the new proposal will deposit them or receive the money on them in the same way and manner that they now receive credit at the local banks, or receive the money in return for their checks.

"This will not cause the distribution or circulation of one extra dollar of actual currency. Therefore, it cannot be considered a greenback or printing-press proposal. It is strictly an orthodox banking method, which will permit the Government to finance the war debt without paying tribute to a few people who are using the Government's credit and idle gold absolutely free.

"HOW NON-INTEREST-BEARING BONDS DISTRIBUTED

"Section 2 of the bill provides the method by which the bonds, which will be noninterest bearing, will be distributed among the 12 Federal Reserve banks. The method that will be agreed upon will doubtless be according to the capital stock or resources of the particular bank. If the Treasury needs a million dollars, it will distribute the bonds among the 12 Federal Reserve banks, which will aggregate a million dollars. The largest Federal Reserve bank, of course, will take much more of the bonds than the smallest Federal Reserve bank.

"The distribution will be made by the Treasury and Board of Governors of the Federal Reserve System.

"BANKS WILL BE PAID FOR SERVICE

"This section also provides that the Federal Reserve banks will not lose any money by reason of servicing these loans to the Government without interest since the bill provides that each bank shall be reimbursed for any expenses incurred in connection with the bonds. The expenses, of course, will be practically nothing (not as much as one-twentieth of 1 percent interest) compared with the huge amounts of bonds that will necessarily be issued to finance the war debt.

"IF MONEY IS TO BE CREATED IT SHOULD BE CREATED BY THE GOVERNMENT AND NO INTEREST PAID ON IT

"Section 3, the first sentence, provides that no more interest-bearing obligations of the United States shall be issued and sold to commercial banks, or banks receiving demand deposits. The reason for that is that such a bank does not have anything to give the Government in return for its bonds. It merely receives the bonds and gives the Government credit in bookkeeping transactions, or pencil-mark or fountain-pen money. Every informed person admits that under such circumstances, the commercial banks create the money outright. If money is to be created outright it should be created by the Government and no interest paid on it.

"BANKS CANNOT FURTHER INCREASE HOLDINGS OF GOVERNMENT BONDS

"Section 3, in the second and last sentence, provides that no bank which receives deposits, in other words a bank that must create the money in order to buy bonds, shall at any time hold any amount of United States bonds in excess of the amount held by it on December 31, 1941. In other words, if a bank held $2,000,000 in Government securities on the date mentioned, it can sell any amount of those bonds that it desires to sell, and may in turn purchase other United States Government securities up to, but not in excess of the $2,000,000, which was the amount held December 31, 1941.

"BANKS NOW LEND $10 TO EVERY $1 OWNED

"The stockholders in all the banks in the United States have invested and would lose if the banks should be forced into bankruptcy or liquidation and there should be no recoveries, the total sum of $8,000,000,000. But three and one-half billion dollars of this is capital; about three and one-half billion dollars is surplus, and about $1,000,000,000 in undivided profits, making about $8,000,000,000. That is all the stockholders in banks in America have invested in these banks. Notwithstanding, only $8,000,000,000 are invested in all these institutions, they have purchased more than $40,000,000,000 in United States Government securities, and now hold these securities and receive interest on them annually and expect to hold $112,000,000,000 by the end of the next fiscal year. Without stating or discussing how much the banks should be allowed to expand, it is evident that orthodox banking methods, safe banking methods, and logical banking methods should prohibit any bank from expanding more than $10 for every one that it owns. Let us presume, for the sake of discussion, that it is right for a bank to be allowed to lend $10 for every one it has, and thereby receive interest on $10 for every $1 invested by the stockholders and still we cannot escape the logical conclusion that no bank should be allowed to expand more than $10 for every one.

"CONGRESS SHOULD NOT SIT IDLY BY

"This being true, why should Congress sit idly by and allow the banks to expand $20 to every one, or $50 to every one, in order to finance the war and the other expenditures of our Government when it is nothing more nor less than Congress permitting the credit of this Nation to be farmed out for the selfish benefit of private banking corporations?

"GOVERNMENT CREDIT FARMED OUT

"The Government of the United States, under the Constitution, has the power, and it is the duty of the Government, to create all money. The Treasury Department issues both money and bonds. Under the present system it sells the bonds to a bank that creates the money, and then if the bank needs the actual money, the actual printed greenbacks to pay the depositors, the Treasury will furnish that money to the banks to pay the depositors. In that way, the Government farms out the use of its own crédit absolutely free.

"BACKING FOR NON-INTEREST-BEARING BONDS

"If the Federal Reserve banks provide the credit to finance the war, as proposed in the bill, inserted herewith, these bonds will be backed by the credit of the Nation, which includes the taxing power of the Nation, and also the $23,000,000,000 in gold that is now idle and unused, except that portion that is used free by the private banking system of this country.

"BONDS BACKED BY TAXING POWER, TOO

"A bond issued by the Government carries with it an obligation that Congress will pass laws levying taxes which will be sufficient to cause the taxpayers to pay money in taxes to pay the interest on the bonds, and to eventually retire them when due. The history of the issuance of long-term bonds by our Government is conclusive that the Government invariably pays $2 to every $1 that it borrows. In other words, it pays $1 in interest and $1 in principal.

"GOVERNMENT TO PAY DOUBLE

"A $100,000,000,000 debt means, under the present system, that the taxpayers will eventually have to pay $200,000,000,000. With a huge debt of $300,000,000,000, which is estimated by many Government authorities as being the amount that the public debt will reach before the war is over, it will probably be impossible for the taxpayers to pay enough money each year to liquidate any part of the principal of the bonds. Therefore they will remain in bondage for centuries because they will be unable to pay any more each year than is sufficient to provide for the interest on the bonds.

"$1 PAID MONEY CREATES FOR EVERY $1 PAID A SOLDIER

"Viewing the situation from the most optimistic viewpoint, the taxpayers will be compelled to pay at least $2 for every $1 borrowed. For every $1 that is paid to a soldier, the money creators have nothing to offer except the Government's credit, which has been given to them free, will also receive $1. For every $1 that is paid to every person for materials furnished, the money creators will receive $1 in interest for no service whatsoever in the form of interest for furnishing the Government's credit, which has been furnished to the money lender free. For every $1 that is paid out for any purpose, in this war or for peacetime pursuit, the interest will amount to at least $1 ,and the result will be that the taxpayer must pay $2 in order to liquidate every $1 debt.

"I cannot understand why anyone should insist that the credit of this Nation and the use of the Government's gold should be farmed out absolutely free to the private banking corporations of this country, and require the taxpayers to pay at least $2 in order to obtain $1 in our war preparation.

"REPAIR HOPELESSNESS OF PEOPLE

"Let us repair the hopelessness that is now being felt by the people on account of what they think will probably happen after the war with a $300,000,000,000 public debt by changing the system so that the Government can use its own credit and its own gold and not pay $2 for every $1 that is borrowed.

"WAR DEBT CAN BE PAID IN 40 YEARS

"If our national debt for the war is $300,000,000,000, it can be paid over a period of 40 years without an unbearable burden on the taxpayers by the Government borrowing money from the Federal Reserve banks and paying it back 2½ percent each year. This 2½ percent will be no more than interest that is being charged today, and the amount will be sufficient to entirely pay off the bonds in 40 years. Whereas if we continue the present system of paying interest on these bonds, at the end of 40 years, after paying 2½ percent each year, we will still owe the principal amount of the bonds, and the debt will be just as large at the end of 40 years as it is today or when the debt is the largest.

"WILL REDUCE CHANCES OF INFLATION

"If we borrow the money to finance the war from the Federal Reserve banks and it is paid 2½ percent each year and entirely paid off and liquidated in 40 years, there will be no likelihood of inflation during that time. Whereas, if we continue paying tribute to a few for the use of the Government's own credit, we will in all probability have inflation unless it is possible to prevent it by price control and other methods.

"DUTY OF CONGRESS TO MAKE CHANGE

"It occurs to me that the duty of making this change is on Congress. It is not on the executive, the judiciary, or any department of our Government. It rests solely and alone upon the Congress of the United States to change the system that causes our credit to be farmed out and enormous interest burden paid unnecessarily and uselessly on its credit.

"ABUSE OF POWER TO TAX

"If Congress continues to require the people to pay billions of dollars a year unnecessarily as interest on Government bonds it occurs to me that it is an abuse on the part of Congress of the power to tax. Congress has the power to tax and is exercising that power to the limit, but certainly Congress should not abuse the power by levying taxes to pay a debt that is extravagant, wasteful, and unnecessary in every way.

"NOW TIME TO MAKE THE CHANGE

"One of these days, the American people are going to wake up and realize the situation, and they will blame this very Congress for not making the change at this time, when we are entering upon a $300,000,000,000 war program. Now is the time to make the change. It is not a change that will involve unorthodox banking methods. It is a change that will save the Government interest on the public debt hereafter contracted, but will not be in any way dangerous to the general welfare of the country. On the other hand, it will be greatly in the interest of the general welfare of the country because the war debt will cost the taxpayers only 50 percent, at least, of what it will cost under the present system.

"BOND SALES TO PUBLIC SHOULD CONTINUE

"I am not proposing that bond sales to the public be stopped or impeded in any way. It is my belief that bond sales to the public should be encouraged because they are calculated to prevent or stop inflation to a certain extent. At the same time we know that the bonds that the public are buying at this time, will, when this emergency is over, be in the market one way or another and, that being true, the money creators will be in a position to purchase them by using the Government's credit free and the idle gold free, and receive interest from the Government for no service whatsoever.

"$1,000 INTEREST PER CAPITA TO BE PAID ON THIS YEAR'S BUDGET

"The Budget for next year is $108,000,000,000. This means that it will cost the American taxpayer by the time the $108,000,000,000 debt is paid, under our present system of farming out our credit free, twice that amount, or $216,000,000,000. This means that every man, woman, and child in America, on this $108,000,000,000 debt, will have to pay about $1,000 in interest and $1,000 on the principal, presuming that the debt can be paid in 40 or 50 years. It is not right for Congress to make the people pay that $1,000 for every man, woman, and child in America as interest for the use of the Government's own credit and for the use of the Government's own idle gold by farming out the Government's great privilege and right to create money to private banking interests of the Nation.

"PERPETUAL DEBT

"The current estimate of what the war, whole war, is going to cost us is $300,000,000,000. If we spend $300,000,000,000 on this war, it will cost about eight or nine billion dollars a year to pay the interest on the $300,000,000,000. In all probability, that is all the taxpayers of this country will be able to pay, and will, therefore, be unable to make any payment on the principal of the debt each year. That being true, all the money that will be raised in taxes to pay on the national debt will go to the people who are using the credit of the Nation absolutely free, and who have had farmed out to them the use of the idle gold free, and the people will thereby be caused to pay a debt that is useless, wasteful, extravagant, and unnecessary.

"It Is Wrong for the Government of the United States That Is Sovereign To Pay Private Corporations To Create Money on the Government's Credit

"UNITED STATES SOVEREIGN

"No city is sovereign because it has superiors, the State and the National Government. A State is not sovereign because it has a superior in the National Government. The National Government is sovereign because it has no superior in the form of a government, and the National Government has the power to create its own credit upon which no interest should be paid instead of farming out that great privilege to the private banks of the country."

The Chairman. Have you finished your statement?

Mr. Patman. Yes, Mr. Chairman.

The Chairman. We thank you.

Mr. Patman. I want you to hear from the Honorable Robert Latham Owen, a Member of the United States Senate from the State of Oklahoma from 1907 to 1925. He was chairman of the Committee on Banking and Currency of the Senate and was coauthor of the Owen-Glass Federal Reserve bill when the Federal Reserve Act was enacted into law December 23, 1913.

Senator Owen is one of the best informed men in the world on our United States monetary system. He organized and has been a director of a successful national bank for 50 years. When President Woodrow Wilson signed the Federal Reserve Act December 23, 1913, he wrote Senator Robert L. Owen a beautiful letter that he was entitled to the gratitude of the country and gave him one of the gold pens with which he signed the bill.

The Chairman. How much time will he require?

Mr. Patman. I assure the chairman he can make a great contribution to this subject, or any other subject, and I hope you will hear him with consideration. I know he will be conservative in time. He never did take up much time. I assure you he will take no more than the subject justifies.

The Chairman. Very well; we will hear him.

Statement of Hon. Robert L. Owen, Former United States Senator From the State of Oklahoma

Mr. Owen. My name is Robert L. Owen. Mr. Chairman and gentlemen of the committee, it is not what I might say to you, but what you receive, that is a matter of importance now before your committee.

You are proposing a bill to expand the credit outstanding, the indebtedness of the United States, up to $210,000,000,000, as I understand it. Mr. Patman suggests that in doing so you hold down, as far as you can, that indebtedness by protecting the taxpayers from unearned interest on that debt. I have some familiarity with the banking system. I regard our free competitive system of industry and our banking structure as the best in the world, and the services of our bankers to the country have been very great. I have been a director of a bank for 53 years, in recent years, I think, purely complimentary, but I am familiar with the banking system, and I am familiar with its history, and I manufactured money myself in that capacity in a few little ways that I think might interest you, if I may take a moment.

When, in a great pressure one time for currency, with the consent of the citizens of the town, the bank of which I was president issued cashier's checks payable to bearer, $5 each. They circulate as money, perfectly good money. They functioned in exchanging commodities and services from one person to another in that locality.

I might give you another instance, or instances. The Chase National Bank has 2,000 forms of script money, issued by the citizens of this country without interest for the same purpose, of facilitating the exchange of commodities and services from one person to another.

On one occasion, as the president of a national bank, I wired to our New York correspondent to place an order and buy $500,000 of bonds, place them with the Comptroller of the Currency, make a deposit from our account of 5 percent, and receive from the Comptroller of the Currency national bank notes to the extent of $500,000, on which my bank received the interest for many, many years, and of which I was a beneficiary as a stockholder, without shame. It was the practice of the country.

But we are now facing a great World War, in which the resources of this country will be taxed to the utmost, to such an extent that this honorable committee has found it advisable to tax the little citizen of the country who is receiving $13 or more a week as compensation. That tax will be employed in defending the interests of our country on the battlefield and in furnishing our soldiers with the weapons of war.

But I call your attention most earnestly to the fact that when you expand this credit to $210,000,000,000 of indebtedness of the United States, as we must do—you have got no option about it; you have got to do it—when you do that, do not add to that burden, as a part of it, unearned interest money.

When I say it is unearned, I must justify that statement, if it is to have any force. Our forefathers had some experience with money. One of the contributing causes to the Revolutionary War, as recorded by Benjamin Franklin, was the fact that the English Parliament stopped the circulation of the colonial money, in order to put English money in circulation in the United States, and caused a tremendous depression, and idleness, and contributing to the distress of our forefathers at that time.

It was done by contracting the volume of money in circulation, which stopped the people from the free interchange of commodities and services, because they didn't have the medium of exchange.

When I say unearned interest, gentlemen, I go back to the Constitution of the United States, where our forefathers put into the first section of the Constitution a provision that the Congress of the United States was exclusively authorized to coin money and regulate the value thereof. The Supreme Court of the United States, in the *Legal Tender cases*, held in substance that the term "coin" covered printing paper money. They also held that the Congress of the United States was exclusively authorized to create money, and that that right was withheld from the States, and when we come to creating money, and the question is asked, "what will be paid for a Government bond?" let us look at that transaction.

The Government sells to a bank a million dollars of Government bonds. Does the bank pay for it in currency or coin? Are they expected to pay for it in currency or coin? Certainly not. Well, what do they pay for it with? They pay for it with their individual banking credit, by an entry on the ledger of the banking house, whether a national bank or any other bank, and against that credit the Treasury Department can draw checks, and the same thing is done with the Federal Reserve banks as an agency of the United States, established for the express purpose of exercising supervisory control over the monetary system of this country.

Precisely the same thing takes place as when $5,000,000,000 was recently sold to the Federal Reserve banks against the credit on the books of those banks. Nothing strange about it. Everybody understands it who pays any attention to this question. But I realize, Mr. Chairman, and gentlemen of the committee, that a great many people in the United States have had no particular time to study the monetary science, there has been a general understanding that money was a mysterious thing, and nobody understood what made the value of money. That has been proclaimed from the housetops by some persons of rather high authority—that nobody knew what made the value of money.

Oh, well, we have learned now what makes the value of money, and we have learned that when we expand the credit of the United States by the issuance of bonds up to the present moment that we have created money and put that money in the banks and into the hands of private citizens, and we have learned that we must contract that amount of taxations so far as we can without destroying our productive processes, and we have found that we must contract it by selling bonds to individuals and corporations who have money on deposit in banks as demand bank deposits.

Why certainly we have got to do that. There is no doubt about it. No doubt about it. Otherwise, the volume of money in circulation would rise to a point where it would be impossible to fix prices and hold those prices down to a reasonable point.

As it is, with great skill, with great patriotism, the Treasury Department has been enabled to sell bonds to the extent necessary to hold the dollar index down to approximately par. It is true that in February a year ago it was 124, but then it came down approaching par, and those efforts on the part of our Government and on the part of this honorable committee and the Congress of the United States and the cooperation of the people have brought that dollar index down again, very, very slowly in the recent months, only a mill or two a week, only two mills last week. It is now 98 as compared to 1926.

If you will examine the volume of money in circulation through the banking system in the device of individual accounts on the books of the banks, not including interbank checks, you will find that in 1926 the volume of money turned over in that way by check, amounted to $845,000,000,000, and has a turn-over approximately 40 times a year the amount that was being circulated. It is not far from that now. And the circulation of money has been kept down by this process of taxation and of selling bonds, so that the dollar index has been held down.

There is one feature, with your permission, I would like to comment upon, and that is this; that it should be true at all times that whether our industrial production is engaging in war products or domestic products, the ratio of the income arising from it corresponds to the amount actually employed in turn-over, the income being three times the amount of the money actually employed in actual circulation. So that it is of importance, particularly in this connection, that our domestic production, to be kept up to the maximum, will require the amount of money in circulation to be according to that formula.

I mention that because we are now being concerned about raising a sufficient amount of production to feed Europe as well as ourselves and our soldiers on the front. Therefore, the question of domestic production needs attention by the Congress of the United States, and in that connection, it needs to consider the employment of money as one of the agencies in expanding that domestic production.

Coming back, therefore, to the Constitution of the United States, where Congress was exclusively authorized to create money, and the process by which Congress has been creating it, I express the hope that this committee will consider with the greatest care the proposition submitted to it by Mr. Patman, of cutting down the expansion of the payment of unearned interest to anybody, including myself, as a stockholder in a bank.

I do not wish to take the time of the committee, further than to express these opinions. If there are any questions which any of the committee would like to ask me to comment on, I shall be glad to do it. My only purpose in coming here is to serve the people of the United States, and because I was urgently invited to come, thinking that my experience might be of interest or value to the committee. I pause, Mr. Chairman, for any questions that you or any member of the committee might care to ask me.

Mr. KNUTSON. Senator, would the plan that Mr. Patman proposes tend to bring on uncontrolled inflation?

Mr. OWEN. It would have a tendency to prevent, to the extent it is employed to prevent the expansion of the money which will produce inflation. I am not going to use the term "uncontrolled inflation." I know that inflation can be controlled by an intelligent and strong government, and I am in favor of it. I have always demanded stability in the purchasing power of money, and when I had been in the Senate less than 90 days I made an address before the Senate making that demand, and I based the address I made on the Aldrich bill, on the grounds of stabilizing the purchasing power of money because it would itself stabilize the industrial activities of this country and stabilize the productive power of the greatest people in the world, and I have been deeply disappointed in the administration of the act, which ought to have accomplished that result in a way in which I pointed out from time to time in the public press, and to which I have the right to refer now. It could have been prevented. The contraction which took place in 1920–21 was over my vehement protest and with my statement on the floor of the Senate that it would cause a depression, which it did cause immediately afterward.

Mr. KNUTSON. That depression you are referring to in 1920–21 was caused altogether by the Federal Reserve calling their agricultural loans, was it not, Senator?

Mr. OWEN. No; not altogether.

Mr. KNUTSON. Largely, then?

Mr. OWEN. No; not largely. It had a ruinous effect on agriculture.

Mr. KNUTSON. From which it has never recovered.

Mr. OWEN. From which it has never recovered.

Mr. KNUTSON. You are right.

Mr. OWEN. Of course, I am right, and everybody knows it. What did take place at that time was a deliberate policy of contraction for the purpose of cutting down the market price of commodities and services and thereby increasing the purchasing power of money, and benefiting creditors and those having their investments in money, without giving time to the people to adjust themselves to it. Therefore, they created a panic.

Mr. KNUTSON. Well, it had the effect, up in our country, of bringing about forced sales of cattle and grain, and as a result the markets became glutted and it further accelerated the movement downward. Isn't that right?

Mr. OWEN. Yes; that took place. What took place in 1929–32 was an occurrence on the other side of contraction, that is, inflation of credit—about $14,000,000,000 in the security market. There was a gross expansion of credit in the security markets, so that billions of dollars of foreign money and billions of dollars of domestic money created by the sale of stocks of our great industrial companies which flowed into the security market, and caused the market price of securities to rise beyond reason, to rise beyond the point where they could possibly earn interest on the investment, rise to a point which showed to the thoughtful, prudent bankers of the country that there would be a collapse, and in May 1929 I wrote a memorandum of 16 pages to President Hoover, with 12 charts, and took it in my hands and presented it to him at lunch and urged him to study the matter for the purpose of meeting what was going to happen. What took place afterward, I will not comment on, except to observe that a credit convulsion and violent bear movement occurred in October 1929 resulting in enormous contraction of the money supply with panic and bankruptcy following.

The CHAIRMAN. What did he say about your charts?

Mr. OWEN. He said, in answer to my prayers, that if he interfered with the Federal Reserve Board or the Federal Reserve banks he would be accused of using politics in the System and it would injure the System, in his opinion. I replied to him that he, as President of the United States, was charged with the responsibility of leadership and of protecting the people of this country against what would inevitably happen unless the full powers of this Government were used to meet the crisis that was impending, and that if he did not do it, it would ruin him politically and ruin his party. And I put that in writing and I gave a copy of it to the chairman of the Banking and Currency Committee of the House, if any of you want to see it.

The CHAIRMAN. Have you brought the same situation to the attention of President Roosevelt? If so, what was his reply?

Mr. OWEN. President Roosevelt had his attention called to the violence of this depression by some very important occurrences which preceded his election, and which had been brought about by the very things I was protesting to Hoover. He came in after 1932, at which time I am telling you this country was manufacturing its own money from one end of the country to the other and establishing barter exchanges in order to exchange products where there was no money available for exchange. Mr. Roosevelt came in when this country was facing the greatest disaster, financially, it ever had faced in its history, and when he came in he had to declare a public holiday for the banks of the country. Why? Because the people of this country were so disturbed there was danger of runs on the banks from one end of the country to the other. Ten thousand banks failed under this depression of 1932 by the destruction of the value of their securities. Then Congress took steps to stabilize, authorized the issuance of money and of credit. As a matter of fact, the Federal Reserve Board and Federal Reserve banks, instead of expanding credit, contracted it during the next 18 months, to the extent of approximately $3,000,000,000. The record shows that and I pointed it out, and I pointed it out in writing to the proper authorities, with proof, and the proof of it can be found by anyone interested in it, by looking up the weekly statements of the Federal Reserve banks of March 14, 1933, and the corresponding week in 1934. I have been deeply interested in these matters and have made a most resolute effort to understand them.

The CHAIRMAN. I didn't quite get clear how far you had gone in prosecuting this matter proposed in Mr. Patman's bill and discussing it with Secretary Morgenthau and Mr. Roosevelt as it relates to our present situation, borrowing large amounts of additional money. Have you had any discussion with the administration about it?

Mr. OWEN. Oh, no; I have not been invited to discuss it, and I do not feel quite justified in imposing my personality upon the authorities of the Government. When I am called on to answer, I am glad to do the best I can to help solve these problems. But I want to say this, and say it very plainly; regardless of anybody's opinion, this committee now has the opportunity of saving the taxpayers 2 or 3 billion dollars a year in unearned interest to be paid to the stockholders of the banks of this country. That is what I have got to say, and I am opposed to any further expansion of the debt for that purpose, and I wish my opposition to be put in the record. I did not come here for that purpose, but now that I am here, I feel like expressing my opinion, because I have no reason not to, and because I think it may be useful. I think it is a very grave responsibility on any member of this Congress to be taxing $13 a week and giving away unearned interest to the extent of billions per annum. I will not approve that, as a citizen of the United States; and, as a citizen, I speak.

The CHAIRMAN. You always speak very interestingly, Senator.

Mr. OWEN. I have a very determined view about it.

The CHAIRMAN. May I ask you this question, just for my own guidance. If the administration and the Secretary of the Treasury have a great responsibility in guarding the credit of the Government at this time, during the war, do you think before we take any further action on this that they should be called in to give their viewpoint?

Mr. OWEN. I certainly do, and I would like them to answer the questions I am putting to you—why billions of dollars in unearned interest to stockholders and taxes on $13 a week? Ask them to answer that and I will be content to hear it.

The CHAIRMAN. I believe Mr. Patman has a bill, H. R. 1.

Mr. PATMAN. Yes, sir; H. R. 1.

The CHAIRMAN. It was thought this matter would more properly come up here, rather than have protracted hearings——

Mr. OWEN. You don't need any protracted hearings, in my opinion.

The CHAIRMAN. We all have respect for Mr. Patman. There is no man in Congress we think more highly of, and I listen very attentively to what he presents. I was wondering whether, on this bill, we would have time to get all the needed information.

Mr. OWEN. You don't require much time.

The CHAIRMAN. And call the various witnesses.

Mr. OWEN. You don't need very much time.

The CHAIRMAN. I know in your opinion, and the opinion of Mr. Patman, you wouldn't require very much time.

Mr. OWEN. Either what I have said it true and just, or it is not. And if Mr. Morgenthau can come here and show it isn't, that can be done in a few minutes.

The CHAIRMAN. I know, but there is hardly ever a question comes up here that there is not a difference of opinion. We have had scores of witnesses here on this other matter, and hardly any two of them agreed, and each one said that what they said was true.

Mr. OWEN. It is for the intelligence and judgment of this committee to determine what is just and true.

The CHAIRMAN. We don't know until we hear both sides of a question, do we? If you have a case in court, you wouldn't hear the plaintiff and not the defendant.

Mr. OWEN. I have just said to you that I suggest Mr. Morgenthau answer what I have told you.

The CHAIRMAN. I just ask you whether you think the committee should do that before we attempt to decide this matter. This bill Mr. Patman introduced should be considered seriuosly, but whether or not, at the same time, we should go into lengthy hearings—the banks will want to be heard, the administration will want to be heard, the representatives of all kinds of people will want to be heard. This is a rather sweeping change, and the committee could hardly be expected to come to a satisfactory decision until it heard all the facts from the people who wish to be heard. And it would require a long time to hold a hearing and hear all the witnesses.

Mr. OWEN. Mr. Chairman, may I make this suggestion?

The CHAIRMAN. Any suggestion you want to make is welcome.

Mr. OWEN. The legislative processes are well understood by most men who have had any experience with legislation, and it is well known how difficult it is to get a bill considered and passed when there are powerful self-centered interests opposed to it. Therefore I think an amendment to the bill you have is important, in a legislative sense, in order to get action upon the prayer which Mr. Patman has been submitting to you. That is what I think. That can be obviated, I think, by the committee itself agreeing to pass upon the bill introduced by Mr. Patman immediately they dispose of the present bill.

The CHAIRMAN. Have you concluded your statement, Senator?

Mr. OWEN. I have.

The CHAIRMAN. We don't want to cut you off.

Mr. OWEN. I have said all I think is necessary. I will be glad to answer any questions. A man often says things which he thinks are understood, and afterward finds they were not understood.

The CHAIRMAN. Mr. Disney wishes to inquire, Senator.

Mr. DISNEY. Senator Owen, in response, I think, to Mr. Knutson's question a little while ago, you rather implied that we now have the legal means in our fiscal system to prevent uncontrolled inflation.

Mr. OWEN. Yes.

Mr. DISNEY. Is that your view?

Mr. OWEN. Yes.

Mr. DISNEY. And that with our further law on the subject?

Mr. OWEN. I think the laws could be improved, but I think even as it stands they have very great power.

Mr. DISNEY. You believe an uncontrolled inflation could be prevented by processes we already have, if they are used?

Mr. OWEN. Yes; I think, of course, they could be improved, and I think the United States ought to unhesitatingly put itself absolutely behind the Federal Reserve System and make itself responsible for all indebtedness and liabilities of the Federal Reserve System. In other words, the Federal Reserve System should be recognized, in explicit terms, as an agency of the United States, behind which is the sovereign power of the United States. One of the reasons why I felt disposed to appear before the committee with regard to this matter of what I call unearned interest was this: That, in my opinion, the sovereign power of the United States was involved, and it is in the exercise of the sovereign power only that money is created by Congress, or through its authority, and I am opposed to any private interest taxing the sovereign power of the United States to make credit for the protection of the people of this country in a great war in which we are involved, or even in peacetimes.

Mr. DISNEY. I have heard it suggested that would put the Government in the banking business.

Mr. OWEN. Put the Government in the banking business?

Mr. DISNEY. I have heard that statement in connection with Mr. Patman's bill.

Mr. OWEN. The Government should leave the banking business to the banks, most emphatically, and the banks should leave the governing business and the exercise of sovereignty to the Government and its Representatives in the Congress of the United States. That is my opinion.

Mr. DISNEY. But the suggestion about the Federal Reserve System, as you may well know, brings out that suggestion, that that may well put the Government in the banking business.

Mr. OWEN. The only thing that will put the Government in the banking business is the failure of the Congress to protect the people of the United States against harm and injury that would come from an unwise administration of our banking system and the creation of another great panic. We have had three. I remember the one of 1907 very distinctly, and that I know was deliberately caused. I was told so in terms most explicit by a very well-informed man in the marble room of the Senate of the United States in January 1907, when he whispered in my ear a great secret, that there was going to be a big squeeze put on in stocks and bonds. It came about, but it didn't squeeze me. I had my bank protect itself by taking additional security without squeezing other people.

Mr. DISNEY. Senator, in a word, give me your understanding of the practical aspects of Mr. Patman's proposal under H. R. 1, if you are familiar with that. How would it operate?

Mr. OWEN. It would operate simply by the United States Government, through the Treasury Department, putting its bonds, or certificates of debt, which is better—you are not going to sell these bonds anyway. It would be just a certificate of indebtedness against which the United States would take credit, and pass those credits through the Reserve System, just as it would through any bank, and then the Government could liquidate that indebtedness without penalty as rapidly as the people of the United States could pay the taxes in without suffering. It has been supposed that we are going to have great difficulty in meeting the terrible cost of this war, $210,000,000,000. I beg the committee to look at the letter I wrote to Mr. Spence, of Kentucky, a year or so ago, pointing out the money we lost directly from the panic of 1932–33, and indirectly. Take it all together, it amounted to above $600,000,000,000. Nobody ever questioned the facts. I stated I took it from the record. The potential loss was nearly $400,000,000,000; the actual loss dropping from $81,000,000,000 per annum to $38,000,000,000 per annum, which made a total in 10 years of about $200,000,000,000. This country has the capacity to meet the cost of this war, great as it is, and to liquidate the debt, and to go through it and come out of it the industrial, commercial, financial, and moral leader of the world. Of that I haven't the slightest doubt.

Mr. KNUTSON. Senator, this question is purely for information, and I hope you treat it as such, because I frankly confess, as I told Mr. Patman, that I am a novice in the field of finance. I am purely seeking information, that is all. What is the difference, Senator, between non-interest-bearing notes, such as I understand the Patman bill contemplates—that is what your bill contemplates, is it not, Mr. Patman, non-interest-bearing notes?

Mr. PATMAN. To the Federal Reserve banks only.

Mr. KNUTSON. What is the difference between non-interest-bearing notes and printing-press money?

Mr. OWEN. I am glad you asked me that question, Mr. Congressman. When you speak of the notes to which Mr. Patman refers, the notes of indebtedness of the United States Treasury to the Federal Reserve banks, it merely represents an indebtedness of the United States Government to be liquidated as soon as it can be conveniently done out of the incoming revenues provided by legislation passed by your committee. When you talk about printing-press money, it is a term of derision employed by those who use the term "green-backs" and use the term "fiat money" in order to express contempt of our currency on the ground that there is nothing behind it. Such criticism ignores the vital fact that our currency daily liquidates itself by exchange from one hand to another and that it is backed by the taxing power of the United States and the sovereignty of Congress with its power to contract and expand and to regulate the value of money. The taxing power that goes into untold billions on the productive energies and income of the greatest people in the world. The idea of printing-press money and greenbacks, is to discredit what Abraham Lincoln did to save the Union when he issued $386,000,000 of greenbacks in 1862, which we promptly discredited by having a provision put into the law that they were not receivable for interest on the public debt or for the payment of duty on imports, and therefore led the people into the belief that that money ought to be sold at a discount and thus permit a racket by which a few profited at the expense of the many.

Mr. KNUTSON. Would it be your thought that such notes as might be issued, such non-interest-bearing notes as you might issue and place with the Federal Reserve, should be to all intents and purposes negotiable money?

Mr. OWEN. It is credit, Mr. Knutson, which is in the Federal Reserve banks, and against which a check would be drawn by the United States Government.

Mr. KNUTSON. Well——

Mr. OWEN. Just a minute; let me conclude. When that check is passed through a commercial bank, the commercial bank would deposit it in a Reserve bank for payment and it would function exactly as if it were money, exactly as if it were currency, for that matter.

Mr. KNUTSON. Senator, suppose that we issued $5,000,000,000 in non-interest-bearing notes and deposited them with the Federal Reserve banks, suppose the holders of those notes were to immediately pay them back to the Government for income-tax purposes.

Mr. OWEN. The Federal Reserve banks holding that credit would not be called upon to pay income tax to the Government.

Mr. KNUTSON. The member banks would.

Mr. OWEN. The member banks would not have the credits to which we are referring.

Mr. KNUTSON. Wouldn't the member banks be able to draw on this $5,000,000,000 deposit?

Mr. OWEN. No; they wouldn't be able to draw on it, as belonging to them. They could not check on it, if that is what you mean. It belongs to the United States Government.

Mr. KNUTSON. You would freeze them?

Mr. OWEN. I don't freeze them at all. I simply put them to the credit of the United States and check on them, because it belongs to the United States. That is all. It is simply a bank credit created by Uncle Sam and Uncle Sam checks on it.

Mr. KNUTSON. The only experience I have had with banking is to pay interest. I have never been——

Mr. OWEN. As a stockholder of a bank, I congratulate you.

Mr. KNUTSON. I wouldn't say I am not a stockholder, but I am not posted on banking. That is all, Mr. Chairman.

Mr. ROBERTSON. Senator Owen, you will no doubt recall that Tom Paine, of revolutionary fame, said that credit is suspicion gone to sleep——

Mr. OWEN. Credit is what?

Mr. ROBERTSON. That credit is suspicion gone to sleep.

Mr. OWEN. That is a very interesting epigram. I would like to say this; that at present we have issued billions of Federal Reserve notes that are not in circulation and have gone to sleep and are not paying any interest, but are held by the people in reserve for their own purposes at a time which will follow this war. There are billions of that money issued, in large denominations.

Mr. ROBERTSON. But the reason for that unprecedented amount of Government obligations outstanding in currency, which you say has been issued on the faith and credit of the Government, is that the people have confidence in the credit of the Government, they think the Government is sound and will stay sound, and they have not gotten suspicious of Government credit. You have told us that if we proceed to finance a substantial part of the war cost by the present method of issuing Federal Reserve notes, we will pay a substantial price in interest for that method of financing. On the other hand, if we adopt the plan recommended by you and Mr. Patman, and the banks of the country should call that new issue printing-press money, let us say, or whatever term they want to use to indicate they do not think it is sound money, it would be possible for them, I fear, to create a psychology of fear and suspicion, which once aroused I feel we could never bring within bounds again.

Mr. OWEN. There isn't the slightest possibility of such a thing. No bank would dare do it, for one thing. No bank would want to do it, for another thing, and it would be against the interest of the bank to create a condition that would destroy the value of its own collateral and cause a panic to occur in the country through his expressing suspicion and distrust of the Government.

Mr. ROBERTSON. Well, you may be right.

Mr. OWEN. I am right.

Mr. ROBERTSON. And yet the fact remains, I believe by your own testimony and likewise that of Mr. Patman, that all the bankers have consistently in the past opposed this method of issuing money.

Mr. OWEN. The banks have not had this particular proposition before them. I think the bankers of this country are just as patriotic as anybody else. What if they are pursuing the natural policy, and following the teachings of the past? That does not argue that they are unpatriotic or unintelligent or unfair in any way, but here we are dealing with the sovereign power of the United States, and you are the custodians of the sovereignty of the United States, and I am telling you that the sovereignty ought not be taxed for the benefit of private individuals, however honorable and worthy they are, and certainly there are no people in the country that deserve more respect than our honored bankers to whom the people entrust all their savings. They are worthy of trust, too. I honor them and I am their friend. But I also believe in the sovereignty of the United States. I believe we ought to cut down this expense by cutting out unearned interest on any more credits extended.

Mr. KNUTSON. Senator, you say, as did Mr. Patman, that the credit of the United States would be behind these notes.

Mr. OWEN. Why, certainly.

Mr. KNUTSON. That being true, why have the Federal Reserve issue these notes? Why not have the Federal Treasury issue them rather than the Federal Reserve?

Mr. OWEN. The Federal what?

Mr. KNUTSON. The Federal Reserve. Why not have the Federal Treasury issue the notes and put them in circulation.

Mr. OWEN. The Treasury would, in effect, be using this agency as its place of deposit and would be using it so as to distribute its activities throughout the 12 districts according to the respective demands in each of those districts. They need the mechanism and the mechanism has been extremely useful for that purpose. The notes of indebtedness to the Reserve banks proposed by me are in very large denomination and not currency but the basis of bank credit. Over 90 percent of our business is thus transacted by checks.

Mr. KNUTSON. Would the Treasury be unable——

Mr. OWEN. The Treasury would have to set up similar mechanism. They have already got all they need in the Federal Reserve System for that purpose. And it should prove the extreme value of the checking system. It is much better than currency. This Federal Reserve System would take your check in California, without you paying postage, or charging you collection or anything else, and it is transferred at par, so that when you write a check on a valid bank, you just send that as money and it functions as money because it transfers money and can be converted into legal tender on demand.

Mr. KNUTSON. And we have travelers' checks——

Mr. OWEN. That is another form of it.

Mr. KNUTSON. I understand, it is a form of negotiable paper that is good all over the country.

Mr. OWEN. All over the world.

Mr. KNUTSON. But you do feel it is necessary to operate the plan proposed in H. R. 1 through the Federal Reserve?

Mr. OWEN. Oh, yes.

Mr. KNUTSON. It couldn't be done through the Treasury?

Mr. OWEN. It could be, but it would be expensive and awkward and require a reorganization. It is unnecessary to do that, because they have a wonderful organization now.

The CHAIRMAN. Thank you, Senator.

Mr. OWEN. Well, I am much obliged to you gentlemen, for your patience with one of your old brothers, and I appreciate coming in and having a little chat with you. I know you will act with patriotism and with intelligence.

The CHAIRMAN. We thank both you and Mr. Patman for your appearance and the information given the committee.

Mr. PATMAN. Thank you, Mr. Chairman. May I express the hope that if you do not pass on this in connection with this bill that you give me a hearing on it some time in the future?

The CHAIRMAN. The committee will now adjourn to reconvene at 10:30 tomorrow morning.

(Whereupon, at 12:30 p. m., the committee adjourned, to reconvene at 10:30 a. m., Wednesday, March 5, 1947.)

DIRECT PURCHASES OF GOVERNMENT SECURITIES BY FEDERAL RESERVE BANKS

WEDNESDAY, MARCH 5, 1947

House of Representatives,
Committee on Banking and Currency,
Washington, D. C.

The committee met pursuant to adjournment at 10:30 a. m., the Honorable Jesse P. Wolcott, chairman, presiding.

The following members were present: Messrs. Wolcott, Gamble, Smith, Kunkel, Talle, McMillen, Kilburn, Cole, Hull, Stratton, Banta, Fletcher, Foote, Spence, Brown, Patman, Monroney, Folger, Riley, Buchanan and Boggs.

The Chairman. The committee will be in order.

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

The Chairman. Had you finished with the witness, Mr. Patman?

.Mr. Patman. I would like him to elaborate a little on a question I asked yesterday on which he did not have an opportunity to finish because it was late. If he would just elaborate on the earnings of the commercial banks, I would appreciate it. He said any excess earnings might be considered a subsidy, and I wanted to ask him what his remedy is, if he has any remedy, or if the Board has discussed any remedy.

Will you just discuss that point, Mr. Eccles?

Mr. Eccles. Which point is that?

Mr. Patman. About the excessive earnings of banks. You said excessive earnings might be considered a subsidy. I would like you to comment on that and especially state what your remedy for it is, if you have any remedy or any suggestion to make as to what should be done concerning the matter.

Mr. Eccles. I would like to correct the statement that you just made, that I said that any excess earnings would be considered a subsidy.

Mr. Patman. Might be considered a subsidy.

Mr. Eccles. As I recall, you had referred to the earnings that the banks got from the interest on Government bonds as being a subsidy, and I had said that I could not agree that all the earnings that the banks got on Government bonds would be a subsidy, but that to the extent to which the banks made excessive earnings out of their interest or income from Government bonds, that that might be considered a subsidy.

Mr. Patman. That is right. That is what I understood. That is the way I understood it. Now, have you considered any remedy or do you believe that any remedy is appropriate to suggest?

98702—47——6

Mr. Eccles. The Board's report of a year ago indicated ways in which the control over the purchase and sale of Government bonds by the banking system could be secured. As it is now, so long as the Reserve System stands ready to purchase all Government securities which are offered, at what we may term the market, and as long as we really make the market by supporting the short-term rate at ⅞, and the long-term rate at 2½, it permits the banks—rather, the Federal Reserve—to control their purchases and sales of Government securities. It enables them to control the amount of reserves that the banking system creates, and thus it gives them a control, to a very great extent, over earnings.

The earnings of the banking system, during the past few years, have been rather large.

I would like to point out here some figures that would indicate the trend of earnings and the source of earnings. They are shown in detail in the accompanying table.

(The table is as follows:)

Member bank earnings, expenses, and dividends 1929, 1935, and 1940–46

[In millions of dollars]

Item	1929	1935	1940	1941	1942	1943	1944	1945	1946 estimate
Earnings	2,399	1,207	1,323	1,417	1,487	1,650	1,874	2,102	2,397
Interest and dividends on securities:									
United States Government	473	467	[1] 229	[1] 239	[1] 336	[1] 594	[1] 802	997	1,060
Other			202	206	204	172	158	139	155
Interest and discount on loans	1,563	498	595	665	649	563	563	588	765
Other earnings	363	242	297	307	293	321	351	378	417
Expenses	1,684	833	921	988	1,002	1,039	1,127	1,268	1,467
Salaries and wages	464	334	400	426	461	487	525	580	700
Interest on time deposits	445	196	147	140	128	124	144	183	215
Other expenses	[2] 775	[2] 303	[2] 374	[2] 422	413	428	458	505	552
Net current earnings before taxes on income	[2] 715	[2] 374	[2] 402	[2] 429	485	611	747	835	931
Recoveries, profits on securities, etc.	137	376	303	278	188	312	318	454	[3] +102
Losses and charge-offs	295	538	356	318	223	251	232	230	
Profits before income taxes	------	------	------	------	451	673	833	1,058	1,033
Taxes on net income	(2)	(2)	(2)	(2)	68	115	184	270	284
Net profits	557	212	349	390	383	557	649	788	749
Cash dividends declared [4]	387	187	210	211	203	208	226	246	263
Asset and liability items: [5]									
United States Government securities	4,161	11,492	14,823	17,753	25,408	48,182	60,324	71,795	71,216
Other securities	5,951	5,422	5,799	5,994	5,842	5,286	5,131	5,566	6,384
Loans	25,615	11,985	14,298	16,699	17,218	16,229	17,682	19,815	24,256
Total assets	46,954	41,607	58,025	65,044	72,610	94,299	108,920	125,132	132,315
Time deposits	13,332	10,181	12,055	12,458	12,413	14,176	17,198	21,487	25,904
Total deposits	37,295	35,694	51,919	58,717	66,103	87,381	101,484	116,983	123,453
Total capital accounts	6,360	5,118	5,597	5,798	5,977	6,304	6,712	7,243	7,868
Ratios:									
Net profits to total capital accounts	8.8	4.1	6.2	6.7	6.4	8.8	9.7	10.9	9.5
Interest and discount on loans to loans	6.1	4.2	4.2	4.0	3.8	3.5	3.2	3.0	3.2
Interest and dividends on securities to securities	4.7	2.8	2.1	1.9	1.7	1.4	1.5	1.5	1.6
Interest on United States Government securities to United States Government securities	(6)	(6)	[1] 1.5	[1] 1.4	[1] 1.3	[1] 1.2	[1] 1.3	1.4	1.5

[1] Estimated.
[2] Taxes on net income were included with "other expenses" and, therefore, deducted in computing net current earnings prior to 1942.
[3] Net recoveries.
[4] Includes interest paid on capital notes and debentures.
[5] Figures are averages of the amounts reported for every call date in the current year and for the last call date in the preceding year, except for 1944 when the figures are the averages for three call dates, the spring call being omitted.
[6] Not available.

Mr. ECCLES. Going back to 1929, the net earnings of all member banks of the Federal Reserve System—and this is the figure shown on the table as net profits, which is after taxes, after charge-outs, and including recoveries, profits on securities—what could be termed the net profits before dividends—were $557,000,000. Earnings on all securities were $473,000,000; earnings on Governments were not separated from other securities at that time, because the amount of Governments held in 1929 was almost negligible.

Now, the total capital account, capital surplus and undivided profits, was $6,360,000,000, at that time. The percentage of earnings on the capital account was 8.8 percent. That is what was earned in 1929.

Of course, in 1931, 1932, and 1933, the banking system as a whole made no money. Their losses were so great that they were in the red.

In 1935 member banks made $212,000,000 net, as against the $557,000,000 in 1929—about 40 percent as much.

They made net 4.1 percent on their capital account, which had shrunk from $6,300,000,000 to $5,100,000,000: they lost $1,200,000,000 of their capital in that period.

Now, coming down to 1940, the earnings went up to $349,000,000. On the capital account, they earned 6.2 percent.

In 1943, they earned exactly the same amount as they did in 1929, $557,000,000.

They then went up in 1944 to $469,000,000, and in 1945 to $788,000,000.

In 1946 on the basis of preliminary figures net profits of member banks are estimated at $750,000,000, slightly less than in 1945. The decrease in 1946 occurred notwithstanding a further increase in gross earnings; it was due in part to an increase in expenses and in part to a decline in recoveries and profits on securities sold, while losses and charge-offs continued comparatively large, and to an increase in tax accruals.

So that, for the past 4 years, member banks have earned as much as they did in 1929, in 1 year, and in the other years, far in excess of what was earned in 1929, which was by far their best year.

Mr. FLETCHER. Do you have the percentages on those last 4 years?

Mr. ECCLES. Yes; I was just going to give you the growth in the capital account.

The capital account in 1943 had gotten back to where it was in 1929. They had recovered all of their losses out of earnings, of course.

In 1944, member banks capital accounts went to $6,700,000,000, and in 1945 to $7,200,000,000, and in 1946, to nearly $7,900,000,000, or $1,500,000,000 more in capital account than in 1929.

Now, the percentages on the increasing capital—you have to remember that as the earnings are put back in, the capital is larger, and hence the same amount of earnings would bring down the percentages, because of increased capital—the earnings, in 1943 were exactly what they were in 1929, 8.8 percent of capital accounts.

Mr. PATMAN. Mr. Eccles, could you not put a detailed statement as to those figures in the record?

Mr. ECCLES. I would be glad to do that.

Mr. PATMAN. And confine yourself to the statement we were discussing.

Mr. ECCLES. Well, I just wanted to make one point here, Mr. Patman, and then I will finish that statement. I would like to point out the amount of member banks earnings, the picture of the earnings and the amount from Government securities, because that would make this point.

Mr. PATMAN. Yes, sir.

Mr. ECCLES. In 1944 the ratio of net profits to total capital was 9.7 percent; in 1945, 10.9 percent; in 1946, an estimated 9.5 percent. The decrease in 1946 is partly because the capital has gone up and partly because net profits were slightly smaller than in 1945, as explained previously.

Mr. PATMAN. Now, just one moment, as to that capital, do you include undivided profits?

Mr. ECCLES. This includes capital, surplus, and undivided profits.

Mr. PATMAN. Why do you include undivided profits? Can they not distribute those profits any time they want to?

Mr. ECCLES. They can, but they have not and use them in the business; they are, therefore, entitled to figure the earnings against what belongs to the stockholders in the business. The capital, surplus, and undivided profits represent the stockholders' interest in the business, and, therefore, any earnings should be figured against that capital account.

Mr. PATMAN. I do not want to argue with it. I just want to know.

Mr. ECCLES. That is why we consider that stockholders' money.

Now, with reference to what portion of this income is on Government:

In 1943 member banks earned $594,000,000 on Governments. The interest on Governments was more than the net profits.

In 1944, the income from Governments was $802,000,000.

In 1945, it was $997,000,000.

In 1946, it is estimated at $1,060,000,000.

Mr. PATMAN. As compared with total earnings of how much?

Mr. ECCLES. In 1946, the estimated net earnings after taxes were $750,000,000, or the interest on the Governments was $300,000,000 more than the net earnings of the banks. I would like to also make this point: that the earnings on Governments, as shown in these bank statements, are somewhat less than the interest paid by the Government on the bonds held, because a great many of these securities held by the banks were bought in the market at premiums, and the earnings are figured after those premiums are amortized. Therefore, the earnings do not reflect the coupon rate, and do not reflect the amount of interest the Government actually has to pay on the securities. It does reflect, of course, what the bank gets out of them, but the speculator bought and sold them at a profit—and there were hundreds of millions of dollars of profits made on Government securities by that process.

This gives you the picture in a general way of the bank earnings—net earnings—the bank capital structure, and that portion of the earnings coming from the Government securities. Now, in order that I not be misunderstood, I should like to say that in the forecasts that we are now making of bank earnings, we expect that they are going to go down rather rapidly this coming year, and possibly in future years, unless there is a very large growth in their loans, which we would not like to see, because bank loans at the present time have reached the high of 1929, and they had a more rapid growth last year than ever before in their history.

There is, of course, the same inflationary element of danger in a rapid growth of bank loans on securities, on real estate, or to consumers, or for almost any other purpose, that do not result in an actual increase in production. Loans to carry excessive inventories—all that type of bank credit—is very inflationary, and can be fraught with danger to the economy as a whole.

Bank earnings, according to our estimates, are likely to drop further next year, we estimate, from $750,000,000 in 1946 to perhaps as low as $650,000,000 in 1947 or about 8 percent of capital. Now, there are two reasons for that expected drop in bank earnings: In the first place, we expect their expenses to go up, perhaps as much as $150,000,000. That is due largely to increased wages and salaries. Bank employees have been notoriously underpaid, especially the clerical forces, and banks are increasing their pay, and that is the biggest item in the increased expense.

On the other hand, bank holdings of Governments have been declining during the past year, and the first part of this year will continue to decline, due to the Government debt-retirement program. Member banks earnings on Governmental securities, therefore, may decline to less than $1,000,000,000.

The element of danger in this situation is that with banks' expenses increasing and their earnings dropping from low interest rates—from the decrease in holdings of Government securities, there will likely be an effort on the part of the banks to recoup or to maintain those earnings, and they may sell short-term Governments and go out in the longer-term market and monetize the public debt. That is the danger element in the situation, and that is a situation which we cannot control directly, which would likely be influenced indirectly if we increased the short-term rate. It would relieve the necessity of the banks selling short-term securities and buying the longer-term securities. And that is the matter that I discussed yesterday. The alternative to that is getting direct controls through the legislation that the Board recommended to the Congress last year.

I am sorry to have taken so much time on this matter, but it is not a subject that can be explained very simply.

Mr. KUNKEL. Will you yield for a question?

Mr. PATMAN. I am through.

The CHAIRMAN. Mr. Kunkel.

Mr. KUNKEL. Mr. Eccles, do not most of the banks write off the premium they pay on Government bonds immediately?

Mr. ECCLES. No, sir. I do not know how many, but I would say that a very few of them do.

Mr. KUNKEL. It is the recommended practice in Pennsylvania, by the banking department.

Mr. ECCLES. Well, if they did write off the premium, out of earnings, extensively, then, the earnings which they have been reporting are really lower than they should reflect.

Mr. KUNKEL. That is true. Because they absorb the premium all at one time.

Mr. ECCLES. However, I do not believe they would be permitted to write off the premium for income-tax purposes. They could do it for accounting purposes. But I am sure the Government would not permit them to pay a certain price for securities and then write them down and charge it against their earnings for tax purposes. It would be my view that there is not very much of that done. I think what banks do generally is that the profits that they make on the sale of Government securities—and they have made very substantial profits during the war loan drives—they frequently set those profits up in a special reserve to take care of losses on Government securities. In other words, those reserves would tend to offset the premiums that they paid for securities in case there was a decline in the Government security market.

For instance, speaking of profits on securities, in 1943 member banks made $312,000,000 in profits on securities and recoveries. In 1944 they made $318,000,000. In 1945 they made $454,000,000. Now a substantial portion of those profits are from operations in Government securities—selling them at a profit in the market.

Mr. KUNKEL. That is a nonrecurring item, is it not?

Mr. ECCLES. That is another reason why the earnings this year, and in the future, are likely to be what I would consider more normal. There is no question but what, for the war years, the banks as a whole have made excessive profits out of their Government security accounts, and we might say that there is some subsidy that the Government permitted them to get as a result of that. That is not likely to be the case in the future—certainly not to the extent that it has been so in the past.

The CHAIRMAN. Mr. McMILLEN.

Mr. McMILLEN. Is there any provision now that would require the payment of this so-called overdraft after it was once created, on the part of the Government? To pay it off?

Mr. ECCLES. Well, there is the same obligation to pay it off that there is for the Government to pay off any of their obligations.

Mr. McMILLEN. As far as the law would exist, then, the Government could create this so-called overdraft up to $5,000,000,000 and it would be possible for it to remain that way continuously?

Mr. ECCLES. Well, no more than it would be possible for the bills that fall due in 90 days not to be paid and to remain that way continuously. The overdraft is an obligation that falls due every day, so that, if the Reserve System refused to extend the overdraft, the Government would be in default, the same as it would if it failed to pay its 90-day bills as they fall due, or their certificates or any other obligations. The overdraft is a 1-day obligation, and because the amount of the overdraft changes from day to day, a Government certificate covering the 1-day overdraft is issued each day, which would mean the certificate issued for the overdraft of the previous day is paid off by a new certificate.

Mr. McMILLEN. Well, it is a continuing privilege that exists, up to the limit, the ceiling; is that so?

Mr. ECCLES. That is a continuing privilege which exists if the Federal Reserve is willing to extend the overdraft. It is the same privilege that exists if the Federal Reserve is willing to buy Government bills or certificates or any other security in the market, and, of course, the Federal Reserve is going to support the Government security market. It is essential, if the economy is to survive at all. We could not permit a chaotic situation to develop in the Government security market.

Mr. McMillen. This is a privilege that the Government is asking, that an individual is denied in commercial banking, in creating overdrafts. That is true, is it not?

Mr. Eccles. Well, an individual has a line of credit—this, in fact, is not an overdraft, in the sense that the individual is denied an overdraft in the bank. In an overdraft by an individual, the individual gives no note, he does not give any acknowledgment of the obligation, and in the case here, it is not just an overdraft, in that it is a line of credit. We call it a 1-day obligation, or a demand obligation.

It really is not an overdraft. It is a 1-day obligation, and an individual is not denied a 1-day obligation by a bank if his credit is good.

Mr. McMillen. Now, may I ask you one question on section 2 of the bill? What amount would you estimate would be necessary to erect the branch bank buildings to accommodate the increased business at this time, an estimate in total dollars and cents that would be contemplated?

Mr. Eccles. I could not possibly give you an estimate, because the initiation for it has to come from the bank in the district involved. Each branch which feels that its facilities are inadequate and desires to expand its facilities would have to hire an architect and would have to make plans and estimates of what it would cost, and that, in turn, would go into the head office.

Mr. McMillen. Would you say it would be in terms of millions or tens of millions of hundreds of millions of dollars?

Mr. Eccles. It certainly would not be in terms of tens of millions or hundreds of millions. It might involve several million dollars, over a period of years. But I am sure that it would not be any very large figure—a few million dollars over the next few years is certainly all that would be contemplated.

Mr. McMillen. That is all.

The Chairman. Mr. Monroney.

Mr. Monroney. Mr. Eccles, do you know of any case in the world's history where any Government or nation, principality or kingdom, has ever carried as much public debt as the United States is now carrying, measured in value?

Mr. Eccles. No, I do not know of any country that has had a public debt of the size of this debt, but there are certainly plenty of countries which have had public debts far in excess of the debt of the United States if it is measured in terms of the resources of the country and the ability to support the debt.

Mr. Monroney. But the debt danger would be not so much in regard to your frozen capital assets as to the turn-over in the business that the assets are doing; is that not true? In other words, if we ever got back to a 60 billion dollar annual figure, we would just be hopelessly involved, would we not?

Mr. Eccles. Well, whether a debt is large or small is dependent upon the national income, or the national product. A $260,000,000,000 debt, with a national product of over $200,000,000,000, as it is running today, is a much smaller debt, so far as the ability of the economy to support it is concerned, than is the case in many countries in the world today. Debts of other countries, in relation to their national product or income, are larger than this country's debt. The measure of the burden of the debt is not the size of the debt; it is the interest cost annually which is the measure of the burden.

Mr. MONRONEY. Right there: What is our average interest rate on all securities?

Mr. ECCLES. 2.06 percent.

Mr. MONRONEY. What is the average historic interest rate that we have had to pay during the past 160 years on our public debt? Is that available, or could you give any estimate as to that?

Mr. ECCLES. That is a figure on which we would have to do some research.

Mr. MONRONEY. Could you supply that for the record without too much trouble? I think it is a very important figure.

(The matter referred to is as follows:)

Interest rate on interest bearing national debt,[1] *1847–1946*

End of calendar year—	Computed rate of interest (percent)	End of calendar year—	Computed rate of interest (percent)	End of calendar year—	Computed rate of interest (percent)
1847	5.50	1881	5.13	1915	2.36
1848	5.59	1882	4.91	1916	2.38
1849	5.66	1883	4.66	1917	3.12
1850	5.72	1884	4.54	1918	3.91
1851	5.68	1885	4.51	1919	4.18
1852	5.59	1886	4.62	1920	4.23
1853	5.42	1887	4.74	1921	4.34
1854	5.25	1888	4.84	1922	4.24
1855	5.22	1889	4.92	1923	4.21
1856	5.25	1890	4.96	1924	4.18
1857	5.31	1891	4.94	1925	4.11
1858	5.40	1892	4.77	1926	4.09
1859	5.51	1893	4.65	1927	3.96
1860	5.62	1894	4.52	1928	3.88
1861	5.66	1895	4.40	1929	3.95
1862	5.75	1896	4.36	1930	3.81
1863	5.92	1897	4.24	1931	3.57
1864	6.04	1898	4.16	1932	3.51
1865	6.07	1899	3.98	1933	3.35
1866	6.05	1900	3.72	1934	3.18
1867	6.06	1901	3.45	1935	2.72
1868	5.98	1902	3.24	1936	2.56
1769	5.88	1903	3.01	1937	2.58
1870	5.79	1904	2.89	1938	2.59
1871	5.77	1905	2.82	1939	2.60
1872	5.75	1906	2.67	1940	2.58
1873	5.71	1907	2.60	1941	2.52
1874	5.73	1908	2.52	1942	2.29
1875	5.73	1909	2.44	1943	1.98
1876	5.74	1910	2.36	1944	1.93
1877	5.72	1911	2.36	1945	1.94
1878	5.71	1912	2.35	1946	1.98
1879	5.55	1913	2.35		
1880	5.38	1914	2.36		

[1] The data are those shown in a chart on p. 10 of Our National Debt After Great Wars, National Debt Series 1, by the Committee on Public Debt Policy.

Mr. ECCLES. Well, in general, the interest that the Government paid for the financing that it did during the last war was around 4 percent. There were securities that were put out at 4½ percent.

The CHAIRMAN. You mean in the First World War?

Mr. ECCLES. Yes; and those securities were partially tax-exempt. So that a 4½ percent tax-exempt security would be equivalent to a security that the Government might put out at a much higher rate, if the interest was taxable, such as is the case with the securities that it now has out.

Mr. MONRONEY. Would you say most of the debt, during the immediate period after World War I, averaged out at about 4 percent? We did not do much short-term financing then, did we?

Mr. ECCLES. The debt was being paid off during that period, and, as Mr. Thomas reminds me, during the twenties the short-term rate was as high as the longer-term rate. So if you will recall, the discount rate in the Federal Reserve banks was 6 percent.

Mr. MONRONEY. But during the immediate postwar period of World War I, then, the average was pretty close to about 4 percent, you would say?

Mr. ECCLES. I would say it was at least 4 percent, tax free.

Mr. MONRONEY. Yes. Well, I think we had better stay with the rate of the carrying charge on the Government debt, without getting involved in income-tax matters. In 1928, about what was it?

Mr. ECCLES. I do not think the rates changed any.

Mr. MONRONEY. In 1934?

Mr. ECCLES. I do not think there was much change.

Mr. MONRONEY. The point I am making then, is, if we go back to the immediate prewar history, a long run, where you do not have the unusually low interest rates that we are enjoying today, that the carrying charge on the public debt which, today is around $5,000,000,000, could easily become $10,000,000,000 if the rates went back to more nearly the historic normal?

Mr. ECCLES. If we had prevailing today the rates that prevailed prior to 1929, the interest carrying charge on the public debt would be twice what it is today, so that instead of a 5-billion-dollar burden on Government revenue, it would be a 10-billion-dollar burden.

Now, the fact that the interest is where it is, of course, is not just an accident. The interest is where it is because that is where the Federal Reserve System put it in conjunction with the Treasury—I mean with the approval of the Treasury. The rates during the twenties and during the last war, had there been an open-market committee—which there was not, in the Federal Reserve System—they could have financed the last war and financed the Government during the twenties at prevailing rates.

Mr. MONRONEY. Do you mean to say that with your present open-market committee, and the operation of the Federal Reserve, as it now stands, that, regardless of what the national income is, or other economic factors, that you can guarantee to us that our interest rate will remain around 2.06 percent?

Mr. ECCLES. We certainly can. We can guarantee that the interest rate, so far as the public debt is concerned, is where the open market committee of the Federal Reserve desires to put it.

Mr. MONRONEY. If you do that, you will probably force the monetization of the public debt and that, in turn, will bring inflation?

Mr. ECCLES. Well, that is correct. There is no question but what, if we force the interest rates down too low, that the investors would not buy Government securities, and the rates that are now in effect are a pattern of rates on which we agreed with the Treasury at the time of the war as the basis upon which the Federal Reserve would assure the Government financing. In other words, we assured them that they could finance the war, no matter what the amount of it was, on the basis of the rates that existed prior to the war, and that is exactly what was done.

Mr. MONRONEY. Then, if we do hold to this 2.06 rate, regardless of business conditions, it is pretty near definite that we will have inflation and a 50-cent dollar, or less, whatever the rigors of holding this interest rate would be?

Mr. ECCLES. I would not say that. No; I would not say that holding to this 2.06 rate would be inflationary at all.

Mr. MONRONEY. It would be if the national income goes to pot, would it not?

Mr. ECCLES. Well, I would not say that. This is an average rate. The rate that savers are getting runs from 2½ to 2.9 percent—2.9 percent is the return they get on the E bonds if they carry them to maturity; 2½ percent is the return they get on the F and G bonds, if they carry them to maturity.

The 2.06 rate, of course, is the average of all securities. Now, to the extent that the short-term debt, held by the banking system, is taken up by savings funds—that is, by the sale of the E, F, and G bonds, just to that extent the interest rate that the Government is paying would be increased, and I think it would be desirable to have the public invest their savings, if they choose to, in savings bonds, and these funds be used to pay off the bank-held indebtedness.

The only reason that the banks financed the war to the extent that they did is because the amount that was raised in taxation, and from the sale of savings bonds, was not adequate, and the banks supplied the difference. Now, to the extent that the savers are willing to buy Governments on balance, those surplus funds, if the Government has a balanced budget, would be available to retire the short-term debt.

Mr. MONRONEY. As your bank loans go up, and which you testified a few moments ago are now as high as in 1929, would there not be a tendency for the banks to back away from this extremely low short-term Government financing?

Mr. ECCLES. Well, I think that the banks are not going to increase their holdings of short-term securities, but that is the danger point in a short-term rate. The danger point, in the short-term rate, is that to the extent that the banks do not take the short-term securities as they are rolled over, or as they are refunded, the Federal Reserve has to take them, or permit the rate to go up to a point where the banks would take them. To the extent that the Federal Reserve takes them, it creates reserves, and those reserves become a basis for a multiple expansion of credit.

If the banks then reach out to buy the longer-term market securities, the effect of that is to drive the long-term rates down. That is why the 2½ percent market bonds which were sold in the eighth drive are selling at more than 103, or around 103. That is why some of the other issues are selling as high as 105. And the rate is not 2½ to the purchaser, the rate is down in some of the bonds to as low as 2 percent, although the coupon may be 2½, the yield is 2 percent.

Mr. MONRONEY. The only reason for that purchase is because they can monetize the public debt with those long-term bonds; is that not right?

Mr. ECCLES. Well, the banks cannot buy those particular bonds directly, but the banks can buy other bonds which are held by the insurance companies and savings banks and investors, and they sell the bonds that the banks can buy and they, in turn, are investing their money in these other securities to such an extent that they have driven them up to these premiums. So it is due to the fact that the banks can monetize the debt, that you create money in excess of the opportunity for investment, and where you create money in excess of the opportunity for investment, you drive down the rate.

Now, there would be no objection to driving down the rate if savings actually exceeded investment demand, but where the rate is driven down through a pure creation of bank money, then, the long-term savings rate is not an expression of the supply of savings money in relation to the demand, and that is where the element of danger comes in, if we permit a monetization of the public debt.

Mr. MONRONEY. It is just purely inflationary when it finally gets around the complete circle. No matter what mechanism they use, when you monetize the public debt by getting these bonds that the banks can hold, you have put that much inflation into your system?

Mr. ECCLES. That is right, and, of course, this other element of danger is also present: To the extent that the banks sell bonds to the Reserve System for the purpose of loaning money when those loans are inflationary in nature, you can have an inflation through the expansion of private credit, such as we had in the stock market in 1929, and today, if banks were permitted to loan excessively on securities, or if they loaned excessively on real estate, on inventories, or on anything, for that matter, aside from loans to get production, it could be just as inflationary to sell bonds to the Reserve System, and build reserves for the purpose of making private loans as would be the case if the banks purchased long-term Governments with the funds that they secured from the sale of short-term Governments.

Mr. MONRONEY. Would you not say, then, that if the Congress should determine on a course of debt reduction—that is, a good sized debt reduction, maybe 6 or 7 billion dollars in debt reduction—it would be an anti-inflationary move?

Mr. ECCLES. Any amount that can be paid in debt reduction by the Government out of a budgetary surplus is anti-inflationary.

Mr. MONRONEY. That is right.

Mr. ECCLES. Just as any deficit financing by the Government, through the banking system, is inflationary.

Mr. MONRONEY. In other words, we will be making up for the lack of taxation we had during the war, in which we spread these bonds around with the banks, because of our unwillingness to tax. Now, we have a chance to correct that error somewhat if we go into a period of rigorous debt reduction out of budgetary surplus; is that true?

Mr. ECCLES. That is correct. However, I think there is an element of danger in too much debt reduction. As I indicated yesterday, it is deflationary, and to the extent that a recession or a deflationary development should transpire, a budgetary surplus applied against the debt would, of course, accentuate your deflation.

Mr. MONRONEY. You would not think a $6,000,000,000 retirement of the debt would be deflationary, would you, out of a $260,000,000,000 public debt?

Mr. ECCLES. Well, that is rather difficult to say. I would not think, at the moment, it would be. What it will be a year from now, is something that would be difficult to predict.

Mr. MONRONEY. We are still in an era of inflationary dangers, though, are we not?

Mr. ECCLES. We are still—I do not agree with some that there is a very great element of danger today, unless we had a budgetary deficit, and unless a round of substantial wage increases should be undertaken, and that was reflected in prices. That could, of course, create a further inflationary development which would be rather short-lived, in my opinion.

Mr. MONRONEY. Then, you would have abuse.

Mr. ECCLES. That is right. That very situation, of course, would bring about a serious decline.

Mr. MONRONEY. In relationship to the conditions of the country today, when we have pretty close to record national income, is it not good, sound banking policy, as well as good business policy, to reduce the debt as much as possible, while we are able to do it?

Mr. ECCLES. I think so. I think that, with the huge volume of liquid assets in the form of currency, bank deposits, and Government securities, which are the equivalent of cash, that we could stand for a pretty substantial payment on the public debt.

Mr. MONRONEY. It can be done with less danger while your volume of business is good and the danger of creating deflation is far less than if you wait until the volume of business goes down considerably, and then you start reducing the public debt?

Mr. ECCLES. Well, as a matter of fact, it is the only time when you can make substantial payments on the public debt.

Mr. MONRONEY. In other words, if we delay now in making a substantial payment on the public debt, we will run the risk of finding ourselves practically freezing—if business declines, as predicted by experts—practically freezing the present public debt and the present record-breaking high level?

Mr. ECCLES. Well, that is likely to happen. That is likely true. I mean I think that is true. It is easier to make payments on the public debt without having a deflationary effect while private credit is expanding than it would be to make payments if private credit was contracting. In other words, as the bank loans increase, their holdings of Government securities through Government retirement of those securities could decrease without it being deflationary. In other words, one would offset the other.

Mr. MONRONEY. Retirement of as much debt as possible, roughly speaking, then, would strengthen the position of Government bonds with the public and help to preserve confidence in our public debt structure?

Mr. ECCLES. Well, I do not think that would be true. I think that the confidence in the public debt today is very great, and it is very great because the open-market committee manages the market and supports the Government debt structure. It is great today because the amount of savings by individuals and institutions is great, and because the national income is great. Therefore, the demand, at least, for the long-term Government securities is supported by this public demand.

Mr. MONRONEY. Is it public demand or bank demand?

Mr. ECCLES. Well, public demand on the 2's and the 2½'s, but, as I indicated awhile ago, the very fact that the banks can monetize some of the debt, of course——

Mr. MONRONEY. And do get these bonds eventually, after they go around the circle, to monetize the debt?

Mr. ECCLES. That is right, and that, of course, is tending to support it. But, in turn, that would not be possible if it was not for the Federal Reserve supporting this short-term rate.

Mr. MONRONEY. At the beginning of your testimony you said that you felt that the debt with relation to the national income was the measure you should take as to its actual size or its burden on the national economy, and that a $260,000,000,000 debt over a $200,000,000,000 national income is, roughly, 2.6 to 2, and yet, when we had a $45,000,000,000 dollar debt, in relation to a $90,000,000,000 income, the debt was only 1 to 2. Now, we have practically doubled the debt burden in relationship to our national income, and yet we find a Congress that is unwilling to go ahead and do whatever is necessary to reduce the public debt. We are apparently, from all sources that you can hear on the floor of the House, and in the newspapers, far more anxious to grant tax reduction than to grant debt reduction and keep the country on a sound financial basis.

Mr. FLETCHER. Will the gentleman yield?

Mr. MONRONEY. Yes.

Mr. FLETCHER. Is that a fact or just an opinion?

Mr. MONRONEY. I am expressing what I have heard on the floor of the House. If the gentleman thinks it is better to reduce the taxes than to reduce the debt, I think he should get in the record on that. I personally, in contacts with my constituents, have found they are much more anxious to have the debt reduced than taxes reduced at this time when, according to Mr. Eccles, we have the greatest public debt ever carried in the history of the world, and he also admits that the debt ratio in regard to national income is now higher, the debt is about twice as high in regard to public income as it was before the war when it was only one-half to 1.

Mr. FLETCHER. For the record, it is a fact that the Senate has already voted debt reduction, is it not?

Mr. MONRONEY. Of $2,600,000,000, which has been called "cock-eyed" by the chairman of the Appropriations Committee of the House, who, I presume, speaks for the Republican Party.

Mr. FLETCHER. That is just presumption, though?

Mr. MONRONEY. I have not heard it denied by any member of your party yet.

Mr. FLETCHER. You will see it denied on the floor.

Mr. KUNKEL. Will you yield?

Mr. MONRONEY. Yes.

Mr. KUNKEL. I would like to know where you and Mr. Eccles get the figure of $200,000,000,000 for the national income. I understood last year it was $167,000,000,000.

Mr. ECCLES. National product.

Mr. KUNKEL. Well, what is the difference?

Mr. ECCLES. Well, the national product——

Mr. KUNKEL. I think we ought to get that straight, because I understand that the revenues——

Mr. ECCLES. The national product is the total value at the selling price of the amount of all goods and services produced, and national income is what individuals are paid for services—that is, salaries and wages, interests, dividends, profits. The difference is represented primarily by taxes that business pays and by depreciation that they charge off, which presumably represents capital equipment consumed during the year.

Mr. MONRONEY. One is a net figure of the other?

Mr. ECCLES. Yes. One is what the individuals get. The other is the total value of the product.

Mr. KUNKEL. The national income is the figure that you have to refer to in connection with taxes. Now, I just wondered if Mr. Eccles could tell us——

Mr. ECCLES. Not necessarily. The national income is dealing with individuals. The national product is dealing not only with individuals but corporations, and the ability to pay taxes is based on the national product.

Mr. KUNKEL. What is the national income running at this stage?

Mr. ECCLES. Around $175,000,000,000. It is at the highest it has ever been.

Mr. KUNKEL. If the national income drops from $167,000,000,000 to $160,000,000,000, I understand that that would cause a loss of revenue of approximately $5,000,000,000; is that correct?

Mr. ECCLES. I could not say. I think that there would have to be a lot of qualifications added to that statement.

Mr. KUNKEL. Well, if it is running at $175,000,000,000, then, assuming that the other statement is at least partially correct, the revenue would run higher than anticipated; would it not?

Mr. ECCLES. At the present tax rates, the higher the national income, the higher the amount of taxes that the Government is going to collect from individuals. The higher the national product, the more taxes the Government is going to collect from individuals and corporations.

Mr. MONRONEY. I have no further questions.

Mr. STRATTON. Mr. Eccles, if you do not mind, I would like to get back to this bill.

Mr. ECCLES. I would be very glad to have you come back to the bill.

Mr. STRATTTON. I have three or four questions here. One thing I am confused on is the average interest paid by Government bonds: 2.06 or 2.6.

Mr. ECCLES. 2.06.

Mr STRATTON. The amount of $5,000,000,000 was set during the war, presumably to provide for the emergencies of war. Why is an amount equally large necessary in peacetime?

Mr. ECCLES. When I appeared before the committees of Congress with reference to that bill, the $5,000,000,000 was not my idea. I figured they should reinstate the law as it existed for 20 years—from 1914 to 1935, that is. The Congress then put the limit of $5,000,000,000 in the bill. I feel that a debt the size of the public debt today, with the amount of refunding there is—that a smaller amount than $5,000,000,000 would be entirely inadequate.

Mr. STRATTON. You have only used $1,300,000,000 here.

Mr. ECCLES. That is right, but the very fact that you have a $5,000,000,000 limit enables the Treasury to carry much lower balances. Now, the fact that the war is over does not in any way lessen the Treasury's job of refunding the debt. The purpose of this proviso is to give the Treasury an assurance that they can take care of their immediate maturities without having to carry sufficient balances to pay them off. It simply meets that—and this is aside from the use to which this $5,000,000,000 of direct credit has been put—the use to which it has been put in the past has been pretty limited, and I think it well may be limited to just as great an extent in the future as it has in the past—that is, merely these 1-day credit arrangements during tax periods. However, the very fact that the Treasury has this line of credit immediately, enables the Treasury to operate with balances very much less than its maturities in any one month. In other words, the Treasury has maturities running from eight to ten billion dollars in a month, and it can operate on balances of one billion to two billion dollars, and I am sure that it would not feel like operating on that low a balance unless it had available upon a moment's notice this line of credit. It, therefore, is in the interest of the Government to permit this line of credit to be used, because it then means that the Government has that much less of idle balances upon which it pays interest on that much more public debt.

Mr. STRATTON. On that point I notice on your schedule here, you do not show any figures for 1946. Would that mean that they were not available or that you did not use this overdraft procedure in 1946?

Mr. ECCLES. I do not think we used it.

Mr. KILBURN. Do you contemplate the use of this authority other than as a temporary measure at tax-payment debts, when large disbursements are to be made for such purposes, which are offset within a few days by tax collections?

Mr. ECCLES. Well, I do not contemplate that we would have to use it for any other purpose, but I certainly would feel that we could use it for any purpose that was in the interest of the Government to use it. That is, if a Treasury certificate issue fell due, and the Treasury felt it inadvisable at that particular time to try to roll that over into the market—that the market situation was not satisfactory or favorable, that, at least on a temporary basis, the Reserve System should be in a position to take up such an issue directly. As I say, it has never been done, and the very fact that it can be done reduces, or practically eliminates, any possibility of it having to be done.

It is my feeling, personally, that the Reserve System can create a market by its purchasing in the market prior to any maturity that would assure a sale of that maturity in the market. At the same time, I think if I was the Secretary of the Treasury, with the responsibility of managing the public debt, which, after all, is his responsibility, and refunding it, I would want to feel that if the market was not satisfactory or favorable, I was not going to be left with a maturity that would not be readily taken, and that I would have no credit line available. I think if I was in that position, I would want to be carrying, instead of 2 or 3 billion dollars of balances, 6 or 7 billion dollars of balances.

Mr. KILBURN. Then, it is possible that you may depart from your previous practice?

Mr. ECCLES. If the need develop, we would certainly do that, and if the need develop, it would be extremely unfortunate if we did not have the authority to do it.

Mr. KILBURN. And even though you have never used more than $1,300,000,000, you still want the $5,000,000,000?

Mr. ECCLES. At least $5,000,000,000. I would think it would be better if we had $10,000,000,000.

Mr. Kilburn. There are recurrent reports of a change in the system of handling Treasury bills, most of which are now held by the Reserve banks. Will the availability of this $5,000,000,000 authority result in direct dealing between the Treasury and Reserve banks with respect to some of these bills?

Mr. Eccles. As I explained yesterday, we think that we should deal directly with the Treasury right now, with reference to these bills. Our lawyers say it has no relationship to this authority; that, because of the fact that we have already bought the bills in the market, we should have the privilege of using the maturing bills each week in the payment of the new bills that are offered, as we do in the case of certificates and bonds that mature. We refund them directly. We have always done that.

Mr. Kilburn. That is all, Mr. Chairman.

The Chairman. Mr. Folger.

Mr. Folger. Mr. Eccles, I am trying to remember the years that I was in the courthouse practicing law, and I will not depart from the relevancy and materiality of any questions I may ask as related to this bill.

I want to ask you a question or two about the value of the Federal Reserve bank not having to pay commissions on the bonds that are bought directly from the Treasury. That is one of the advantages of this bill; is it not?

Mr. Eccles. No; I would not say that that was an advantage, because we do not expect to buy any securities direct from the Treasury.

What I said in my statement was that the objections that some people raise to the bill are based on the principle that they feel that no Treasury financing should be done except through the market. And, of course, to the extent that it is done through the market, a commission is received by the dealers whenever the Reserve System buys securities in the market.

We expect to continue to do that. We do not object to that. And the purpose of the bill is not to change in any way the relationship that has existed between the market and the Federal Reserve System.

The initiative for the sale of securities is on the part of the market—that is, the owners of the securities. The Federal Reserve does not go out and bid up the price of securities. It does not go out and buy the securities, except when those securities are offered to the Federal Reserve, because that is the only market available at the support price.

The great bulk of securities that the Government bond dealers handle never come to the Federal Reserve at all. The Federal Reserve only gets those securities which cannot be readily sold to others at or above the support price. And, of course, the commission is paid by the seller of the securities.

Mr. Folger. But that probably is reflected in the amount that has to be paid for the securities, even by the Federal Reserve; is it not?

Mr. Eccles. I do not get your point, Mr. Folger.

Mr. Folger. Notwithstanding the fact that, technically the seller may pay the commission, that commission is finally taken care of in the purchase of the securities; is it not?

Mr. Eccles. Well, that is right; yes. Naturally, the securities are going to be sold at the purchase price plus the commission.

Mr. Folger. Yes. I did not object to that at all. And I was not troubled about it, either, because this is more to provide for that period when the Treasury may have a few days in which moneys are going out and relatively not so much coming in.

Mr. Eccles. Yes. The only purpose for which it would be used—and, I think, the only purpose for which there will be any occasion to use it—would be in the same manner in which it has been used in the past.

Mr. Folger. And it is a somewhat unhappy suggestion that this is no more than an overdraft transaction.

The bill states that "Any bonds, notes, or other obligations which are direct obligations of the United States, or which are fully guaranteed by the United States, may be bought by the Federal Reserve," as this bill provides.

Mr. Eccles. Yes.

Mr. Folger. It is not what we commonly know as a slipshod overdraft proposition.

Mr. Eccles. Well, as I explained to one of the Congressmen earlier, this really is not an overdraft. An obligation is issued, for 1 day, by the Treasury to the Federal Reserve Bank of New York, and it would be considered a 1-day obligation and would bear a small rate of interest.

Mr. Kilburn. What is that rate?

Mr. Eccles. A quarter of 1 percent per annum.

Mr. Folger. I was wondering, before you made this statement, whether this $5,000,000,000 was deemed a ceiling that was considered entirely sufficient to meet any situation which might arise. But you said it might have been $10,000,000,000.

Mr. Eccles. Well, I think the $5,000,000,000 is certainly adequate to meet any amount that may be required on the 1-day basis, and I do not contemplate that it would be used for any other purpose. However, I would think, that the Treasury would possibly feel more comfortable if it were a larger amount. I think, though, that they will be satisfied with an extension of the present authority.

For instance, in the month of April there are $8,000,000,000 of Government securities that will fall due in that one month. And $10,000,000,000 worth will fall due in the month of March. The fact that you have a line of credit available naturally is going to make the Treasury feel that they can get along with less balances than they could get along with if they did not have this line of credit.

The larger the line of credit available to them—it does not mean that they would use any more than they have—but the larger the line of credit in relation to their monthly maturities, the better they would feel, I imagine, about the balances.

Mr. Brown. Will you yield, Mr. Folger?

Mr. Folger. Yes.

Mr. Brown. You stated a moment ago that the rate of interest was one quarter of 1 percent. If you took care of $1,300,000,000 for the Treasury on one day that would amount to only one-three hundred sixty-fifth of a quarter of 1 percent; is that right?

Mr. Eccles. That is right.

Mr. Brown. In other words, it is just a "tip."

Mr. Eccles. It certainly does not cost a lot of money.

Mr. FOLGER. This arrangement would have the effect of having the Treasury feel a little more comfortable about the size of their regular balances; is that right?

Mr. ECCLES. I am sure it would.

Mr. FOLGER. That is all.

The CHAIRMAN. Mr. Cole.

Mr. COLE. Mr. Eccles, do I understand that you would object to an amendment to the bill which would restrict the purchase of the issues by the Treasury to special short-term Treasury certificates only?

Mr. ECCLES. Yes; I would feel there is no necessity for restriction. I think the record of its use, over the years, is sufficient to justify putting no restriction on it. I would see no purpose to be accomplished by the restriction.

Mr. COLE. However, would that not permit you to purchase any of these certificates from the Treasury and thus provide the balance required?

Mr. ECCLES. Yes, we could finance the Treasury on a day-to-day basis, but that would certainly seem to be an undesirable thing to do. If there were a situation that called for some other use of the fund, this is a fund that would be expected to be used only as an emergency matter and is certainly to be used only in the interest of the Government. The only people who are opposed to this are some of the New York banks. The rest of the banks of the Government favored it. The bankers' committee—with the exception, I think, of two bankers out of about 18—are very much in favor of this.

The Federal Advisory Council, which is composed of 12 bankers from all over the United States, are favorable to this. There are one or two bankers in New York who have been opposed to any direct purchase authority.

Mr. COLE. May I ask, though, whether they would be favorable if tomorrow a bill were passed to purchase direct $5,000,000,000 of Governments and to retain them in your assets? Would the banks be just as favorable to the idea?

Mr. ECCLES. If we what?

Mr. COLE. If tomorrow, under this authority, you purchased $5,000,000,000 of Governments direct?

Mr. ECCLES. Well, no; I suppose they would feel that unless we had some good reason for doing that they would not be favorable to it.

Mr. COLE. I am not assuming you are going to do it; I am just making the supposition.

Mr. ECCLES. Yes. Let me make this point: We could buy $5,000,000,000 in the market tomorrow. There is nothing to limit us from going right out in the market and buying $5,000,000,000 and then selling the $5,000,000,000 worth. The only difference would be that the $5,000,000,000 goes through the market and you pay the commission.

Mr. COLE. Yes.

Mr. ECCLES. That is the point. The price would be the same, because we determine the price. The opposition, as I say, comes from the dealers in Government securities, pretty largely, and it is entirely unjustified because there is no thought or intention, on the part of the open market committee, to interfere with the normal market—and they have been supported, over the years, by the Reserve System.

The Reserve System buys securities from nobody else but the Government bond dealers. And if a bank wants to sell to the system it cannot do so. It can only go through these channels. And they have been given, in a sense, a monopoly. But, of course, anyone can qualify to come in as a dealer.

But we have undertaken to protect the market, so that it has been a very profitable operation for those who got into the Government dealer business. And why they should object to this authority I do not know. I suppose they think it is a case where, if your toe is in the door at all, you might undertake to do all the financing directly and cut off operating through the market. And that, of course would, in a sense, be bad for the market.

Mr. COLE. The statement is made, however, that it is inflationary to permit you to purchase directly.

Mr. ECCLES. Well, it is inflationary to permit us to purchase indirectly. It does not make a particle of difference.

If we purchase directly we do not create any more reserves than if we purchase indirectly. And there is not a particle of difference in the inflationary effect of a direct purchase as against an indirect purchase—absolutely no difference.

Mr. COLE. Thank you. That is all.

The CHAIRMAN. Mr. Riley.

Mr. RILEY. Mr. Eccles, how many of your regional and branch banks are now renting outside space?

Mr. ECCLES. I really am unable to tell you.

Mr. RILEY. Could you get that information for us?

Mr. ECCLES. We will be glad to get it and put it in the record.

Mr. RILEY. I would also like to know what rent you pay for that outside space.

Mr. ECCLES. We will get that and put that in the record also.

(The documents referred to are as follows:)

Space rented by Federal Reserve banks and branches, Jan. 1, 1947, and rent paid during 1946

Federal Reserve bank or branch	Number of square feet of space rented Jan. 1, 1947	Rent paid 1946 [1]
Boston	12,000	$22,221.53
New York		9,422.44
Buffalo	7,500	10,028.88
Philadelphia	62,900	84,888.28
Cleveland		
Cincinnati [2]	60,568	111,384.77
Pittsburgh	5,634	18,647.57
Richmond	[3] 8,783	
Baltimore	11,000	17,901.87
Charlotte	2,140	3,796.98
Atlanta	5,000	14,351.17
Birmingham	12,591	12,168.80
Jacksonville	10,602	13,095.31
Nashville	9,125	21,714.61
New Orleans	7,900	27,008.21
Chicago	98,066	197,520.67
Detroit	38,336	79,250.90
St. Louis		8,293.67
Little Rock	1,683	1,885.68
Louisville	30,000	9,012.67
St. Louis—Continued		
Memphis	(4)	
Minneapolis	18,300	17,564.80
Helena		
Kansas City		
Denver	7,068	9,221.08
Oklahoma City	4,609	6,950.90
Omaha	12,200	17,731.45
Dallas	1,475	811.25
El Paso	2,755	4,093.39
Houston	(4)	3,643.96
San Antonio	[4] 7,762	10,938.75
San Francisco	26,800	17,767.99
Los Angeles	39,090	46,891.95
Portland [2]	39,950	42,760.81
Salt Lake City		
Seattle [2]	35,016	59,095.87
Total	578,853	900,066.21

[1] Rent paid in 1946 does not relate to space rented Jan. 1, 1947.
[2] Represents all space occupied by branch.
[3] Temporarily subleased. To be vacated shortly by present tenants. Annual rental, $14,844.
[4] Exclusive of some storage space.

Source: Board of Governors of the Federal Reserve System, Division of Bank Operations.

Mr. RILEY. You now have authority to construct these buildings within a $250,000 limitation of cost?

Mr. ECCLES. Yes, sir.

Mr. RILEY. That is all. Thank you.

The CHAIRMAN. Mr. Stratton.

Mr. STRATTON. I have only one further question.

Is it my understanding that this authority is only to be used sparingly, as in an emergency, and that you do not anticipate any continued condition where you have to use it all the time, as a common practice?

Mr. ECCLES. No; I certainly would not expect a condition to exist where we would use it any more than we have in the past; namely, merely to meet the situation that may develop principally at the quarterly tax period dates and for the purpose of smoothing out what we term the money market.

Mr. STRATTON. What conditions of the Treasury have obviated the necessity of using this power this past year? Can you tell us briefly why it is that in all of these other years you had to use this power and last year you did not have to use it?

Mr. ECCLES. I would have to study the situation that might have existed on these tax dates.

I think the situation in the past year was that the Treasury had cash and was paying off the debt. It had plenty of money to meet its obligations. It is quite apparent that, as I pointed out yesterday, as a result of the eighth war loan the Treasury built up in excess of $25,000,000,000 in balances, and during the past 10 months they were able to pay off in excess of $20,000,000,000 of maturing obligations. So it is quite apparent that their balances, both with the Federal Reserve and in the market, were so large that there was no need or justification for using this privilege.

Mr. STRATTON. Thank you.

The CHAIRMAN. Mr. Buchanan.

Mr. BUCHANAN. Would the enactment of this legislation have the tendency to ease, or would it tighten, or would it have no effect whatever on the open market?

Mr. ECCLES. I would say it would have no effect on the open market committee's operations. It is a help to the money market rather than to the System. It is a big help to the banks, because if the banks are losing deposits through the payment of taxes, and those taxes are piling up in the Federal Reserve banks to the credit of the Treasury, and at the same time there are maturing obligations of the Government so that the banks are also having to sell securities in order to get funds to meet the withdrawals that, if instead of drawing from what we call the war loan deposits accounts with the banks, are left there, then it reduces the pressure.

In other words, if the Treasury should withdraw from its balances with the banks at the same time that the customers of the banks are drawing out balances to pay their taxes, then you have a double pressure on the banks. And it is much better for the Treasury to not draw from the banks while the customers are drawing to pay taxes.

Therefore, in order for the Treasury to meet its expenses during this period when tax money is coming out of the banks, it is borrowed temporarily from the Reserve System. The tax money, as it comes in, is therefore used to pay off the Reserve System. So what really happens is that this one-day borrowing privilege is used in anticipation of tax receipts, and it smoothes out the demands or what I would say are the conditions in the money market. If this were not done, the banks would be forced to sell Government securitise to meet their withdrawals or would be forced to borrow from the Federal Reserve banks. And as long as it is for a very short period there is no use of putting them under those pressures. So this really is primarliy in the interest of the banks.

Mr. BUCHANAN. It would have a tendency to ease the money market?

Mr. ECCLES. It has a tendency to avoid a tightening. It keeps things more normal. It does not ease it any, but it would avoid what would otherwise would be a tightening.

Mr. BUCHANAN. This is aside from this legislation. What are the private capital requirements necessary for us to have an expanding economy, say, of $200,000,000,000 net income, in the next 5 years, as against what it is today—165 or 175 billion dollars?

Mr. ECCLES. You say if the national income is to increase?

Mr. BUCHANAN. To expand to a $200,000,000,000 net income as against 165 or 175 billion dollars this year.

Mr. ECCLES. Well, a lot of factors, of course, would have to enter into that. It would depend on the price level. If you could go up to a $200,000,000,000 national income without any increase in the use of capital, if you had enough inflation in prices——

Mr. BUCHANAN. Well, what are the private capital requirements necessary to create that type of an economy?

Mr. ECCLES. At the present price level?

Mr. BUCHANAN. Yes; at the present price level—expanded to a 25 percent higher net income level.

Mr. ECCLES. I do not think it is possible for anyone to say. It would be the roughest kind of a guess. But I would venture to say this: That there will be plenty of private capital available to take care of all of the capital requirements of an expanding economy and that the savings of the country as a whole will be adequate to meet all investment requirements.

I only hope that the savings of the country as a whole are in balance with new investment demands and do not exceed new investment demands, because if they do we will get a depression unless the Government runs a deficit and uses the excess savings and puts them back into circulation.

Mr. BUCHANAN. That is, if there is an overaccumulation of excess savings?

Mr. ECCLES. If there is an overaccumulation the Government will have to borrow that excess and put it into circulation. The effect of that is a deflationary process.

Mr. BUCHANAN. Well, the idea back of those who advocate tax reduction on an incentive theory basis is that there is a shortage of private capital and that we would greatly increase the amount of private capital available—hence, the reason for the incentive tax reduction.

Mr. ECCLES. Well, I just do not believe that that is true. Certainly, as of today, there is no evidence of any shortage of capital. The shortage which is slowing up expansion and investment in new projects is not the shortage of capital. It is a shortage of labor and a shortage of materials, and not of capital. Capital is one thing, in this picture, which is not short. And there is no need of decreasing taxes for the purpose of adding to the supply of savings to take care of the capital requirements.

Mr. FLETCHER. Will the gentleman yield?

Mr. BUCHANAN. Yes.

Mr. FLETCHER. Is it not a matter of the unwillingness of capital, rather than the lack of capital?

Mr. ECCLES. There is no unwillingness. The willingness of capital to invest is so great that all of the materials available—and they are in excess of any amount that we have ever had available—and all of the skilled labor available are entirely inadequate to meet the demands of capital.

Mr. FLETCHER. You are speaking of capital for expansion. I am speaking of venture capital for new business.

Mr. ECCLES. That is what I am talking about. I am talking about venture capital, because new businesses require men and materials, and there is so much venture capital now that there is a terrific shortage of both men and materials in every field you consider.

Mr. FLETCHER. For the record I would like to say that I have run across a great many large investors who will not venture with their capital at the present time because of the tax situation.

Mr. ECCLES. Well, that is what they say. But the point is that it is, maybe, a good thing that they do not, because the ones who are willing to venture today are so much in excess of supply of labor and materials that you would have an inflation. So that it is a very good thing if because of the tax situation a great many of them would not venture today. It is a very good thing that that is so and it is certainly desirable because if they did venture you would only add to the inflationary pressures while you have a short supply.

If we had a situation of unemployment and a situation of excess supplies, then we might say that anything that could be done to induce capital to use that labor and materials should be done. But it has been shown by past experience that with very low taxes venture capital does not go forward in a depression, because the opportunity for investment at profit ceases to exist. The very time when you need venture capital to go forward is the time when it does not.

The CHAIRMAN. Mr. Fletcher, have you finished?

Mr. FLETCHER. In the order of seniority I believe Mr. Banta is ahead of me.

The CHAIRMAN. I beg your pardon, Mr. Banta.

Mr. BANTA. Mr. Eccles, in view of your statement that you do not anticipate any conditions which would make it necessary for the Federal Reserve System to use the authority which this bill would provide, and also in view of the statement that the seller of Government securities pays the commission when the sale is affected, I do not understand why you insist upon the broader authority provided in this bill.

Mr. ECCLES. Well, I will have to repeat what I have already said.

Mr. BANTA. Well, you have not said anything, as I understand it, that gives any reason for insisting upon the broad authority, when you anticipate no condition or situation——

Mr. ECCLES. I know. But because one does not anticipate a fire is no reason why you should not have insurance on your house.

Mr. BANTA. That might be one reason for it. And there are many persons who carry much less insurance on their house than it is worth because they do not anticipate a fire.

Mr. ECCLES. Well, as I said, this is a minimum amount that would really be of any value to us in view of the huge amount of monthly maturities that the Treasury has, and certainly the Government should not be deprived of an immediate line of credit upon which to call in an emergency.

Why should our Government have to depend upon a market that for some reason or other may just be unwilling.

Mr. BANTA. Well, you have stated, as I understand it, that you establish the market, anyway.

Mr. ECCLES. That we what?

Mr. BANTA. That the market is established by you, anyway.

Mr. ECCLES. Well, we influence the market by our purchases in the market.

Mr. BANTA. Yes.

Mr. ECCLES. In other words, we buy $5,000,000,000 in the market, and if the Government wants to refund they may refund it.

Mr. BANTA. And you now have the authority to buy in the market all that it is necessary to buy?

Mr. ECCLES. That is correct.

Mr. BANTA. And you anticipate no situation which would bring about the necessity for using the authority provided here? That is, on the broad base?

Mr. ECCLES. That is correct.

Mr. BANTA. Yet you insist upon the broad base. Do you intend doing something which a nonanticipated condition would bring about?

Mr. ECCLES. Well, of course the Board is an agent of the Congress and our action is reported to Congress. If we abuse the power that Congress gives us, and if we do not have sufficient reason for doing so, they can always take the power away.

It seems to me that the record of the use of that power in the past has been such that we should not be mistrusted too much with having a broad power for such a limited amount.

That is a very limited amount when you consider the job that we are expected to do. And certainly the only interest that we have in the matter is the interest of the Government.

Mr. BANTA. I have one other question, which relates to an answer you gave yesterday, I believe. I understood you to say that $66,000,000,000 of Governments are now held by the commercial banks.

Mr. ECCLES. Yes, I think that is correct.

Mr. BANTA. What other very large holders are there, Mr. Eccles?

Mr. ECCLES. Banks reporting monthly to the Treasury held on December 31, 1946, $66,484,000,000 of market issues. And they have $1,282,000,000 of nonmarket issues which they were permitted to take in very limited amounts in relation to their savings, which makes a total of $67,765,000,000. In addition it is estimated that nonreporting banks held about $3,000,000,000 of securities.

Mr. BANTA. What other very large holders are there, Mr. Eccles?

Mr. ECCLES. The mutual savings banks according to the Treasury's monthly survey, have $11,767,000,000 of securities. The life insurance companies have $21,525,000,000. Other insurance companies have $3,000,000,000. The Federal Reserve banks have $23,350,000,000.

Mr. BANTA. That is the Federal Reserve and members?

Mr. ECCLES. No; that is the Federal Reserve banks directly. Most of that, of course, is necessary to offset the expansion of currency. That is the basis and background for the expansion of currency.

The United States Government agencies and trust funds have $30,900,000,000. Of that, there are $24,000,000,000, which are called "special issues." These are not market issues. All other holders—corporations, individuals, trust funds, State and local governments, etc.—have nearly $100,000,000,000.

Mr. BANTA. Incidentally, are there any issues upon which the banks may loan—that is, that may be used as collateral, which the banks could not purchase?

Mr. ECCLES. Will you repeat the question?

Mr. BANTA. Are there any issues upon which the banks could loan—that is, that could be used as collateral but which the banks themselves could not directly purchase?

Mr. ECCLES. Yes.

Mr. BANTA. What are those issues?

Mr. ECCLES. There are a great many issues on which they could loan but which they could not purchase. Practically all of the 2½ percent market issues and the 2¼ market issues are not eligible to banks, and that includes by far the greatest part of them—about $50,000,000,000 worth. Those securities, however, all become eligible for bank purchase prior to their maturity.

Mr. BANTA. At some fixed date?

Mr. ECCLES. I think in most cases it is 10 years prior to maturity. Then they become eligible. That is why these 2½ percent market issues, noneligible to banks, go at a premium: because when they get within 10 years of maturity they become eligible to banks and they therefore sell on the basis of what a 10-year bank security would sell. As they approach that maturity that puts them at a very substantial premium. That is why the insurance companies and the market are so anxious to get the Treasury to issue some more 2½ securities—because in effect, as I said yesterday, they can very easily get around 3 percent.

Mr. BANTA. Might there also not be another reason why they would like to have them issued? For instance, for the reason that a very large number of them are in the banks now as collateral for loans that were granted at rather low rates of interest?

Mr. ECCLES. Well, that is not true now. During the eighth war loan drive there was a lot of speculation, and there were a great many people, and corporations, for that matter, who borrowed from the banks—and that was contrary to the advice that we gave to the banks—at 1 percent, and purchased these securities at 2½ percent.

It ran up into several billion dollars of bank credit for the purchase of the 2½'s, in the eighth war loan. A great many of those securities have been sold and the bank loans have been paid. Of course there was a very nice profit made on those operations.

Mr. BANTA. That is all. Thank you.

The CHAIRMAN. We apparently cannot finish this morning, Mr. Eccles. Can you come back for a short time at 2:20 this afternoon?

Mr. ECCLES. Yes; I will be glad to, Mr. Chairman.

The CHAIRMAN. I may say that we would like to dispose of this today, if possible. We have the hearings on sugar set definitely for tomorrow morning.

Without objection, the committee will stand adjourned until 2:30 this afternoon.

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

AFTERNOON SESSION

The committee met pursuant to adjournment at 2 p. m., the Honorable Jesse P. Wolcott, chairman, presiding.

The following members were present: Messrs. Wolcott, Gamble, Smith, Talle, Sundstrom, McMillen, Cole, Banta, Fletcher, Foote, Spence, Brown, Patman, Monroney, Folger, Riley, Buchanan, and Boggs.

The CHAIRMAN. The committee will be in order.

Mr. Boggs, do you have any questions?

Mr. BOGGS. Yes, Mr. Chairman.

Mr. Eccles. I understand that you recommend an increase in the amount from $5,000,000,000 to $10,000,000,000.

Mr. ECCLES. No, I am not making any recommendation. I merely made the statement, when I was asked this morning if we should not have less than $5,000,000,000, that I would prefer more than $5,000,000,000 rather than less. The $5,000,000,000 is satisfactory however.

Mr. BOGGS. Why would you prefer more?

Mr. ECCLES. Because I think that with the very large amount of Treasury maturities, if it was a larger amount, the Treasury might feel a little more secure with reference to its ability to refund its maturities.

Mr. BOGGS. You do not think you would have to have it?

Mr. ECCLES. I do not think so. I think we could get along with the $5,000,000,000 all right.

Mr. BOGGS. I want to ask one or two other questions. Yesterday Congressman Patman asked your opinion about the proposed reduction in taxes. If I understood you correctly you expressed the opinion that a reduction in taxes would have an inflationary effect. Do you consider the present price level inflationary?

Mr. ECCLES. Well, you mean the average price level, the average cost of living?

Mr. BOGGS. Yes.

Mr. ECCLES. Yes, I do. It is inflationary as compared with what the prices were in 1940. As a matter of fact, the amount of inflation that took place in the year 1946 was equal, almost identically, to the amount of inflation which took place in the 5 years of the war and the defense preparation. I do not think there was ever a period when we had a greater inflation in as short a time as we had in 1946. There is no year in our history when we ever had anything like the amount of inflation that we had in 1946.

Mr. BOGGS. Do you feel that the inflationary tendency has stopped, or is it continuing?

Mr. ECCLES. I think it certainly has slowed down, and I would not expect to see very much more inflation—that is, I do not expect to see very much further increase in the cost of living. I think that we have reached the plateau, and there may be some slight further increases between now and the middle of the year, but it would be my expectation, after that time, to see some declines, particularly in the cost of food, which is a big element in the cost of living. There are, of course, factors that could prevent a decline, such as a drought and short crops either here or throughout the world outside of this country. If we should get a series of strikes, reducing production, with further substantial increases in labor costs, which are added to the prices, that, of course, would be a retarding factor, but taking all of the available information that we now have, it is the view of the Federal Reserve people that there should be a substantial reduction in the cost of living within a year, and that after the middle of the year a gradual decline will likely be under way.

However, that can all be upset if the fiscal policy should be one of further deficits, should be one of not making some reductions or payments on the public debt. I feel that it is more important, under the present situation, to make some payments on the public debt than it is to reduce taxes. I think the payment on the public debt should come first, under present conditions. If we were in a deflationary situation, I would certainly say the opposite, that we should reduce taxes and increase the deficit.

Mr. Boggs. As I understand it, you advocate the continuance of taxes on their present level and a reduction of the national debt as much as possible. Now, do you advocate or suggest any other remedy which might further effectively curtail any possible increases in the cost of living? That is, do you have any ideas on the subject?

Mr. Eccles. I do not know that there is anything else that we can do on an important scale—that is, that the Government can do—except to maintain taxes which, of course, restricts demand for products, and apply excess revenues to the payment of the debt. That would be a very sound fiscal policy, under a condition of inflationary pressures.

It would be a desirable thing if the inflationary pressures continue, for the banking authorities to do what they can, although what they can do is rather limited. For instance, I think it is desirable that consumer credit continue to be restricted through the application of our Regulation W, at least under the present situation. That, of course, is curbing to some extent the demand for the short supply of consumer durable goods.

We also have the restriction on the use of credit for the purpose of buying securities on the registered exchanges, and so long as there are these inflationary pressures, it would seem undesirable to relax those credit restrictions.

If banks continue to expand credit rapidly for the purpose of building up what may appear to be excessive inventories, for speculative purposes, in commodities of any kind, or further encourage speculation in real estate, homes, farms, through the use of bank credit, that would be undesirable. But I do not know of anything that we can do directly to prevent that. A mere raise in the short-term rate, by the amount that would likely be permissible, would have practically no direct effect on the curbing of the use of credit for business purposes. To have to pay a half of 1 percent more for money is not going to deter or curb the businessman in his operations, if he thinks that the use of that credit is profitable or desirable. Therefore, a raise in short-term rates would not directly affect the use of credit for business purposes. It would indirectly affect the expansion in the supply of money through curbing the monetization of the public debt, which is anti-inflationary in its effect. So the effect of that would be indirect, but not direct, through putting a rate sufficiently high that would make borrowing unprofitable.

To put a rate sufficiently high that would make borrowing unprofitable, and to curb expansion, of course, is out of the question with the public debt being the size that it is. It would affect the public debt as the debt was affected after the last war, when a 4½ percent bond went down to 83, and, of course, with the public debt the size that it is, and with the large volume of short-term debt maturing, you simply can not let the cost of interest to the Government, in the aggregate, increase materially, if at all. And it would increase very greatly if we raised the discount rate, if the Federal Reserve pursued what we may term a tighter restrictive credit policy for business, because we cannot separate the credit policy as it applies to business under any present authority we have from the credit policy as it would apply to government.

Mr. Boggs. One other question. I have read a great deal about growing buyers' resistance—this may be entirely outside of the scope of this bill, but I would like you to answer it if you can, and tell us if there is any indication that prices have gotten so high that there is a showing of buyers' resistance.

Mr. Eccles. There is still sufficient demand for consumer durable goods and capital goods to take all the supply. Consumer resistance at this point has not affected the demand for building materials, for example, the demand for automobiles, and other consumer durable goods. I think, however, that if present prices continue that the market for automobiles and houses and other capital and consumer durable goods will shrink, and there will be a consumer resistance. Because there may be 5,000,000 people who can pay present prices for automobiles it does not mean that there are 10,000,000. And to touch the market for another 5,000,000 or another 10,000,000, either the prices of automobiles will have to come down or the income of the people will have to go up. But that is not likely to happen, as I say, during most of this year. I think the same may be true of housing. There possibly is a market for such housing as can be built this year at these prices, but there would not be a market, I do not believe, at present prices next year. The prices are going to have to adjust themselves, because the great rank and file of the people are not getting sufficient income to pay present prices, particularly for housing and consumer durable goods.

Now, so far as food is concerned, and clothing, there is no choice. People, after all, have got to spend what income they have for the basic essentials, and the supply of food will likely bring down prices. I think by the end of the year, the supply of clothing will tend to level prices off, and we know that prices have leveled off on certain luxury items, such as furs, jewelry, which, today, are in excess supply.

Mr. Boggs. Do you feel that when that cream has been skimmed off the top, that is, when the 5,000,000 people who can buy automobiles at the present prices, have bought their automobiles, do you feel that we will have an inflationary period?

Mr. Eccles. I think we will have some recession. And I think that whether or not it is serious will depend upon how much further inflation we might have. It seems to me we would avoid a great deal of trouble if we could avoid further increases in wages, especially the organized worker, who represents the high-paid group of consumers. If we could avoid further increases in those wages, and if industry would decrease prices so that all of the public, the 40,000,000 of unorganized workers, farmers, and professional and business people, whose incomes are out of line today with those of the organized workers could buy, if there was a better balance—and that is what we need—between the various groups in the economy, we would go a long way toward avoiding a recession which will largely be brought about because of these maladjustments. If we could keep wages from going up, and if industry would reduce its prices, the whole economy would get the benefit of that, and we would have a better balance.

Then, if, later on, we could reduce taxes to the lower income groups so that their purchasing power would be increased by the reduction in taxes, and so that it would also be increased by the reduction in prices, so that between the increased purchasing power through a reduction in taxes, on the one hand, and through increased purchasing power through a reduction in prices, on the other, we would get our economy in balance. The trouble today is that it is very much out of balance. You have terrific maladjustments which sooner or later are going to force some recession.

Mr. Boggs. That is all, Mr. Chairman.

The Chairman. Mr. Fletcher.

Mr. Fletcher. Chairman Eccles, I have only three very short questions. First, I want to say that I have enjoyed your very full answers on these economic problems.

The first question is one that was suggested by Chairman Wolcott early in the hearing, regarding the possibility of a report to Congress showing the various balances of purchases of short-term commercial paper. Would there be any reason why that could not be included in the regular report? How often is that report given, by the way?

Mr. Eccles. The Board is required, under the statute, to make an annual report to the Congress. We have always included in our annual report the use of this direct purchase privilege. We would, of course, continue to do that, whether it was required in the bill or not. We would have no objection to a requirement being included in the bill.

The Board, of course, can make special reports, and could report to Congress just as often as the Congress may require. In that connection, I would like to say to the committee that the Board is very conscious of the fact that they are an agent of the Congress, that the Board was created by act of Congress, and that they are to report to the Congress and not to the executive branch of Government. We are, in that sense, an independent agency by provision of the statute, and it certainly is the desire of the Board to work as closely with the Congress as possible, and to keep the Congress as fully advised and as fully informed as possible, and particularly the Banking and Currency Committees of the House and Senate, who have the responsibility, jointly with us, for these banking and credit operations.

Mr. Fletcher. You have referred to the fact that you want to use this $5,000,000,000 as an emergency source, that is, so far as the notes go. But that you also want to use it in order not to have to keep such large cash balances in regard to the short-term paper. Is there any reason why, if an emergency should arise, you could not issue short-term paper, three-eighths, or seven-eighths, or whatever it took to do the job, pending the proper development of a market on which you could finance your longer term paper?

Mr. ECCLES. It is not the long-term paper that really bothers us. The certificate is the principal item of short-term paper that is held by the market, and, there are, of course, bonds and notes which also fall due, but the large volume of maturities is made up of these 1-year certificates. I do not contemplate that there would be any question about the Treasury's ability to refund them as they fall due. Naturally, any holders of certificates, if they want their money as they mature, are entitled to get it, and although the Treasury, in its financing operation, where it has not the money to pay off the maturity, offers to the holder of the maturing certificate the right to exchange it for a refunding issue. That is the right that usually goes with a maturing security. But up until the books are closed, or up until the time of maturity, the Treasury never knows to what extent the refunding operation is going to be successful.

For instance, they may have $5,000,000,000 of certificates falling due on a given date, and they do not know how many of the holders of those certificates are going to want cash at maturity. Therefore, they are more likely to want to carry substantial balances in their account to take care of the amount that may not be refunded than would be the case if they have the privilege of drawing against this account.

Mr. FLETCHER. I was thinking of your specific answer to Congressman Cole's question about the restricting of this to the short-term certificates rather than the long-term notes. You said that you didn't feel that that should be restricted to the short-term certificates.

Mr. ECCLES. I do not. As I say, it has never been used. But at the same time, I cannot see what there is to be gained by putting a restriction on it. I mean it is one of those things that you cannot always foresee what use may be made of it. It seems to me that to tighten up the restriction is not going to be of any great assistance. It might work against the Government, and for that reason I cannot see why Congress would want to unduly restrict this credit line.

Mr. FLETCHER. Well, the point I am trying to make is that $5,000,000,000 worth of long-term credit purchased by the Federal Reserve System is quite a different thing from $5,000,000,000 worth of short-term credit, which will have to be reviewed periodically.

Mr. ECCLES. Well, we are not restricted. We could go out and buy $10,000,000,000 of the long-term credit in the market today.

Mr. FLETCHER. That is true.

Mr. ECCLES. We are not restricted there. And I see no more reason for restricting us from buying, from the Government, a refunding issue of bonds until such time as the market may be able to absorb that issue, than there would be in trying to restrict us from going out to the market today, if the market was bad, and buying $5,000,000,000 worth of bonds, or $10,000,000,000 worth of bonds in the market. I do not see any distinction.

Mr. FLETCHER. The other question I had was this: As to the $250,000 limit. In your opinion, would you think that a limit would be necessary at this time, say, of $500,000, or $400,000, or some limit, in order not to make this a blank-check proposition?

Mr. ECCLES. Well, I would dislike to see a limit, and it seems to me that the Congress is pretty safe in leaving the limit off. They left the limit off in the case of buildings which cost millions, such as New York, Chicago, all these big Federal Reserve bank buildings. There was no limit in those cases. The Congress gave to the Board the responsibility for acting in its stead in the approving of these buildings. The initiation for them, in the first instance, as I explained, came from the directors of the board of the banks. In the case of branches, there could be a great variation.

For instance, if a branch were to be built at Cincinnati, where there is no branch, that would naturally cost a good deal more than putting an addition onto some branch in Pittsburgh, where they own a branch and you may want to put an addition on. We also have this problem: we may have a situation where a branch is entirely inadequate and where we have an opportunity to dispose of the property, where it is not feasible to get adjourning property and build an addition, where the property is too expensive, for example, and we may sell the existing branch and want to go out and build a new building that would be adequate. It is difficult for me to say what limit should be put on. As I said this morning, I am sure the expenditure for branches is not going to constitute an item of a great many million dollars. It would be small at best. I would say if there was to be a limit, the limit should be an aggregate limit, covering all branches. If the committee felt that they wanted to state that the Board cannot approve expenditures for branches or improvements beyond $10,000,000, so that you would not be giving a blank check, and if the committee felt better about that, it might do that.

Mr FLETCHER. Getting back to that second question again, to clarify the matter in my own mind, if you buy from the Treasury these short-term certificates, is the bookkeeping the same? Do they show in the Treasury the same as a debt of the Government?

Mr. ECCLES. Oh, yes, it would be a sale. Whether we own it or a private bank, it makes no difference. Even if a Government trust fund owns it. You see, there were $30,000,000,000 of the public debt held by Government trust funds.

Mr. FLETCHER. And it is a 1-day certificate outstanding which would show in the Treasury statement?

Mr. ECCLES. It is a 1-day certificate, the way we have operated. Now, we may buy from the Treasury, although we have not, and we may find that the ⅞ certificates that they are refunding, that the amount of the exchanges that come in by the owners of the certificate for the new certificate may fall short, a sufficient amount, if the Treasury's balances are low, where they do not have enough to take care of it. We could, in that case, take up the certificates that the market did not take, and which they may want to offer. In that case, we would certainly sell those certificates to the market, whenever the market could take them, or what would likely be done would be to get the market, the dealers and others, to take up enough of the issues so as to be sure that it was successful, even if we had to take them back in a day or two.

That is really what we do as a practical matter. So that we would be doing indirectly what this authorizes us to do directly, but which we have never done directly.

Mr. FLETCHER. You said awhile ago that it made no difference whether you bought Treasury notes in the open market or whether you were to buy them directly from the Treasury. That is true from the point of view of the Federal Reserve banks system, but how about the point of view of the Treasury? Is it not quite a different process if they sold in the open market and then you buy in the open market than when they are able to sell to you directly on this basis? If they sold notes instead of short-term certificates, they might be freezing into the Federal Reserve banks system some longer-term notes at a time when the market would not be willing to accept them; is that right?

Mr. ECCLES. Well, whether the Federal Reserve has notes or bonds or certificates that are in excess of what the market will take, and they got them direct from the Treasury or whether they got them from the market, because the market was unable to carry them, and thus the Federal Reserve had to buy them in order to keep the market from dropping: what is the difference? The effect is identically the same.

Mr. FLETCHER. It is as far as the Federal Reserve bank goes, but as far as the Treasury is concerned?

Mr. ECCLES. It makes no difference to the Treasury. The Treasury would be unconcerned whether the Federal Reserve or the private banks held the paper, so far as the Treasury is concerned. It is primarily interested in a market for its obligations. Its primary interest is to be sure that it can refund its maturities.

Mr. FLETCHER. Now, if they could not refund a maturity at a time, would it not be just as plausible if they offered to the Federal Reserve System the short-term certificates pending the time when they would refund the longer-term paper?

Mr. ECCLES. The Federal Reserve, I do not think, would want to take anything else. You see, it is not the option of the Treasury. The Treasury cannot require us to take them. The option as to what we will take is with the open market committee, which is the agent of Congress. It is our option, and certainly it would be the policy of the Federal Reserve to take the shortest possible paper. There would be no question about that being, I think, the desire, and if you will look at the Federal Reserve portfolio, they have practically nothing but short-term paper in it.

Mr. FLETCHER. That is why I cannot see the reason for having the right to buy longer-term notes, because you would prefer the shorter-term paper, and they would rather give you the short-term paper, because the long-term paper is long-term financing.

Mr. ECCLES. I know, but here is a bond issue, for example, which the Treasury wants to refund into a bond issue, and they have $5,000,000,000 worth of bonds maturing. They offer them as an exchange, and they only get subscriptions for $4,000,000,000 worth. It may well be desirable to have the Federal Reserve take up that extra billion dollars worth of bonds and have them available for the market a month or two months later or some other later date. It may well be desirable to have them do that rather than have it appear that the $5,000,000,000 refunding has been a failure.

Mr. FLETCHER. That is what I wanted to bring out. It is purely a practical problem. You would not say that they would take the entire $5,000,000,000, then, right off the bat?

Mr. Eccles. The only purpose would be, if you took them at all, to assure the success of their operation. We do it indirectly now through the dealers. In this way, if the dealers did not want to respond, we are in a position to do it directly, to make their offering successful, or their refunding successful.

Mr. Fletcher. I understand.

Mr. Eccles. But we have not had to do it and the very reason that we can do it is one of the reasons we have not had to do it.

The Chairman. Mr. Foote.

Mr. Foote. Mr. Eccles, with further reference to section 2 of the bill: it may be a purely technical point. It refers to the erection of any branch-bank building. I take it that that really contemplates new construction, but I also see from your statement that you also intend to enlarge existing structures, as well as possibly build new ones. So would you seek authority to expend in excess of $250,000 for the enlargement or remodeling of an existing building also?

Mr. Eccles. Oh, yes; the $250,000 would not touch some of the expansions. For instance, the vault facilities primarily are one of our very inadequate facilities, and that is due to the Treasury's operations which are handled through some of the branches. The amount of Government securities that are held are very large at certain times in these branches, and our vault facilities for carrying Government securities, as well as important records, are quite inadequate, so that I understand that the building of vaults, as you know, in and of themselves, is a pretty expensive proposition these days.

Mr. Gamble. More so than the building itself; is that not right, sir?

Mr. Eccles. That is certainly true.

Mr. Foote. That is all.

Mr. Fletcher. Mr. Chairman, may I ask a general question?

The Chairman. Mr. Fletcher.

Mr. Fletcher. Chairman Eccles, when do you think there is a possibility of returning to a free and open market, instead of all this pegged and controlled financial market we now have?

Mr. Eccles. You mean for governments?

Mr. Fletcher. That is right.

Mr. Eccles. Never. Not during your lifetime nor mine.

Mr. Fletcher. This ⅜ and ⅞, allowing it to move upward, would that not, in a sense, bring it into play with what is more or less the going market now?

Mr. Eccles. But not without support for the long-term securities as the short rates goes up, it may push the long rate up and instead of having a 2½ long rate, you may have a 3, 3½, or 4. So in letting the short rate go up, you have also got to see to it that it does not push the long rate up.

Mr. Fletcher. Well, if, as you said, people are going to change from short-term certificates to long-term notes, is that not a desire on their part to more or less make the better purchase? Is that not an expression of marketability?

Mr. Eccles. Well, that is right. Of course, the great bulk of transactions in securities is handled in the market. What the Federal Reserve open market committee does is, of course, manage the market. Our job is to try to keep it orderly. The very fact that there is a market at the support price means that the market goes on outside of the Reserve System for the great bulk of the market, but for the open market committee to withdraw completely would, in a very short time, likely cause chaos in your whole Government market, as well as your whole credit financial structure. The reason that I say never is because the public debt today is such a large part of the total debt structure. The total private debt is about $160,000,000,000, and that includes open accounts, and every form of debt, as against $260,000,000,000 for the Government debt. You can readily see that the thing that determines the market is the public debt, and it is impossible to set the interest rate on the public debt or know just where it may go, without any control whatever. That is why, as long as the public debt is as large as it is in relation to the private debt, it has got to be the determining factor. If the public debt was a tenth of the private debt, you would not worry about where it went. You would not worry so much, at least.

Mr. GAMBLE. Will the gentleman yield?

Mr. FLETCHER. Yes.

Mr. GAMBLE. When you say private debt, sir, does that include the municipalities, State, and cities, and so forth?

Mr. ECCLES. Well, that is comparatively small. That total, I think is 16 or 17 billion dollars.

Mr. GAMBLE. And that has been dropping during the war, I believe, has it not?

Mr. ECCLES. That dropped, yes. Not very much, but I believe 2 or 3 billion dollars. It got up to 20 billion dollars, which, I think, was the peak of what we term the municipal debt, and I think it went down to 16 or 17 billion dollars. It could have gone below that, but a great many of the municipal securities were not due when the cities and counties got a lot of surplus revenue in, and they went to such a high premium because of the tax-free feature, that they were not bought into sinking funds, and many of the cities, States, and counties bought Government bonds, so that I think if you had deducted the amount of Government securities held by a lot of these funds, against their outstanding debt, the municipal debts would have been reduced considerably more than was apparent on the face.

Mr. GAMBLE. May I ask another question, Mr. Chairman?

The CHAIRMAN. Mr. Gamble.

Mr. GAMBLE. When you speak of buying Government bonds, as a matter of information, has the Treasury the right to buy its own bonds, or does the purchase of the Treasury of its own bonds amount to a cancellation and retirement? They cannot go in and support the market, can they? That is your function?

Mr. ECCLES. Well, I do not suppose there would be anything against their doing that, except that they are limited in the amount they can buy at prices above par. There would be no point in it. They would use up the money they had to buy their bonds. They could not do much of that and they have not done it.

Mr. GAMBLE. I know they have not. I did not know whether it was legal or not.

Mr. ECCLES. I do not know of anything illegal about the Treasury using its balance to buy its own bonds.

Mr. GAMBLE. Would that be an automatic retirement, or could they resell those?

Mr. Eccles. Well, I would think they could resell them. You see, there are a great many trust funds which the Treasury manages. For instance, the Federal Deposit Insurance is one. I think the Railroad Retirement is another. And the total amount of marketable Government securities held in these funds is in excess of $6,000,000,000. Now, the Treasury is buying and selling Government securities through those funds. They would sell out of those funds, if they needed the money. If they had surplus, they would buy securities in the market and put in those funds. That operation, however, is handled with the open-market committee.

In other words, the open-market committee is not out working in the market in conflict with the Treasury. All these fiscal operations of the Treasury are handled by the Federal Reserve banks, and in this case of buying and selling Government securities for trust funds, it is handled by the open-market committee.

Mr. Sundstrom. Mr. Eccles, I do not know whether the questions I have will be particularly germane, but as has been previously stated, the questions are prompted by views you have expressed.

Mr. Eccles. Well, they would not be the only ones that are not germane.

Mr. Sundstrom. I missed your testimony this morning because I had another committee meeting, but I heard your views on taxes. Can you tell me whether they are your personal opinions or are they opinions reflecting the views of the Federal Reserve Board?

Mr. Eccles. Well, I cannot speak for the Board. It is a matter that the Board has not taken any formal action on. I suppose you mean whether or not taxes should be reduced at this time.

Mr. Sundstrom. Yes. I want to know if that is your personal opinion or whether it is the Board's opinion.

Mr. Eccles. I think that is the general view of the Board. I do not know whether we have put it to a formal vote specifically, to see what the Board's position would be, but I know in our general discussions of monetary matters, credit matters, and from the statements that have appeared in the Federal Reserve Bulletin, certainly the implication is that it would be sound policy not to reduce taxes, and to reduce the public debt, under this inflationary situation, and I am sure that I have heard no adverse view expressed by any member of the Board.

Mr. Sundstrom. Let me further ask, then, I would assume that you would further believe that any reduction in Federal expenditures would be deflationary rather than inflationary, would you?

Mr. Eccles. Yes; and I would favor it.

Mr. Sundstrom. I think you testified or stated a few minutes ago that when supplies are adequate or that when we have excess supplies, prices will come down, and, therefore, it constitutes a good fight against inflation?

Mr. Eccles. That is right. That is the best one. In other words, everything else is secondary.

Mr. Sundstrom. In other words, production is the best weapon we have against inflation?

Mr. Eccles. It is really the only one that will finally win. All the others are merely supplemental. They are merely tending to hold the line, but you never will win against inflation ultimately without production.

Mr. SUNDSTROM. In view of that statement, has it ever been considered by you or the Board that a reduction in taxes, perhaps, might restore some incentive?

Mr. ECCLES. I discussed that rather fully this morning.

Mr. SUNDSTROM. I stated I am sorry I was not here this morning, because I had to attend another committee meeting.

Mr. ECCLES. Yes; I undertook to point out that it was not incentive that was needed today, but that we need labor and materials, and when we say incentive, we are thinking of inducing people to invest their money in new enterprise. What we need today is labor and basic materials. Our shortages are in such items as lumber, steel, copper, lead, and those basic materials, and we certainly do not want to stimulate new investment which would only put on further inflationary pressures on the short supply of materials and labor. So the problem is not one today of getting more capital or more savings. That is the one thing we have a surplus of.

Mr. SUNDSTROM. Well, maybe you have been staying in Washington too much

Mr. ECCLES. No; I get out quite a bit.

Mr. SUNDSTROM. I can say in the last years, certainly since VJ-day, I have had it stated to me, many many times during the summer months by businessmen, in many businesses: What is the use of working any more? Because we cannot keep any of the money, and I can get you probably 150 or 500 or 5,000 witnesses who would tell you that taxes have destroyed incentive, and have destroyed production.

Mr. ECCLES. Well, I happen to be a businessman primarily. I was very active in business and have a great many business interests now—lumber, sugar, mercantile businesses, and I am in very close touch with extensive business operations in Oregon, Idaho, California, Utah, and Wyoming, and my business primarily is that of a businessman, and that is the only background I ever had before I came to Washington, which was one of meeting pay rolls.

Mr. SUNDSTROM. I am glad to hear that, but I would like you to go out and talk to a lot of the other businessmen.

Mr. MONRONEY. Will you yield, Mr. Sundstrom?

Mr. SUNDSTROM. Yes.

Mr. ECCLES. The line is primarily to get taxes down. I know my own friends and family give me the same line. But it does not restrict their production any.

Mr. SUNDSTROM. I yield for a question.

Mr. MONRONEY. Mr. Eccles, in line with what Mr. Sundstrom says, is not most of the accent in our industrial production on corporate structure and corporate investment, and yet no proposal on income tax has been made to adjust the corporation profits, it is all on the individual taxpayer's side?

Mr. SUNDSTROM. Oh, no; what difference does it make whether it is corporation or individuals?

Mr. MONRONEY. It makes a great difference. If your personal income tax is high, your corporation has more interest in going out and making new investments so as not to declare dividends, and be taxed higher still.

Mr. ECCLES. This is true: A corporation, of course, no longer has the excess-profits tax. When there was the excess-profits tax, the argument that you just mentioned, Mr. Sundstrom, was used much more than it is today. Today the corporate tax is 38 percent and there is no proposal to reduce that tax, and even with that tax on today, the earnings of corporations in 1946 will far exceed the net earnings that corporations have made—and that is after taxes—at any other time in their history, far exceeding anything they made during the war or in 1929.

Now, taxes would not deter corporations from expanding their business if they could get the labor and the materials.

Mr. SUNDSTROM. Well, who do you think owns those corporations? I happen to be a businessman, too. You have no monopoly on it, and neither has anybody else. But I know this: It makes no difference whether a corporation makes the money that I have an interest in or whether I make it in my own personal company. When my own personal income gets up to a bracket where it is unnecessary, or, at least, there is no incentive left to keep on making any more money, why, then, I have lost my production, and I have seen that happen literally thousands of times in the last year or so.

Mr. ECCLES. But the corporations keep on producing, and the value of your interest in your estate is built up through the growth of that corporation. That is the only place today where fortunes are made. They are made through people owning stocks in corporations, and the corporations not disturbing the earnings, and that is why section 102 of the Federal statute is designed to force corporations to pay out earnings that they do not use and do not need.

Mr. SUNDSTROM. Of course, I am not defending the present tax structure which has prevented everybody from becoming wealthy again, because I think we may reach the day when we may regret that, because there are a lot of charitable institutions that may come around some day and need money and I would rather get them from private funds than I would from Government. Now, I heard you make a statement a little while ago, Mr. Eccles. You were talking about the loans on securities. I guess that is regulation T and U.

Mr. ECCLES. That is right.

Mr. SUNDSTROM. It was my understanding that when that law was originally passed by the SEC that it was the intent of Congress that that was not necessarily passed as a credit control, but it was established to protect the customers of brokerage firms against loss of money, very similar to the way banks had certain restrictions put on them.

Mr. ECCLES. No; this was passed in the Securities and Exchange Act of 1934, and the power was given to the Federal Reserve Board for the purpose of controlling credit.

Mr. SUNDSTROM. Are you sure that was the intent or was it for the protection of customers of the brokerage firms?

Mr. ECCLES. It was put in strictly for the purpose of controlling credit, and it was put in because of what happened in 1929 through margin trading.

I read from the act:

> Margin Requirements, section 7. For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security other than an exempted security, registered on a national-securities exchange.

And so forth.

Mr. SUNDSTROM. Yes. Well, I still think that the intent was to protect the individual from the abuses that were practiced at that time. I only mention it because you talk about that as a credit control when you increase the margin from 50 to 75 percent, or from 75 to 100 percent, what were the total loans at that time of brokers?

Mr. ECCLES. They were comparatively small.

Mr. SUNDSTROM. Therefore, they had very little to do with the inflation in the country?

Mr. ECCLES. We think it had considerable to do with it, because if we had not increased it you would likely have seen a lot of credit go into the field. Cotton is the best example. We did not increase the margin on cotton trading, and the net result is you saw cotton boom, and you saw a lot of credit go into the field. Now, it did not go into the security field, because the regulation was a preventive. In other words, it is better to stop it before it happens than after it is too late, because this is not a bring-up margin. The margin we applied did not affect the existing margin on the loans that existed at the time. All it did was serve notice that in the future credit could not be extended except on a basis of the required margin.

Mr. SUNDSTROM. Well, it affected the present ones because it froze all the accounts. It affected them that way.

Mr. ECCLES. Yes, that is right; it froze them to the extent that they did not have the margin. What it really did, primarily was to affect the traders, because they are the ones who are trading in and out. We certainly wanted, in an inflationary period, to discourage security speculation, because the psychological effect under the inflationary conditions that existed last year, of having a further inflation in the stock market, would certainly have been undesirable.

Mr. SUNDSTROM. Yes; but what I am trying to drive at is this: Is it not a fact that the brokers' loans were such a small part of the entire credit or inflationary pressure that, in reality, it was picayune as compared to the entire inflationary picture when you figure $127,000,000,000 in loan savings and commercial banks, and 27 or 28 billion dollars in circulation——

Mr. ECCLES. It was a small matter, but it was far more important in its psychological effect, far more of a barometer for influencing action than the amount involved.

Mr. SUNDSTROM. Well, if it had such a psychological effect, you just stated a few minutes ago that 1946 was the most inflationary year you have ever seen.

Mr. ECCLES. Well, it was the most inflationary year from the increase in the cost of living and that is just one reason why we did not want to add anything to that, or it might have even been more than it was.

Mr. SUNDSTROM. Then, if this credit expansion on loans and securities was such a great factor psychologically, how do you justify reducing margins just at the end of that time and putting them back on the 75-percent basis?

Mr. ECCLES. Well, we reduced the margin because the situation had completely leveled off.

Mr. SUNDSTROM. Then, it had little effect on the over-all picture. You were only looking at stock prices, then, and not at the over-all picture, because you just said the cost of living had gone up.

Mr. ECCLES. What I said was that the cost of living actually went down in January slightly, and that it leveled off, and I think you have reached the plateau. It started leveling off in December, and there was a slight reduction in the cost of living, I think in January. It had been going up rapidly and it leveled off, and what I said was that it might go up a little more, over the next few months—I am not certain that it will, but I certainly would not be surprised if it did go up a little more—before it actually starts to turn down. But when we made the reduction, it was after we had felt that the real inflationary dangers were over and that the situation was quite different at the time that we reduced the margin than the situation was at the time we put the margin up to 100 percent, which was prior to the inflation that took place in 1946. It was in January of 1946, and the real inflation took place after that. And, as we said at the time, we did not expect that that was going to be any important factor in affecting it, but whatever influence it might have, the Board felt that it should do what it could toward preventing the use of credit for a purpose that would not help production, which was the only thing that would tend to stop inflation.

Mr. SUNDSTROM. I would like to ask, Has it ever occurred to you—it has always seemed to me—that it is a question of whether or not it is constitutional to tell a person what they can borrow money on or what they want to borrow on. Supposing, as an example, a man has a hundred shares of telephone stock, and he decides he wants to borrow some money on it and he goes down to the bank and decides he is going to buy stocks in the building industry, we will say, and he says, "No, you cannot buy them," but another man can go out and take that same money and speculate in real estate, on a program which will pyramid much greater than he could ever pyramid on loans on securities, and so you are taking away from one individual——

Mr. ECCLES. We did not. Congress did.

Mr. SUNDSTROM. Well, do you think it is fair?

Mr. ECCLES. Well, it is a question of what is practical. If the committee is interested, I would just as soon make a statement with reference to this very question.

In the first place, the law does not prohibit a person from borrowing on listed securities for the purpose of building a house or for the purpose of doing anything else other than buying other listed securities. That is the statute.

The law does prohibit the banks from loaning on anything, not only listed securities, but loaning on unlisted securities, for the purpose of buying listed securities. Congress debated this question as to whether or not they would give the Board authority to put margins on loans on unlisted securities or on other assets, and they recognized that it would be desirable to do so if it was practical. It was determined that it was not practical for the reason that you could not determine a margin on an unlisted security, because on any asset, to try to say that it shall have a margin of 50 percent, there is no quotation on it if it is not listed on an exchange, and you have no practical way of issuing a regulation to determine the margin. And it was felt that the use of credit and the whole market for unlisted securities was pretty largely influenced by and determined by what happened in the registered markets for listed securities, and, therefore, the Congress, after very much debate, decided to apply the control to listed securities, and it was induced to do that because of what happened after 1929 in the registered markets for listed securities.

Now, as to the question of equity, which you raised, of course, it does not sound very reasonable to say that you can loan on real estate to speculate in other real estate, or to loan on unlisted securities to speculate in other unlisted securities, or to loan on cotton to buy cotton. All that is true. But it just gets down to a practical case, and we never get perfection in any of these rules and regulations. All the Board is trying to do is to do the best that it can with the authority and the powers that Congress conferred upon it.

I just do not know how you could enlarge the powers of the Board to deal with unlisted securities and other items. You could take away the powers they have and open the door and let margin trading go unlimited, if you want. You can go back to where it was. But I do not see how you could give us further powers that would be practical of administration in dealing with unlisted securities and real estate.

Mr. SUNDSTROM. That is the question I was coming to. That is what I wanted to get your view on. We know there is a lot of inflation in real estate today. We know there is a lot of speculation in real estate, developments and otherwise. I just wondered if the Board had ever considered the possibility, because I have heard talk about it, of limiting credit expansion of any kind on real estate. Because if you have done it on securities, it is just as possible that you might turn around and do it on real estate.

Mr. ECCLES. Of course, it is a very different market, it is an unlisted market, and to try to say what the value of every piece of property is that somebody may make a loan on is pretty difficult.

Mr. SUNDSTROM. You could certainly stop all loans.

Mr. ECCLES. Well, with reference——

Mr. SUNDSTROM. The same as you have done on securities.

Mr. ECCLES. Well, there is no prohibition against loaning to carry listed securities if an individual or a nonbanking corporation wants to make a loan. The reputation only applies to banks and to brokers. Anyone who is able to borrow from a financial institution other than a bank, or borrow from an individual or a corporation, can do so, and there no rules apply.

Mr. SUNDSTROM. Of course, that is exactly what happened as soon as you put the restriction on it. There are a dozen people in New York who were loaning money in the black market—money that could be had at 1 percent—were loaning it at 6.

Mr. ECCLES. Well, that might deter them from going into the market. It is too bad they did not loan it at 10.

Mr. SUNDSTROM. Well, so far as you know, your Board has never discussed the possibility of applying the same rule to real estate and other assets?

Mr. ECCLES. Yes; we have had a lot of discussion on it, and during the war period, the Stabilization Director, Mr. Vinson, and later Mr. Davis—I happened to be on that Stabilization Committee—were very anxious to get an Executive order putting power in the Board to control credit on real estate, including farms. We looked into the thing very, very thoroughly, and I blocked such an order. The order was prepared in their office, and the order went on up to the White House, and I wrote a dissenting opinion and succeeded in preventing the Executive order from being signed, and the authority given to us to deal with that question, because it was a job that I just did not think was possible, and others connected with the System did not think it was possible, to undertake successfully. There is an example. It is usually thought by the public, and often by the Congress, that administrative agencies are always seeking and reaching for power. There is a case that certainly does not bear that out, and I would say, so far as we are concerned today, we would want to shy clear away from having any such responsibility. I think the administrative job would be terrific.

Mr. GAMBLE. You have not the power to do that now, anyway, have you?

Mr. ECCLES. We do not have the power, but it could have been given to us as a war measure by Executive order, and, as I say, we studied it, and if the committee is interested in the matter, we would be glad to discuss some of the reasons that were given as to why we felt the administration of it was impractical.

Mr. SUNDSTROM. In other words, you do not care to assume any more specific credit restrictions than you already have?

Mr. ECCLES. I do not think so. So far as I am personally concerned, I am not seeking any more.

Mr. SUNDSTROM. That is all, Mr. Chairman.

The CHAIRMAN. Dr. Smith.

Mr. SMITH. Mr. Eccles, you make the statement in your prepared statement:

> The first proposal would restore to a limited degree an authority which the Federal Reserve System had, from its inception, in 1914, until the Banking Act of 1935.

To what extent did the Federal Reserve, or the Treasury, resort to this provision during that period?

Mr. ECCLES. Well, it was rather limited. I cannot give you from memory just to what extent this authority was used. It was used all during the twenties to a limited degree.

Mr. SMITH. That is, the Federal Reserve did acquire securities directly from the Government during that period?

Mr. ECCLES. It bought 1-day certificates to take care of what otherwise would have been an overdraft.

Mr. SMITH. But you have no record of those transactions?

Mr. ECCLES. Oh, yes; we have, and so does the Congress.

Mr. SMITH. I mean you have none with you?

Mr. ECCLES. I do not happen to have it with me, but we would be very glad to put it in the record.

Mr. SMITH. Those were bought directly from the Treasury?

Mr. ECCLES. Directly from the Treasury; yes, sir.

Mr. SMITH. One-day notes?

Mr. ECCLES. One-day certificates.

Mr. SMITH. Yes. Now, this bill provides that any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities, either in the open market or directly from the United States. Just where is that provision in the original Federal Reserve Act?

Mr. ECCLES. Just where is what?

Mr. SMITH. Where is that provision in the original Federal Reserve Act?

Mr. ECCLES. This puts a limit of $5,000,000,000 on it. The original act had no limit. That is the difference. In the original act, up until 1935, the Reserve banks could buy without limit directly from the Treasury, and it was not until 1935 that that authority was eliminated entirely, and then, in 1942, the Board was given authority, with the limit of $5,000,000,000.

Under section 14, the authority to buy and sell Government securities——

Mr. SMITH. Which paragraph—(b)?

Mr. ECCLES. Yes.

Mr. SMITH. Let me read that section:

> To buy and sell, at home or abroad, bonds and notes of the United States and bills, notes, revenue bonds, and warrants, with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision,or municipality in the continental United States, including irrigation, drainage, and reclamation districts, such purchases to be made in accordance with the rules and regulations prescribed by the Federal Reserve Board.

Does that paragraph cover it?

Mr. ECCLES. Yes; that covers it.

Mr. SMITH. Does that paragraph say that these obligations can be bought directly from the United States?

Mr. ECCLES. Well, it was so construed——

Mr. SMITH. It was so construed?

Mr. ECCLES. Yes.

Mr. SMITH. What is the title of section 14 of the Federal Reserve Act?

Mr. ECCLES. "Open market operations."

Mr. SMITH. "Open market operations"?

Mr. ECCLES. Yes.

Mr. SMITH. Who construed this section to mean that you had authority to buy securities directly from the Treasury?

Mr. ECCLES. I cannot say. I was not with the Board at that time. It probably started during the last war.

Mr. SMITH. Can you supply me with the information showing who construed that section to mean that you had authority to buy these securities directly from the United States Treasury?

Mr. ECCLES. We can see if we can find a record of it. I do not know whether it is possible to find a record on it or not. It was done for 20 years.

Mr. SMITH. What I am trying to find out is, Who construed this section, in the original Federal Reserve Act, to mean that the Federal Reserve Board had authority to purchase securities direct from the Government?

Mr. ECCLES. It is not the Board; it is the Open Market Committee. It is the banks. You see, the Board does not do it.

Mr. SMITH. I meant the banks. I am sorry. I will make that correction. Have you ever considered this question yourself, Mr. Eccles?

Mr. ECCLES. No; I have not considered it.

Mr. SMITH. You never have considered it?

Mr. ECCLES. No, sir; not the question as applying from 1914 to 1935. I have considered the question from 1942 up to the present, but I have not considered the question during a period when I was not connected with the System.

Mr. SMITH. Have you no one here from the Federal Reserve System who might give me some light on this section?

Mr. ECCLES. Well, Mr. Townsend is our assistant general counsel, and Mr. Thomas here is the head of our Division of Research. I do not know whether they can offer you any light or not.

Mr. TOWNSEND. I would suggest, first, Congressman, that the proviso that you read from was added by provision of the Second War Powers Act, and it may take an examination into the previous statutes, which do not appear in the book that we have here, to ascertain the direct authority for the original statement made by the chairman, with respect to the policy operating in the period from 1914 down to the time when the limitation was put on, and we will certainly undertake to supply you with information with respect to that.

Mr. SMITH. Find out who made that construction, please.

Mr. ECCLES. Yes, sir.

Mr. SMITH. Now, coming back to this bill, Mr. Eccles, you would not say that the bill before you reads like subsection (*b*) of section 14, would you?

Mr. ECCLES. Will you answer that, Mr. Townsend?

Mr. TOWNSEND. He has already pointed out the difference by reading it, Mr. Chairman. It is in the record.

The CHAIRMAN. As I understood it, there was no difference in the language in the bill as introduced and the proviso of subsection (*b*).

Mr. ECCLES. I think it is identical.

Mr. SMITH. You say that this provision in H. R. 2233 is identical in wording?

Mr. ECCLES. Well, as I get it here, the law says that—

> any bond, note, or other obligation which are obligations of the United States, or which are fully guaranteed by the United States as to principal and interest, may be bought and sold without regard to maturities either in the open market or directly from or to the United States, but all such purchases and sales shall be made in accordance with the provisions of section 12 (a) of this Act and the aggregate amount of such obligations acquired directly from the United States which is held at any one time by the 12 Reserve banks shall not exceed $5,000,000,000.

Now, the bill says the same thing.

Mr. SMITH. Does subsection (b) say "directly from the United States"?

Mr. ECCLES. Yes. It says "open market, or directly from or to." What I am doing is reading from the present law. I do not know what was in the original bill.

Mr. SMITH. That is exactly what I wanted to bring out.

Mr. ECCLES. Yes.

Mr. SMITH. You made the statement that this has been in effect since 1914. When was the amendment put in here which changed the original?

Mr. ECCLES. Well, the original authority was repealed in the Banking Act of 1935 and the provision that I just read was passed in 1942.

Mr. SMITH. This is like the 1942 provision—is that what you are saying?

Mr. ECCLES. Yes.

Mr. SMITH. That is not my question.

Mr. ECCLES. I do not know what it was in the original bill.

Mr. SMITH. That is not the question at all. That is not the question that I am asking.

Mr. ECCLES. I cannot answer your question, then.

Mr. SMITH. Well, you made the statement, Mr. Eccles, that this has been in force since 1914—since the inception of the Federal Reserve Board.

Mr. ECCLES. Well, let me say this: I did not mean to say that this particular wording of the statute that was put into the law in 1942 is the exact working of the statute——

Mr. SMITH. Not 1942?

Mr. ECCLES. No. I am not saying that the wording of the statute in 1942, which we are proposing now, is an extension of the wording of 1914. What I meant to say, if I did not say it, was that during this 20-year period the Federal Reserve banks could purchase directly from the Treasury without limit.

Mr. SMITH. And exercised that authority?

Mr. ECCLES. And that they did purchase 1-day certificates from the Treasury, which is all that has been done under the act since 1942, when it was reinstated.

Mr. SMITH. Let us forget about 1942 now and hold to 1914. I am still asking for the information.

Mr. ECCLES. We will have to get it for you.

Mr. SMITH. With respect to the construction that was put upon this provision which permitted the use of this particular provision for the purpose of purchasing, by the Federal Reserve banking system, or the acquiring by that system, of Government obligations directly from the Government.

Mr. ECCLES. We will get that information for you.

Mr. SMITH. Because you make the statement, in your prepared statement, that—

> The first proposal would restore to a limited degree an authority which the Federal Reserve System had from its inception in 1914—

and I want you to point out where that authority is.

Mr. ECCLES. We will get it for you.

(The matter referred to is as follows:)

AUTHORITY OF FEDERAL RESERVE BANKS TO PURCHASE GOVERNMENT OBLIGATIONS DIRECTLY FROM THE TREASURY

This statement is in response to questions raised during hearings on H. R. 2233 before the Banking and Currency Committee of the House of Representatives on March 5, 1947, as to the authority of the Federal Reserve banks to purchase Government securities directly from the Treasury.

Section 14 of the original Federal Reserve Act, approved December 23, 1913, provided in part as follows:

"SEC. 14. Any Federal Reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

"Every Federal Reserve bank shall have power:

* * * * * * *

"(b) *To buy and sell, at home or abroad, bonds and notes of the United States,* and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board;" [Italics ours.]

No question was ever raised as to the authority of the Federal Reserve banks, under the provisions of subsection (b) set out above, to buy United States bonds directly from the Treasury. The contrasting provisions of section 14 and subsection (b) would seem to supply ample legal justification for this fact. Under section 14 Federal Reserve banks could purchase and sell eligible paper only "in the open market"; but their power under subsection (b) to deal in Government bonds was not so limited. Accordingly, the Board at all times assumed that the Federal Reserve Banks had the legal authority to purchase Government bonds directly from the Treasury and there were no formal expressions of opinion by it with respect to the question. The closest approximation of any formal opinion was contained in a letter addressed by the Board to the Secretary of the Treasury in December 1920, in connection with a proposed new issue of Treasury certificates, in which the Board stated that the Federal Reserve banks clearly had authority to purchase such certificates under the terms of subsection (b) of section 14 of the Federal Reserve Act.

During the period from the enactment of the Federal Reserve Act until 1935 the Federal Reserve banks carried on operations under this section of the law and purchased Treasury certificates directly from the Treasury from time to time; and the amounts of those purchases were reported to Congress in annual reports of the Board or of the United States Treasury.

For reasons which have already been adequately covered during the hearings on H. R. 2233, the power of the Reserve banks to make direct purchases was repealed by the Banking Act of 1935, by an amendment to section 14 (b) of the Federal Reserve Act requiring that Government obligations should be bought and sold by the Federal Reserve banks only in the open market.

However, in order to assist Treasury financing during the war, the power of the Federal Reserve banks to make direct purchases was restored by the Second War Powers Act of March 27, 1942. That act amended section 14 (b) of the Federal Reserve Act so as to provide that Government obligations might be purchased by the Federal Reserve banks either in the open market or directly from the United States, with a provision limiting the aggregate amount of direct purchases to $5,000,000,000. In thus restoring the authority of the Federal Reserve banks to make such direct purchases, Congress expressly recognized the fact that such authority had existed prior to 1935. In the report of the Committee on the Judiciary of the Senate, dated January 22, 1942 (Rept. No. 989, 77th Cong.) with respect to the Second War Powers Act, it was stated that title IV of that bill, amending section 14 (b) of the Federal Reserve Act,

"* * * would revive powers formerly vested in the Federal Reserve banks so as to permit these banks to make direct purchases of Government securities, including those fully guaranteed by the Government, instead of having to purchase them in the open market.

"*Authority to make off-the-market purchases existed in the Federal Reserve banks prior to and during the last World War.* It was continued and used only in connection with the purchase of short-term Treasury obligations until 1935. At that time, this power, which had never been used extensively, was repealed." [Italics ours]

Mr. Smith. Now, Mr. Eccles, since you have made this statement—and I am going to assume that this particular section has been construed to mean that the Federal Reserve System had the authority which you claim in your statement it did have—we will assume that for argument's sake, because I do not admit it—what were the conditions when that section was written?

We were on the gold standard. We had free markets, both with respect to commodities and with respect to gold and silver, and with respect, also, to Government securities.

The Federal debt, at that time, was about $1,200,000,000. Of that amount, about $600,000,000 represented notes that has the circulating privilege. They bore a rate of interest of 2 percent. The remainder represented borrowed money.

At that time we did not have a politically managed money as we have at the present time. We had an altogether different philosophy concerning finance and money. Nobody believed in prosperity by deficit financing. The conditions were altogether different.

You have predicated your request here on the basis of restoring conditions to what they were in 1914. Do you think that your parallel is correct?

Mr. ECCLES. I think you have come to an entirely erroneous conclusion. I am not asking for this authority with any relationship to what existed in 1914. I have no interest now in what existed in 1914. There is no comparison between the conditions of the world or the problems that exist today and those that existed in 1914.

I am asking for a continuation of this authority to deal with problems of today. I am interested in what exists now and the problems that we have to deal with in the future. I would still be as much in favor of the bill as if the power had never existed in 1914. And the mention of it is merely incidental. It could have been left out of the argument altogether. It really is not an important matter at all, in arguing for this bill.

Mr. SMITH. Then you think that this statement that you are making here now, Mr. Eccles, to return to the conditions of 1914, is not really——

Mr. ECCLES. It is irrelevant, completely irrelevant.

Mr. SMITH. It is completely irrelevant? It would have no influence at all? It was not injected to influence anybody?

Mr. ECCLES. It was merely to let the Congress know that the power to deal directly with the Treasury had been in effect for a period of 20 years; that is wasn't anything that was entirely new.

Mr. SMITH. When they passed the 1935 act forbidding the Federal Reserve from buying directly, or acquiring directly from the Treasury, Government obligations, just what was the purpose of the act?

Mr. ECCLES. I think it was based upon an entirely erroneous view of the situation. I think some people were of the opinion that if the money market were going to be left with the decision as to whether or not the Government could get money that it might need to finance its deficits that would deter the Government in its operations.

Well, of course I take the position—and I think the facts of the situation will verify it—that when the Congress appropriates more money than they are willing to levy taxes to cover, there is thereby created a deficit, and that deficit has got to be financed. And I think that there was some feeling that they ought to put the money market, perhaps, in control of—let me put it this way: There was some feeling that they ought to give the money market more control and influence over what money the Government was going to be able to raise, and that if they stopped the open-market committee from purchasing directly from the Treasury they thereby would deter deficit financing.

Well, of course that was a completely erroneous conception because they did not stop the open-market committee from buying in the open market. and if it was desired to stop deficit financing, then they should have stopped not only any ability to borrow directly from the Treasury but they also should have stopped any ability to borrow at all for deficit financing.

But I say that the Congress is the one to determine whether or not there is going to be a deficit. The Congress is the one to determine the appropriations, and the Congress is the one to determine whether or not it is desirable or advisable to collect taxes in sufficient amount to meet appropriations or in excess of the amount necessary to meet the appropriations, and it should not be left up to the private banking authorities to determine whether or not the Government can finance its deficit.

Mr. SMITH. You would not consider the Federal Reserve System a private institution, would you?

Mr. ECCLES. No, I would not, for all practical purposes. It is true that the stock of the System, as Congressman Patman brought out yesterday, is owned by the member banks. But the member banks have no residual interest whatever in the Reserve banks, and the member banks have nothing to say about the salaries, the expenditures——

Mr. SMITH. I understand. I have read all that, Mr. Eccles.

Mr. ECCLES. And for that reason I would say that the Federal Reserve System is a public institution.

Mr. SMITH. It is a Government institution.

Now, Mr. Eccles, when did the Treasury acquire authority to deposit bonds or other securities in the commercial banking system? When did they acquire the authority to——

Mr. ECCLES. I believe it was in 1932—the Glass-Steagall bill.

Mr. SMITH. When did they acquire authority to purchase or finance Treasury bonds through the commercial banking system?

Mr. ECCLES. I just do not get your point. When did the Treasury what?

Mr. SMITH. Acquire the authority to finance its obligations directly through the commercial banking system?

Mr. THOMAS. Through the National Banking Act of 1863.

Mr. SMITH. The Second War Powers Act had nothing to do with that?

Mr. ECCLES. No, no. When the Treasury offers its bonds for sale it can permit banks to buy those bonds if it chooses to. It can make the banks eligible to buy, or it can make the bonds eligible to any that it chooses. And the Treasury, in its financing, made certain securities eligible for banks, while other securities were not eligible for banks.

Mr. SMITH. So the power to monetize the Government debt was provided in the National Banking Act of 1863; is that right?

Mr. ECCLES. Well, I think national banks, when they were set up, were permitted to buy Government bonds.

Mr. SMITH. I am trying to elucidate the question that Mr. Thomas' answer suggested.

Do you give the same answer, Mr. Eccles?

Mr. ECCLES. Well, I do not know when the authority was given to banks to buy Government securities, or when authority was given to the Treasury to issue Government securities that may be eligible for the banks to purchase. I could not tell you that. That may take a review of a lot of legislative history and law.

Mr. SMITH. You do not agree, then, with the statement of Mr. Thomas that that power was acquired——

Mr. ECCLES. I do not know. I do not disagree, because I do not know. As long as I can remember—and I have been in the banking business since 1913—there was no prohibition against banks buying Government securities. Now, what happened before that I do not know.

Mr. SMITH. All kinds of banks?

Mr. ECCLES. All kinds of banks.

Mr. SMITH. Now, this question we are dealing with is rather simple. You are asking for certain authority here. You say that that would give you the power to acquire securities directly from the Treasury. That is correct, is it not?

Mr. ECCLES. That is right—up to this amount.

Mr. SMITH. Up to that amount.

Mr. ECCLES. $5,000,000,000.

Mr. SMITH. Which is only for the purpose of what you call overdrafts.

Mr. ECCLES. No; I did not say it was only for that purpose.

Mr. SMITH. For what other purpose?

Mr. ECCLES. Well, I have stated that at least five or six times, in answer to various questions.

Mr. SMITH. Yes. Well, now, if you do not mind, I would like to have you state it again.

Mr. ECCLES. The other purpose is to be able to purchase notes, bonds, or certificates when, in the judgment of the Open Market Committee, that seems to be necessary due to the conditions of the market. I have outlined a situation where it may be desirable to buy certificates or notes or bonds—when there was a maturity and the Treasury offered to refund it and fell short of success of its refunding, so that the Reserve banks could take up the difference. There would be a case in point. They have never had to do it. They have done it indirectly through the market, but they certainly should have the power to assure the Treasury success in its refunding operations. Otherwise the Treasury would want to carry much larger idle balances, upon which they would be paying interest, in order to feel safe and sure that they could take up any maturity in case they were unable to refund all of it.

Mr. SMITH. And that, in substance, would resolve itself into this: That you are asking that the same arrangements be made with respect to the Federal Reserve System that now prevail with respect to the commercial banking system?

Mr. ECCLES. Well, the Federal Reserve System has had power to buy in the market.

Mr. SMITH. Let us not get away from the question. I am talking now about buying directly from the Treasury.

Mr. ECCLES. Well, the Treasury determines whether or not they are going to sell directly to commercial banks. Most of the war financing was done through the market, and they did not sell directly to commercial banks. The commercial banks bought in the market most of the securities which they have.

The Treasury elected whether they would sell or not directly to the banks and whether they would permit the banks to subscribe.

In practically all of the war loan drives the banks were not permitted to subscribe, except for certificates.

Mr. SMITH. You still have not answered my question, Mr. Eccles. I just wanted to know whether this arrangement you are asking for here is not in substance, the arrangement which prevails now—where the Treasury finances its obligations directly through the commercial banking system.

That is the question I am asking.

Mr. ECCLES. Well, it is much more limited than that. The power we are asking here is the right to purchase up to $5,000,000,000.

Mr. SMITH. All right.

Mr. ECCLES. The Treasury has no limit as to what they may choose to offer to commercial banks.

Mr. SMITH. Then you do agree that this is the same arrangement, in principle?

Mr. ECCLES. For entirely a different reason.

Mr. SMITH. Well, for the purpose of raising money to satisfy the requirements of the Treasury.

Mr. ECCLES. But the private banks buy Treasury bonds for profit, for income, because they are privately owned. The Reserve banks are not profit institutions. Our operation is not an operation for profit.

Mr. SMITH. So this is merely a device to get away from this profit; is that the idea.

Mr. ECCLES. It is what?

Mr. SMITH. This is a device, then, to get away from this profit?

Mr. ECCLES. No; it does not get away from the profit. What I am saying is that our purpose, the purpose of the Reserve System——

Mr. SMITH. You say it does not get away from the profit?

Mr. ECCLES. I say the purpose of the Reserve System, in buying the securities, is an entirely different purpose from that of the commercial banks.

We have a public responsibility for stabilizing the Government securities market and assuring the Treasury of a market for its bonds. That is our responsibility and duty. That is the responsibility of the open market committee.

The private banks have no such responsibility at all. The private banks operate strictly for profit. We do not operate for profit.

Mr. SMITH. I do not think that is apropos. What I am trying to find out here—and you have already admitted that the two propositions are alike, with the exception that in one profit is involved and in the other no profit is involved——

Mr. ECCLES. No; they are not alike even that far. The mechanism of buying directly is the same. The purposes are entirely different.

Mr. SMITH. Speaking of purposes, Mr. Eccles, let us get down to seeing what these purposes are. Is there any other purpose except that of raising money for the Treasury?

Mr. ECCLES. Yes.

Mr. SMITH. What other purpose?

Mr. ECCLES. It is not for raising money at all. It is to assure its refunding.

Mr. SMITH. Suppose, then, we took away from the Treasury the power to finance its obligations directly through the commercial banking system. What position would your proposition be in then?

Mr. ECCLES. Well, I do not think it would make any difference. If you took the power away from the commercial banking system it would not make any difference.

Mr. SMITH. Wouldn't this provision that you are asking to be written into law then give you the power to take those obligations directly from the Government, in the same manner that the commercial banks are now taking them from the Treasury?

Mr. ECCLES. Well, if you give the Federal Reserve the unlimited power to purchase Government securities, market securities, and you prohibit the commercial banks from buying Government securities at all, and Congress would certainly indicate, in connection with that, that it was their intention that the Government should be financed by the Federal Reserve banks rather than the commercial banks—that is the thing that Mr. Patman discussed yesterday—then, of course, that would be true.

In other words, the Congress could require that the Federal Reserve System finance the Government and that private commercial banks would not be permitted to finance the Government or to create any money.

Now, you can do just that.

Mr. SMITH. Now, Mr. Eccles, this is what I am thinking of: In following this procedure, it identifies itself with that followed in France, with what followed in Germany and other European countries. It identifies itself completely.

Mr. ECCLES. It has no relationship to those operations.

Mr. SMITH. Well, you are financing the cost of government through the central bank.

Mr. ECCLES. That is exactly what they do—they finance the Government through the central banks, indirectly. They finance the Government through the central banks purchasing in the market. And that is exactly what they did. That is the only way the war could be financed. The war was financed here by the Treasury indirectly through the central bank.

And as long as you keep on running deficits it is the deficits that create all the trouble. It is not the financing that creates the trouble.

In the German economy and the French economy, where you had the extreme inflation that you refer to—and where you blame it on the financing by the central banks—this was brought about in the first instance by huge deficits, creating money beyond the supply of goods and materials, and not by the way they were financed. It was the deficit, in the first instance, that created the trouble.

Mr. SMITH. Mr. Eccles, we have cleared up one subject. Let us go a step further. Suppose something should happen whereby the commercial banks decided that they could not buy any more obligations—and you admitted that that could take place?

Mr. ECCLES. No; I do not admit at all that it could take place because we would create reserves for them.

Mr. SMITH. Pardon me?

Mr. ECCLES. The Federal Reserve would do just what we did during the war. We would create reserves for the commercial banks so that they could finance the Government. That is the way the war financing was done.

Mr. SMITH. The debt is $260,000,000,000, plus I do not know how much more—considerably more than you have on the statement of the Treasury, however. I just got an item today of $6,900,000,000 that will have to be added to it—

Mr. MONRONEY. What is that for?

Mr. ECCLES. That is for social security obligations, resulting from freezing the tax rate at 1 percent.

Mr. MONRONEY. We should not have frozen it, you mean?

Mr. SMITH. I voted for freezing it.

Mr. Monroney. But if we are for social security, we should have raised it. I voted for raising it.

Mr. Smith. You were consistent.

Now, Mr. Eccles, we have established the fact that the procedure you have proposed in the pending bill would be the same as that now practiced with respect to the Treasury financing its obligations through the commercial banking system.

Mr. Eccles. Well, I would like to make this distinction: If the Treasury finances obligations through the commercial banking system the commercial banks have to have reserves to offset the deposits that the commercial banking system creates. In the case of financing through the Federal Reserve System they create reserves, so there is a very basic difference as to whether the financing is done through the central bank or the commercial banks. It is not the same at all.

Mr. Smith. Let us narrow the thing down.

Mr. Eccles. The one creates reserves; that is, the Federal Reserve bank creates reserves for the commercial banks. When the Federal Reserve buys Government securities, directly from the Treasury or in the market, they put that much money into the market, and that becomes reserves.

Mr. Smith. That is, after the transaction.

Mr. Eccles. That is right.

Mr. Smith. I am just talking about the simple transaction of the Federal Reserve acquiring Government securities or the commercial banks acquiring Government securities.

Those procedures certainly, insofar as that is concerned, are the same.

Mr. Eccles. I suppose the mechanism would be that the Treasury would get the money, but the effects would be entirely different because the sources of the money are different.

Mr. Smith. All right. That is enough on that point.

Now, Mr. Eccles, in studying the history of these movements we see that you are doing here exactly what has been followed all over the world by the central banks in conjunction with their Governments. And if anything should happen so that the commercial banks could not carry this load, this authority you are asking for here would give the Treasury direct authority or power to finance its obligations through the Federal Reserve banking system.

In other words, what you are pleading for here is to short-circuit this old route which has been followed. By that I mean the financing of Government obligations through the commercial banking system to the extent, at least, of $5,000,000,000. Is that true or is it not true?

Mr. Eccles. It is not true.

Mr. Smith. Well, you have admitted that the Treasury gets the money, and, after all, that is the ultimate thing aimed at.

That is all, Mr. Chairman.

The Chairman. There are two statements which have been submitted for the record, and without objection, they will be inserted at this point.

(The matter referred to is as follows:)

STATEMENT OF ROBERT V. FLEMING, CHAIRMAN, COMMITTEE ON GOVERNMENT BORROWING, AMERICAN BANKERS ASSOCIATION

MY DEAR MR. CHAIRMAN: On behalf of the committee on Government borrowing of the American Bankers Association, I desire to record by means of this communication our viewpoint in respect to H. R. 2233, introduced on February 26, 1947, with particular reference to that part of the bill providing for the permanent extension of the power of the Treasury of the United States to borrow directly from the Federal Reserve banks sum or sums not in excess of $5,000,000,000.

The committee on Government borrowing was created in 1942 at the request of the Secretary of the Treasury, and from time to time since its creation has been consulted by the Treasury Department in regard to fiscal policies.

At a meeting of our committee held on January 23 and 24, 1947, with the Secretary of the Treasury, consideration was given to the questions involved in the power of the Treasury to borrow directly from the Federal Reserve bank sums not in excess of $5,000,000,000, which power expires, under existing law, on March 31, 1947. At this meeting the committee recommended the continuance of this power, by legislative enactment, for a period not to exceed 3 years.

The committee's recommendation on this subject was the result of an examination of the uses to which this power has been put since first granted to the Treasury, it having been ascertained that the use of such power has been restricted to requirements of the day-to-day convenience of the Treasury and exercised mainly prior to or near tax payment periods. In our judgment, to date the power has not been misused.

When this power is exercised as an occasional, temporary expedient in the Treasury's borrowing operations, its effect upon the national economy and the Treasury's fiscal position cannot be considered dangerous. Furthermore, the committee feels that the Treasury should hold its working balance to as low a figure as possible in order to make the maximum saving in interest in connection with the debt service, and to make retirements of the public debt as rapidly as possible. On the other hand, with the size of the existing debt, it hardly could be expected that the Treasury would reduce its working balance to a minimum unless it had the use of such power as it now enjoys under the Second War Powers Act. However, our committee feels that this power should not be made permanent, but should be extended from time to time, in order that the Congress of the United States may have an opportunity to examine to see that there has been no misuse of the power.

Therefore, in its recommendations to the Secretary of the Treasury in January, and now to your committee by means of this communication, I desire to advise that our committee is of the opinion that while it is appropriate to extend this power at this time, it should be extended for a period not to exceed three years.

A MESSAGE TO CONGRESS ON DEFECTS IN OUR MONETARY SYSTEM

Thanks, Mr. Chairman and members, for the privilege of addressing your committee, and I trust a few words from one of the few 100-percent Americans left in America will find receptive ears in a Congress bewildered by complexities.

I am much concerned over the monetary policy now in force in the United States and as I watch the steady debasing of the dollar I view the futures with great alarm.

It seems strange that in 150 years we have never been able to balance the amount of money created, with the money in circulation, and each year for 150 years we see on the Treasury reports a certain sum set aside for redemption of money that has long ago been lost or destroyed and there should be some way devised to eliminate the unnecessary bookkeeping and I will later on suggest a remedy. Until 40 years ago we had in the United States a sound money, no currency was issued by the Government without a 100-percent backing in gold and silver, then partly to cure error in our economic policy we began to deflat the percentage, began to deflate the grains in the dollar, with furthur deflation in percentage, until today, due to the inflation in the price of gold, and the additional deflation in percentage we have but a 5-grain dollar compared to 40 years ago.

It has been the custom of Congress by new laws in the past 65 years at least to inflate cost of government, commodities and taxes, this in turn debasing the dollar in the same proportion. There was no effort to keep the dollar on a parity with wage salary, commodity, or tax, so now we find outselves using a dollar—mind you an ounce of metal—with but an 8-cent value in commodities as compared to 65 years ago.

By this system of deflation we have nearly destroyed the paper as well as the silver dollar as a medium of exchange, and have as you know demonitized the gold dollar entirely, pretty much for the same reason.

But strange to find that 70 percent of our working circulation or medium of exchange is the subsidiary coins, these doing most of the cash transactions, while the dollar and larger denominations are the keeping and saving money of the Nation.

Again I refer to the gold and silver dollar, wherein, according to statistics it took a 10-hour day work and sweat to create each dollar, based on our old weights, size, and fineness. This then established the intrinsic value of the dollar, and the value of the day's work in other industries. But now with Government given the power to create $100 paper money with but 3 cents worth of labor (and printing presses don't sweat) it has allowed our economy to inflate everything to a dangerous degree, and in so doing is putting us well on the way toward a Chinese dollar and nothing.

This dollar I hold in hand, the same dollar we coined 150 years ago, now worth but 8 cents in essentials of life, worth but 5 cents in our per capita tax structure as compared to just 65 years ago. Think of it, an ounce of metal with an average circulating value of but 5 and 8 cents—doesn't this concern you—for the safety of the tomorrows? And along with this tragedy, think of the 20,000,000,000 in idle gold as it stands worth nothing, but costing the taxpayers 2 and 3 percent in interest perpetually to say nothing about the cost of an army to guard this useless horde. Now that we have for 65 years deflated the dollar to less than 8 cents by inflationary laws, I would ask that you begin to deflate cost of Government—taxes, wages, and commodities—and thus inflate this dollar back up to 100 cents. Do this by passing a law, that by Government edict at 7 a. m. on a certain morning we will discount everything of value in the United States 10 percent—bonds, stocks, mortgages, commodities, wages, salaries, services, interest, and taxes, with a capital tax of 10 percent on cash money in hand, continue this for 9 successive years and when the dollar is then restored to 100 cents, never again let it lose its parity with the cost of Government and the essentials of life.

I further propose we deflate gold to its old value and remove the billions of inert useless gold bullion in the vaults of this Nation. Stamp into coin at our old weights, size, and fineness, and for these pagans of the east who do not care for the motto "In God we trust" stamped on their money, let them have the germy, microby, dog-eared, and flimsy paper, but see to it that it be backed by 100 percent gold and silver so in case we Christians get hold of it we can redeem in honest dollars.

I propose that our domestic gold producers be paid a bonus on new production over the reestablished price of $20.67 per ounce, until the wage scale again reaches the 1935 dollar standard, and under no condition accept gold from countries at more than our established price of $20.67 per ounce. This will not only bring our own monetary system in order but will give other less fortunate countries something to build on.

As for silver, stop robbing the producer of 38 cents an ounce, and forbid the destruction or mutilation of our money. What manner of ruling is this that allows any man or industry to remelt or reduce to acid solution our circulating coins under the false premises that destroying is not mutilation. Whoever heard of destroying anything without mutilating it in some degree? By such a false ruling the industries could actually (if they wish) destroy our subsidiary coins of 10-, 25-, and 50-cent denominations, and thus leave us without 70 percent of our circulating and working medium of exchange.

This deflation process then will cure our monetary ills and hereafter lets get our money balance straightened out, by calling in first year and each decade thereafter all the money in circulation, exchange for new stamp or design, and after 1 year declare all money not exchanged null and void, for truly the circulation of money is the lifeblood of a nation and to hoard or freeze or destroy the circulation is just as disastrous to a nation as freezing the lifeblood in the human body. America at the moment is close to the breaking point. Democracy, representative Government, even solvency, is threatened. The power to tax is the power to destroy and for the past 65 years we have worked overtime to actually bring this about. Poverty, misery, distress, and tragedy comes not from the foreclosure of mortgages as in the old days, but by the foreclosure on tax defaults, thus in these same 65 years we find per capita taxes increased 1,900 percent, other things in proportion, this burden destroys incentive, initiative, and ambition, and will bring us to the point where no man will dare venture.

Yes, two things are sure—death and taxation—but death is final, while taxes on the achievement of the deceased go on and on forever. So I warn you that any new bills passed, adding to cost of Government, commodities and taxation, will destroy our solvency and our money with it. America depends on three things—sound money, sound legislation, and saintly women, and if, as I am led to believe, all are going to Hell, count our Nation lost.

Grieve not too much when you, my representatives, reach that stage where your salary will be but 10 percent of what it is now, but rather remember your dollar will be worth 100 cents instead of less than a dime as it is now, and remember again the savings on our printing presses, the denuding of our forests, and the depletion on our mines, when we once again make our 100-cent dollar a thing to be honored, respected, and revered, and ever ready to pay for an honest day's work.

As I have passed down life's highway, I find that too much money easily acquired is the most dangerous thing in the world. A fool and his money are soon parted. I am not saying all men are fools but when we find that 85 percent of our population are still afflicted with 12-year-old mentalities, who may be wiser than we think, or the adults who may be dumber than we think, a loaded gun is safer in their hands than too much money The mountainsides of the old West are covered with the graves of my friends who died not so often by the bark and bullets of the six-shooters of the desperadoes, but by having too much money, easily earned and wrongfully spent, and along with this loss was left behind wrecked morals, debauched womanhood, intensified greediness and Christian principles of man. But still to be settled is the equalization problem. God forbid that we continue as we are now with 40 percent of our citizens lolling in luxury while 60 percent are on the border line of distress. Dream no more of the wide open frontiers—yes, we still have plenty of wide open spaces, but it is already denuded of its fertile soil, water, oil, timber, and mineral wealth; but if representative government is to survive it will be by a more equitable distribution from production and not from loot from the United States Treasury.

Thanks for your attention and if any dissenting opinion arises I am here to answer and defend my statements.

The Old Prospector,

H. E. GIMLETT.

The CHAIRMAN. If there are no further questions, the hearings on this bill are concluded and the committee will adjourn to meet in executive session tomorrow morning at 10, to consider H. R. 2233.

(Whereupon, at 4:30 p. m., the committee adjourned, to reconvene at 10 a. m., Thursday, March 6, 1947.)

×