

**REDUCTION IN RESERVE RATIO FOR FEDERAL
RESERVE NOTES AND DEPOSITS**

HEARINGS
BEFORE THE
COMMITTEE ON BANKING AND CURRENCY
UNITED STATES SENATE
SEVENTY-NINTH CONGRESS
FIRST SESSION
ON
S. 510

A BILL TO AMEND SECTIONS 11 (c) AND 16 OF THE
FEDERAL RESERVE ACT, AS AMENDED,
AND FOR OTHER PURPOSES

FEBRUARY 20, 28, AND MARCH 7, 1945

Printed for the use of the Committee on Banking and Currency



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REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

TUESDAY, FEBRUARY 20, 1945

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met, pursuant to call, at 10:30 a. m., in room 301, Senate Office Building, Senator Robert F. Wagner (chairman) presiding.

Present: Senators Wagner (chairman), Murdock, McFarland, Taylor, Fulbright, Taft, Butler, Capper, Buck, Millikin, and Hickenlooper.

The CHAIRMAN. The committee will come to order.

Governor, as you know, we are considering S. 510, in which you are very much interested. We would like to hear from you on the proposed legislation, and why this legislation is needed.

(The bill under consideration, S. 510, is as follows:)

[S. 510, 79th Cong., 1st sess.]

A BILL To amend sections 11 (c) and 16 of the Federal Reserve Act, as amended, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) the third paragraph of section 16 of the Federal Reserve Act, as amended, is amended by changing the first sentence of such paragraph to read as follows:

"Every Federal Reserve bank shall maintain reserves in gold certificates of not less than 25 per centum against its deposits and reserves in gold certificates of not less than 25 per centum against its Federal Reserve notes in actual circulation: *Provided, however,* That when the Federal Reserve agent holds gold certificates as collateral for Federal Reserve notes issued to the bank such gold certificates shall be counted as part of the reserve which such bank is required to maintain against its Federal Reserve notes in actual circulation".

(b) The first sentence of the fourth paragraph of section 16 of the Federal Reserve Act, as amended, is amended by striking therefrom the words "40 per centum reserve hereinbefore required" and by inserting in lieu thereof the words "25 per centum reserve hereinbefore required to be maintained against Federal Reserve notes in actual circulation".

(c) Subsection (c) of section 11 of the Federal Reserve Act, as amended, is amended to read as follows:

"(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act: *Provided*, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And provided further*, That when the reserve held against Federal Reserve notes falls below 25 per centum, the Board of Governors of the Federal Reserve System shall establish a graduated tax of not more than 1 per centum per annum upon such deficiency until the reserves fall to 20 per centum, and when said reserve falls below 20 per centum, a tax at the rate increasingly of not less than 1½ per

centum per annum upon each 2½ per centum or fraction thereof that such reserve falls below 20 per centum. The tax shall be paid by the Reserve bank, but the Reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Board of Governors of the Federal Reserve System."

SEC. 2. The second paragraph of section 16 of the Federal Reserve Act, as amended, is amended to read as follows:

"Any Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal Reserve agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section 13 of this Act, or bills of exchange endorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this Act, or bankers' acceptances purchased under the provisions of said section 14, or gold certificates, or direct obligations of the United States. In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Board of Governors of the Federal Reserve System of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Board of Governors of the Federal Reserve System may at any time call upon a Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it."

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

Mr. ECCLES. Mr. Chairman, I have here a prepared statement, which is rather long, as I have attempted to explain the need of the legislation and to anticipate questions that might arise. I thought that might facilitate matters; and if I may I would like to read this statement through and then if there are questions still left to be answered, I will be glad to answer them.

The CHAIRMAN. Any way you want to do it. Will you distribute copies of your prepared statement around the table to the members of the committee?

Mr. ECCLES. I will be glad to do that. This is a little different statement from the one put in the record; it is more extensive.

Now, if I may read the statement.

The CHAIRMAN. You may proceed to do so.

Mr. ECCLES. The bill under consideration (S. 510) would accomplish the following purposes: (1) Extend indefinitely the authority of the Federal Reserve banks to pledge United States Government securities against Federal Reserve notes issued by the Federal Reserve agents. Existing authority expires June 30, 1945; and (2) reduce the requirements of reserves to be held by Federal Reserve banks from their present level of 40 percent in gold certificates against Federal Reserve notes in circulation and 35 percent in gold certificates or lawful money against deposits, to a uniform minimum of 25 percent in gold certificates against combined note and deposit liabilities.

The need for reducing the high reserve requirements of the Federal Reserve banks was mentioned by the President in his Budget message transmitted to the Congress on January 3, 1945.

Pledging of United States Government securities against Federal Reserve notes. In conditions prevailing today, with Federal Reserve notes outstanding in an amount of 21.7 billion dollars and deposit liabilities of the Federal Reserve banks in an amount of 16.4 billion dol-

lars, it is imperative to extend the power to pledge United States Governments as collateral against notes. Without this authority the Federal Reserve banks would be obligated to engage in a series of operations for the sole purpose of obtaining other assets that would be eligible as collateral for Federal Reserve notes in place of United States Government securities which would not be eligible. They would have to sell a large enough volume of Government securities to make it necessary for banks to borrow as much as 10 billion dollars from the Federal Reserve banks at this time and possibly as much as 18 billions by the end of the year. The manner in which this would work is that the Reserve banks would sell the securities in the open market; payment for them would take out an equivalent amount of funds from the market, and member banks would have to borrow this amount from the Federal Reserve banks in order to replenish their reserves. The promissory notes of member banks at the Reserve banks would be eligible under the law as collateral for Federal Reserve notes. No public interest would be served, but in the process the market for United States Government war obligations would be disrupted at a time when the Treasury must still raise vast sums to finance the war. It is clear that this must not occur and that, therefore, the power to pledge Government securities against Federal Reserve notes must be continued.

In proposing to permit the Reserve banks to pledge United States Government obligations as collateral for Federal Reserve notes, it is recommended that no time limit be placed on this authorization. In view of the fact that the Federal Reserve banks' assets, other than gold certificates, consist at present almost entirely of Government securities, most of which were acquired during the war, and the improbability that these banks will have any considerable volume of other earning assets in the foreseeable future, it would not be in the public interest to have the authority to use United States securities as backing for notes terminate at a predetermined date.

Periodic renewal of this authority not only involves delay, unnecessary expenditure of effort for the Congress and the Board, and the necessity of rehearsing the same arguments over and over again, but it also may result in a period of uncertainty which is disturbing to the United States Government security market. Maintenance of stable conditions in this market is essential in view of the dominant role that Government securities have come to play in our financial structure, and this stability has been and must remain indefinitely a primary objective of Federal Reserve policy. Uncertainty about continued eligibility of Government securities as collateral for Federal Reserve notes would have an adverse effect on this stability.

The pledging of Government securities as collateral was first authorized 13 years ago as an emergency measure at the depth of the depression when the Federal Reserve banks needed to buy Government securities in order to ease the pressure of debt on member banks and thus create easier credit conditions. The authority has been renewed from time to time. It is apparent that it will have to be renewed for many years to come. It would be far wiser to extend the authority for an indefinite period, the Congress, of course, always retaining the right to repeal the authority if this should appear to be desirable.

When the collateral provisions for Federal Reserve notes were first formulated there were practically no Government securities in the

market; member banks had a large volume of so-called eligible commercial paper, and were expected to borrow on that paper when they required additional reserves or currency. The situation has radically changed since then. There is now an enormous public debt which constitutes a large part of the earning assets of member banks; the total volume of eligible paper has declined, and many banks have practically no such paper. Banks are also reluctant to borrow from the Reserve banks and, if they should borrow in considerable volume, this would result in a tightening of credit conditions with disturbing effects on the price of Government securities. Furthermore, if they borrowed, they would borrow on their promissory notes secured by Government obligations. Consequently, what would be back of the notes would still be United States Government securities—but with an endorsement by a member bank. Surely an obligation of the United States Government is not improved in credit standing by endorsement of some member bank.

Collateral requirements are not an effective limitation on credit expansion by the Federal Reserve banks. Open-market operations of these banks are governed by considerations of the public interest and not of Federal Reserve bank earnings. When the Reserve banks purchase United States Government securities they pay for them by deposit credit. Once these deposit liabilities have been incurred the Federal Reserve banks are obliged to permit their withdrawal in currency. The public demand for currency, in turn, depends on business conditions, activity of trade, the volume of wage payments, the price level, and the extent of the people's will to hold their liquid assets in the form of cash rather than bank deposits or Government securities. Member banks, to avoid insolvency, must permit their customers to withdraw their deposits in currency; Federal Reserve banks in turn must permit the member banks to obtain the currency by drawing on their balances with the Reserve banks. Consequently, the Reserve banks have no choice in the matter because they have no control over the demand for currency. It serves no useful purpose to encumber these unavoidable operations by legal restrictions which inevitably must give way as soon as they would actually restrict.

In any case Federal Reserve notes have a prior lien on all assets of the Federal Reserve banks and are obligations of the United States Government. Segregation of special assets of the Federal Reserve banks as collateral for these notes adds nothing to their quality. It is merely an obsolete piece of machinery conceived at a time when conditions were radically different from those that prevail today. By authorizing the pledging of Government securities as collateral for Federal Reserve notes the collateral requirement is extended to practically all the assets of the Reserve banks and ceases to be an interference with the performance of their duties and the discharge of their responsibilities. This extension should, therefore, be a permanent part of the law.

SENATOR TAFT. Mr. Eccles, I want to propound a question or two only for the purpose of getting clearer in my head the actual process that goes on: On the issue of Federal Reserve notes a Federal Reserve bank goes to the Federal Reserve agent—who represents the United States Government, by the way, does he not?

MR. ECCLES. Represents the Board.

Senator TAFT. In fact, it is a governmental body.

Mr. ECCLES. Yes.

Senator TAFT. And request is made for these Federal Reserve notes the Government has printed. In order to get them; what do they do? Do they deposit 100 percent of assets of some kind?

Mr. ECCLES. That is right; gold certificates up to the required amount or a greater amount. There was a time when there was sufficient gold so that you did not need—either eligible paper or Government securities to make up the difference—there was enough to give 100-percent coverage in gold notes.

Senator TAFT. They will have to give 40 percent?

Mr. ECCLES. Yes.

Senator TAFT. And the other 60 percent is made up of other assets?

Mr. ECCLES. The other assets must be what is known as eligible paper.

Senator TAFT. Except for this emergency provision?

Mr. ECCLES. Yes. There is practically no eligible paper. This chart here will give you a picture of the situation.

Senator MURDOCK. Mr. Chairman, could we not have the easel brought up, so we may all see this chart?

The CHAIRMAN. Yes. That will be done.

Mr. Eccles, in view of the fact there is no eligible paper, you provide Government securities; do you not?

Mr. ECCLES. Government bonds.

Senator MURDOCK. But you still have to have the 40-percent gold?

Mr. ECCLES. That is right.

Senator MURDOCK. Plus other Government securities or some other eligible paper.

Mr. ECCLES. Other Government securities or a bank note secured by Government securities, or what is known as eligible paper. That is, in order to get it, one has to have commercial paper not exceeding 90-day maturity or agricultural paper not in excess of 9 months' maturity.

Senator TAFT. There is no eligible paper shown here.

Mr. ECCLES. No. Federal Reserve banks have very little eligible paper of member banks because, for the most part, member banks are not borrowing; so Federal Reserve banks have little eligible paper.

Senator TAFT. Their assets are almost entirely gold and Government securities?

Mr. ECCLES. Yes.

Senator TAFT. What are the assets now in the way of Government securities?

Mr. ECCLES. About 19 billion dollars.

Senator TAFT. Do you say they are now about 19 billion dollars?

Mr. ECCLES. Yes.

Senator TAFT. That is an increase of how much in the last 3 years?

Mr. ECCLES. I do not know offhand. What was it 3 years ago, four or five billion dollars?

Dr. GOLDENWEISER. Something like that.

Senator MURDOCK. And in 1933 I think it was four billion dollars.

Mr. ECCLES. Not that in 1933. I think it was around 2 billion dollars, and stayed near that figure to the end of 1941.

Senator TAFT. Federal Reserve holding of Government bonds.

Mr. ECCLES. Not bonds. The biggest part of that is Treasury 90-day bills. Federal Reserve banks own close to \$12 billion of those bills. They own about 80 percent of all outstanding Treasury bills, which are 90-day $\frac{3}{8}$ paper.

Senator TAFT. How much have the holdings of Government bonds increased in 1944? It is going up at an increasing rate; is it not?

Mr. ECCLES. It is at about the same rate, so long as deficit financing continues at the present rate, and expansion of currency continues, at the rate it has been expanding for the past 2 years. As the currency goes out the reserves in banks diminish by the amount of currency that goes into circulation, hoarding, or whatever it may be. The banks sell Governments to meet that shrinkage in reserves. So the Federal Reserve buys Governments to meet the expansion of currency. That is about \$5 billion a year.

Senator TAFT. And it has now reached what figure?

Mr. ECCLES. About \$21 billion of Federal Reserve notes, and with silver certificates, which make up practically all of the balance, the total is about \$26 billion.

Senator TAFT. And that is three or four times what it was before the war.

Mr. ECCLES. Here are the figures down below on this statement. It shows Federal Reserve notes outstanding of \$8,200,000,000 in 1941, and \$21,700,000,000 in December 1944. That would get to about \$26,700,000,000 by the end of this year.

Senator TAFT. Just to get a general idea of the figures shown in your table, let me ask this question: We now require a reserve of 40 percent as against outstanding notes, which is 40 percent of \$21 billion; and 35 percent on deposits, which are now \$16,400,000,000, those are deposits of the member banks in the Federal Reserve System required as a reserve for their own good?

Mr. ECCLES. The law requires that all national banks must be members, and State and city banks that choose to become members can be members if they are accepted, and all of these member banks are required to carry certain reserves under the law, with Federal Reserve banks. And this \$16 billion of deposits with Reserve banks represents largely the reserves that are carried by member banks.

Senator TAFT. And what is the size of the deposits in member banks that requires \$16 billion of reserves, about, today?

Mr. ECCLES. As to the member banks, about \$100 billion.

Senator TAFT. It is about \$100 billion.

Mr. ECCLES. What it is, is this: Reserve city banks and central reserve city banks are required to carry 20 percent of their demand deposits as reserves. What is known as the country bank classification, is required to carry 14 percent of reserves against demand deposits. All banks are required to carry 6 percent reserve against time deposits. Those are the percentages of reserves they carry. Of this \$16,400,000,000, it may be a portion of it in excess; the excess runs about \$1 billion. So the actual reserve requirements are usually about a billion dollars less than member bank reserve deposits.

Senator TAFT. Then 35 percent of \$16,400,000,000 is about \$6 billion. So that \$6 billion of gold, then, supports \$100 billion of bank deposits. Is that about correct?

Mr. ECCLES. That is about right.

Senator TAFT. Under the present law?

Mr. ECCLES. Yes.

Senator TAFT. And if you reduce it to 25 percent, it will be something more than \$4 billion of gold against \$100 billion of deposits?

Mr. ECCLES. Yes.

Senator TAFT. How much have these deposits increased in the last 3 or 4 years? I mean, bank deposits.

Mr. ECCLES. I have not the actual figures. I can look that up.

Senator TAFT. Is it at least three times as much?

Mr. ECCLES. No. But demand deposits have increased very rapidly. You have to distinguish between time deposits and demand deposits. The rapidity of increase has been in demand deposits.

Is that shown in the bulletin, Dr. Goldenweiser?

Dr. GOLDENWEISER. Yes.

Mr. ECCLES. Senator Taft, if you will pardon me, the first part that I have just read covers the pledge of Government securities. I know they are closely related.

Senator TAFT. Very well. I am through questioning you on that. I merely wanted to get a picture of the size of the operation.

The CHAIRMAN. One question right there, Governor Eccles: If we should enact this legislation as proposed, Federal Reserve notes would be supported by 25 percent of gold certificates?

Mr. ECCLES. That is right.

The CHAIRMAN. And the other part would be, probably, Government obligations?

Mr. ECCLES. That is what it would be. Now it is 40 percent of Government obligations.

The CHAIRMAN. All right.

Mr. ECCLES. This chart will give you a vivid picture of what has happened. In 1939 the amount of Federal Reserve notes outstanding was around \$5 billion. There was, of course, a substantial amount of silver certificates, which is covered only by silver. You will notice, as the Government debt went up as a result of war financing, what happened here [pointing to chart]. You will notice here the expansion of currency went up with the national income even more rapidly, until it reached the point here on the chart.

Senator TAFT. Where did that go?

Mr. ECCLES. Until it reached the point here on this chart where there was sufficient gold to cover. We had sufficient gold to cover the Federal Reserve notes 100 percent. The Federal Reserve notes would be covered right up to this point on the chart which I now indicate.

This is the currency line. Then, as the currency continued to expand, there was not sufficient gold. Gold went down. Here is the high point of the gold [indicating on the chart]. Gold, since that time, has gone in a movement following this line here, the last line, and that represents 2 or 3 billion of gold. The volume of gold went down.

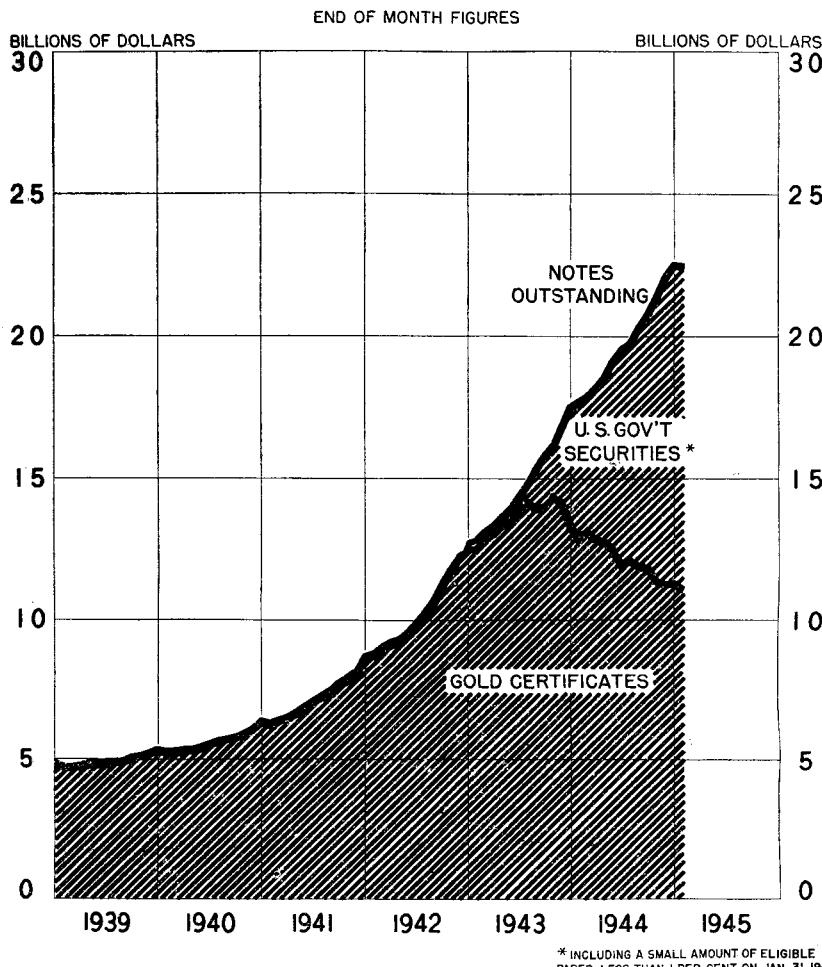
The volume of currency went up, which increased the need for other collateral to the Federal Reserve, this increased need is indicated by this line here to which I point.

The CHAIRMAN. Why did the gold go down?

Mr. ECCLES. Most of it was earmarked. There is the earmarked gold indicated here, which runs somewhat close to 4 billion dollars.

CHART 1

COLLATERAL FOR FEDERAL RESERVE NOTES



The figure is \$3,891,000,000 of gold which was earmarked. That gold is in this country, and held in the vaults of the Reserve bank for the benefit of the owner.

Senator TAFT. We lost that because of the adverse balance of trade, and we are losing most of it on lend-lease? Is that the reason we have lost it? Or, Governor Eccles, would you say it was due to something else?

Mr. ECCLES. The bankers of foreign countries have chosen to carry it in the form of gold instead of dollars. As their dollar balances grew they apparently preferred to carry some of those dollars in the form of gold, and made an appropriate change.

Senator TAFT. They do not have the right to get the gold unless we allow it?

Mr. ECCLES. That is right. We have to give them a license.

Senator TAFT. And their dollar balances have grown as a result of the adverse balance of trade?

Mr. ECCLES. Yes. What we have bought for import we paid for in money; what has gone out in the form of export has not been covered that way.

Senator TAFT. It has been covered by lend-lease?

Mr. ECCLES. What we have exported we largely gave away in the form of lend-lease. We could not permit them to spend their balances for the reason that we did not have the ships or the goods. However, the South American countries have built up their balances in that manner.

Senator TAFT. I notice in the bulletin of the Federal Reserve Board that the total gold and dollar balances of foreign countries amounted to \$17,000,000,000 on the 1st of October; I suppose that has increased?

Mr. ECCLES. Undoubtedly. The \$17,000,000,000 represented total foreign gold reserves plus dollar balances here of foreign central banks and governments. If we add in private foreign holdings of United States currency, dollar balances, and securities the total would probably be over 25 billion. In November we had dollar balances of about \$5,500,000,000. That is the official and private dollar balances held by foreigners in this country. We had gold in the earmarked class which amounted to about \$4,000,000,000.

Senator MFARLAND. Could not the gold reserve be increased by increasing the price of gold?

Mr. ECCLES. Yes.

Senator MURDOCK. On the chart it shows, as I get the picture, the gold certificates which are now held as a reserve against Federal Reserve notes is still much above the 40 percent of the reserve, does it not?

Mr. ECCLES. No; if you will read this line here, I think you will notice it refers to the reduction of reserve. Perhaps I could comment on that at this time.

Senator MURDOCK. The chart indicates that the gold reserve is much larger than the United States Government securities?

Mr. ECCLES. Yes. You have, in addition, deposits to be covered by that gold. You have both of them.

Senator MURDOCK. Do you want to proceed a little further with that?

Mr. ECCLES. These deposits [indicating on chart] would be covered by it, in addition to the notes.

Senator MFARLAND. That group?

Mr. ECCLES. Yes; this entire group here.

Senator MFARLAND. I believe that explains it.

Mr. ECCLES. It is a little complicated, I will admit.

Senator MILLIKIN. How much free silver is there in the Treasury?

Mr. ECCLES. I do not know.

Dr. GOLDENWEISER. Just about a hundred million dollars worth, I would say. In addition there are about 838 million ounces of silver which has not been monetized but is carried at its cost value \$391,000,000.

Senator MILLIKIN. Can you state why we do not issue paper money against the free silver?

Dr. GOLDENWEISER. I could not tell you why we do not issue them; you would have to ask the Treasury.

Mr. ECCLES. I believe that is the only place you could find that out, frankly.

Senator TAFT. Is that free silver in a sense that we have not monetized it at all or is it the difference between the cost of the monetary value?

Mr. ECCLES. When it is monetized it goes up to \$1.29.

Senator TAFT. So that it is 70 cents instead of \$1.29. So, perhaps the suggestion is that it is not worth \$1.29 and that is why we don't monetize it.

Senator MURDOCK. You can relate the value more readily to silver than you can to gold, or is it not a fact that you can relate it more readily to gold than you can to silver?

Mr. ECCLES. The value of both gold and silver depends upon what governments are willing to pay for them. It is not a question of relating the value of silver to gold, or the value of gold to silver. It merely depends upon what governments are willing to pay for either the gold or the silver.

Senator MILLIKIN. There has been the suggestion that we increase the price of gold in order to take care of this situation. Since that question has come up, I hope that you will, before you finish, discuss that in some detail.

Mr. ECCLES. I will be glad to.

Senator BUTLER. Is it possible that free silver is kept free so that it is easily available for lend-lease?

Mr. ECCLES. You mean the actual silver itself?

Senator BUTLER. Yes.

Mr. ECCLES. They are apparently using all of it, so they say, for lend-lease. Of course, I do not know, but they possibly could still use it for lend-lease, and it could still be back of the currency. In other words, it is not destructible. It could be brought back at such time as it had served its use.

Referring now to the matter of the reduction of reserve ratio, conditions arising out of the war have caused the reserve ratio of Federal reserve banks to decline from 91 percent at the end of 1941, soon after our entry into the war, to 49 percent at the end of 1944. If developments continue at the rate of recent months, the ratio will fall almost to the legal minimum by the end of the present calendar year. This is shown in the following table.

Federal Reserve bank	Dec. 31, 1941	Dec. 31, 1944	Projections	
			June 30, 1945	Dec. 31, 1945
In billions of dollars				
Reserves.....	20.8	18.7	18.2	17.7
Deposits.....	14.7	16.4	17.4	18.4
Federal Reserve notes outstanding.....	8.2	21.7	23.7	26.7
Liabilities requiring reserves.....	22.9	38.1	41.1	45.1
Percent				
Reserve ratio.....	90.8	49.0	44.3	39.2

Senator MURDOCK. I wonder if you can elaborate on that a little bit?

Mr. ECCLES. Yes; I would be glad to.

If gold export or currency withdrawals or both should be greater than in 1944, the legal minimum will be reached sooner. The following table [indicating] shows the factors in the situation, together with hypothetical projections through 1945 based on probable trends of currency, deposit, and gold movements.

If you will look at this table, you will see that the table is, first, of the Federal Reserve bank reserves, the deposits, the Federal Reserve notes outstanding, and the liabilities requiring reserves. Lastly it gives the reserve ratio. These are given as of December 31, 1941, and December 31, 1944. There are projections into June 30, 1945, and December 31, 1945.

In other words, the table shows that the reserves here as of December 31, 1945, or at the end of this year, would be \$17,700,000,000, that is the estimated reserve. That, of course, is assuming the same decline in gold, which is likely, and it anticipates an increase in currency, and an increase in deposits of the member banks.

Turning to the charts to my left, you will notice that we exhibit here [indicating on the chart] the figure as we felt it would be at the end of the year if the trend keeps on at its present rate [indicating on the chart]; there is where it will be.

We show gold going down and currency going up, which is shown here on the chart, and the deposits moving in this manner, as I indicate on these lines to which I am pointing on the chart.

In other words, deposits call for increased reserves. This would require 40 percent reserve against this increase in currency. They are both going up. The gold going down works in this manner [indicating on chart].

So that the total reserves would drop down to this point [indicating].

Senator MILLIKIN. Does the gold line show a proportionate amount, or a quantitative amount?

Mr. ECCLES. A quantitative amount.

Senator TAFT. Quantitative.

Mr. ECCLES. Quantitative, that is correct. So if the war continues we will get pretty low.

Senator TAFT. You have assumed about the worst, and in your opinion it would reach that at some time in 1946; is that correct?

Mr. ECCLES. I have not assumed the worst. It could be worse than that.

Senator TAFT. Can you not refuse to pay in gold?

Mr. ECCLES. We have not done so. If a country which has gold here has called on us for it, we have never refused it. I think it would be a very bad precedent to do so.

Senator TAFT. If they want to reduce it too much, what would you do then?

Mr. ECCLES. We have never refused it. We have no expectation of doing so in the future.

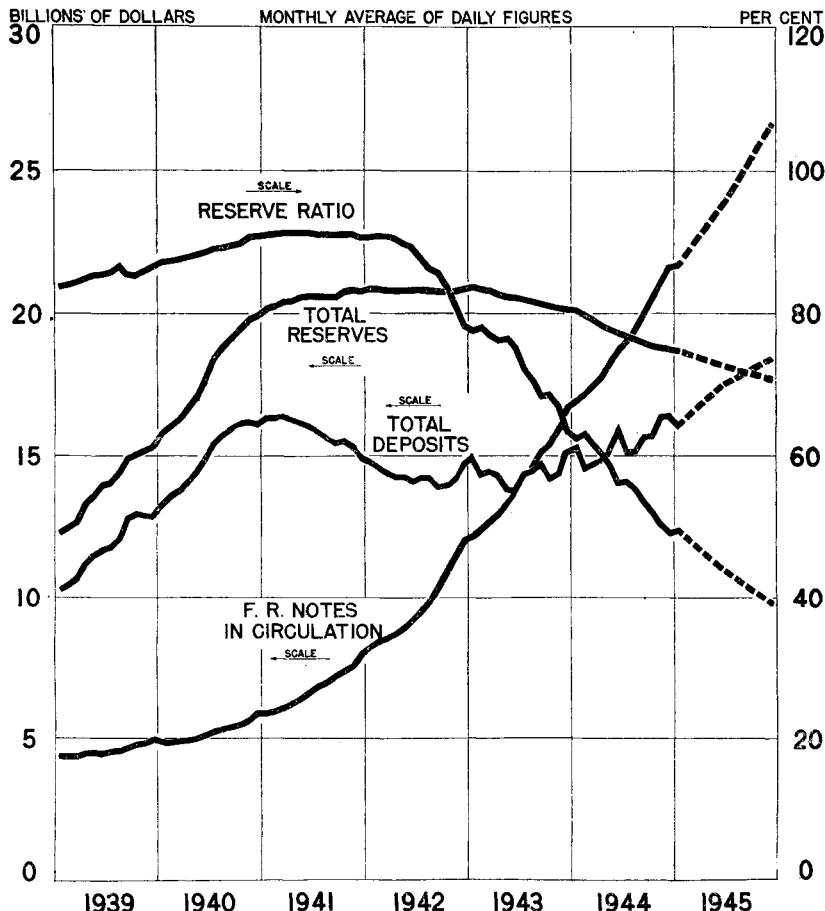
Senator TAFT. I understood you had refused to ship Argentina. Is that not so?

Mr. ECCLES. Argentina has already had earmarked gold set aside in this country, but we have merely refused to allow that to leave

CHART 2

RESERVE POSITION

FEDERAL RESERVE BANKS 1939 - 1945



the country. But, the gold is in the possession of Argentina. So, if the price of gold should change, and would go up, they would get the benefit of it; if the price of gold were to go down, they would take a corresponding loss.

Senator MILLIKIN. Are we shipping any gold, physically, out of the country?

Mr. ECCLES. I think there is some gold being shipped out of the country.

Senator MILLIKIN. To whom did we ship that gold?

Mr. ECCLES. I do not know. The Treasury, of course, would have that information.

Senator MILLIKIN. Governor Eccles, I think we should consider the situation after the war is over. As soon as the war is over there will be an enormous foreign demand for all sorts of American goods, and since the production of gold has been going on in Africa and Russia and possibly other places, since these foreign gold supplies have been increasing, as soon as the war is over will that not cause a resumption of gold shipments into this country?

Mr. ECCLES. Yes.

Senator MILLIKIN. So what we are talking about here will be substantially affected by this gold movement after the war is over?

Mr. ECCLES. If we are going to get a reverse flow of gold, and the currency expansion were stopped, the situation would be affected.

Senator MURDOCK. Is the line which refers to "Reserve ratio" a line which refers exclusively to gold?

Mr. ECCLES. Yes. That is the gold reserve back of the Federal Reserve notes and deposits; it is nearly all gold.

Senator MURDOCK. The line relates exclusively to gold, that is a fact?

Mr. ECCLES. Nearly all gold.

Senator MURDOCK. As I understand it, it will continue—and I am referring now to your chart—it will probably continue until the end of 1945 in sufficient quantities so there will be at least sufficient to maintain the 40-percent reserve requirement; is that right?

Mr. ECCLES. That is about right. However, I want to show you how, as a practical matter, it does not work, because we have 12 separate banks.

It will be seen that the decline in the reserve ratio has been due to a reduction in Federal Reserve bank reserves and to increases in Federal Reserve note and deposit liabilities. Reduction of reserves has reflected the fact that most of this country's exports have been on lend-lease, while our imports have been on a cash basis. Countries that have sold commodities to the United States have not been able to buy goods here, on account of war restrictions, and have either withdrawn or earmarked gold against the time when goods will once more be available for sale.

Growth of Federal Reserve note circulation has been a part of the general expansion of currency which has accompanied war activity in every country in the world. Expansion of both notes and deposits has reflected growth of Government war expenditures, enlargement of national money income, and advancement of pay rolls and trade at higher prices. So long as the Federal Reserve banks continue to do their part, as they surely must, to assist the Treasury in Government financing and in maintaining stable conditions in the market for United States Government securities, these banks must not be restricted by an arbitrary reserve ratio.

While the reserve ratio for all the Federal Reserve banks combined is at present still nearly 49 percent, that is, considerably above the legal minimum, individual reserve banks have ratios that are much nearer to the low point required by law. A table is attached showing the reserve position [pointing to the table] of individual reserve banks at selected typical dates. While adjustment in individual bank ratios is made periodically by changing their participation in the system

holdings of United States Government securities, this involves a great deal of unnecessary work in practical operation.

Reserve ratio of each Federal Reserve bank on the 15th of the month from July 1944 to February 1945

Federal Reserve bank	July 1944	Octo- ber 1944	Jan- uary 1945	Febru- ary 1945	Federal Reserve bank	July 1944	Octo- ber 1944	Jan- uary 1945	Febr- uary 1945
	Percent	Percent	Percent	Percent		Percent	Percent	Percent	Percent
Boston.....	53.8	43.6	45.4	45.8	St. Louis.....	54.2	58.0	43.3	46.5
New York.....	50.6	46.4	52.8	50.7	Minneapolis.....	49.6	51.5	44.9	44.8
Philadelphia.....	48.8	48.6	43.8	44.4	Kansas City.....	53.2	45.7	45.0	45.9
Cleveland.....	52.9	43.3	45.3	43.6	Dallas.....	51.1	46.6	45.5	44.1
Richmond.....	57.5	47.6	45.6	46.6	San Francisco.....	66.5	63.8	54.2	51.3
Atlanta.....	57.0	51.7	52.0	52.1	Total.....	56.0	52.0	49.3	48.8
Chicago.....	64.7	63.6	49.7	51.7					

Since it is apparent that means must be found to handle the ratio problem, it is highly desirable that action be taken promptly. This would not only allay fears and uncertainties among holders and prospective purchasers of United States Government securities, but would also eliminate the necessity of making frequent and complicated adjustments among the Reserve banks.

Senator MURDOCK. Where are your demand deposits established? Are they established with your member banks or elsewhere?

Mr. ECCLES. With the member banks.

Senator MURDOCK. So far as demands deposit, your Government demand deposits on any transaction involving exclusively Government bonds, and the establishment of the demand deposit on the part of Government, no reserve is required at all.

Mr. ECCLES. That is correct. There is no reserve requirement at all. It is the establishment of the war loan account. Those funds are set up in that manner.

As funds are shifted from individual and corporate loan accounts in the bank, to the Government War Loan, the excess reserves of the bank go up because the individual or corporate funds in the bank are subject to reserves.

As that becomes a deposit to the credit of the Government, they are not subject to reserve. We did that to ease the money situation during the time of war as a Government convenience.

What happens is that the banks during the period of excess reserves, go into the market and buy securities and in conjunction with that they buy back the bills which we hold. We have been buying the bills, which are three-eighths of 1 percent bills, and we give the banks an option of buying them back at the three-eighths of 1 percent rate. It is really a form of discount. The banks are so allergic to borrowing or discounting that they operate instead under this set-up, which means that they can sell these bills today and buy them back tomorrow.

As the reserves go up during war financing, we buy back the bills and the certificates from corporations or individuals so that they can subscribe to the War Bond drives. That is really what happens, so in these War Bond drives, we have usually about \$21,000 000.000 of bonds sold, and out of those you will find, for instance, in the last drive, possibly \$10,000,000,000 of them will, from the beginning of

the drive to the beginning of the next drive, be in the hands of the banks.

Senator MURDOCK. In this transaction all that happens is that the bank establishes a demand deposit for the Government on whatever quantity of bonds they purchase no reserve whatever is required.

Mr. ECCLES. That is right.

Senator MURDOCK. As the Government pays that out to different contractors, and your contractors, in turn, establish their demand deposits with the checks of the Government, then, of course, as those deposits come in they must maintain a reserve against them.

Mr. ECCLES. Yes. And that is of course provided for. They sell securities to the Federal Reserve to meet reserve requirements.

For instance, I would imagine that between the Sixth War Loan Drive, which closed in December, and the next War Loan drive starting in the middle of May or the 1st of June, between that period where the war-loan deposits account reached its peak at the end of the last drive of over \$20,000,000,000, that War Loan deposit will go down two or three or four billion dollars by the time the next drive starts.

The \$20,000,000,000 of War Loan deposit is not subject to reserve. As it is spent and returns to the banks, however, it will be subject to reserve. And that applies to the further expansion of the currency which is going on, and we assume the Federal Reserve will have to buy between December 21 and the 1st of June around \$3,500,000,000 of Government securities.

Senator MURDOCK. May I ask this further question so that we may have the figures clear: Let us take one particular figure, for illustration, in one particular bank. Say it purchases a million dollars in Government bonds—in that transaction that bank needs no money whatever?

Mr. ECCLES. That is right. If they are qualified for a War Loan deposit account.

Senator MURDOCK. Now, if I buy a bond or a nonbanking corporation buys a bond, there must be a payment by the individual or the nonbanking corporation of the actual money for the bond?

Mr. ECCLES. That is right.

Senator MURDOCK. On the other hand, in the purchase by a bank, the bank needs no money at all, and is required to keep no reserve as against the demand deposit established by the Government.

Mr. ECCLES. That is right.

Senator MURDOCK. Again, the member bank that has carried on that transaction immediately goes to your Federal Reserve bank and the Federal Reserve bank, in turn, goes to the Federal Reserve agent, and by adding 40 percent gold to those Government bonds immediately converts them into the same amount of currency.

Mr. ECCLES. Yes.

Senator MURDOCK. That currency is then usable as a reserve behind any demand deposits that come into the banks; is that about the situation?

Mr. ECCLES. The currency, of course, is not used as a reserve against demand deposits. The reserve required by the law must be a deposit in a Federal Reserve bank, and the bank will not withdraw this deposit in currency except as the customers of the banks want to withdraw currency.

Senator MURDOCK. They could do this: the member bank could give its note, secured by Government bonds to the Federal Reserve bank and it, in turn, could use such Government bonds plus 40 percent gold and secure 100 percent Federal Reserve notes.

Mr. ECCLES. Yes.

Senator MURDOCK. Therefore, that is the transaction that takes place by the bank in the purchase of Government bonds?

Mr. ECCLES. That is right.

The bank can borrow to get currency to meet the demands of its customers, or it can borrow in order to take care of its reserves but the banks, rather than borrow to do that, sell their Government securities. That is what they do. They do not borrow, they just sell to the Federal Reserve, and the Federal Reserve has to supply a market for the Government's, in order to provide the necessary reserve to handle the war financing.

As I just indicated, we estimate that we will buy about \$3,500,000,-000 to \$5,000,000,000 of Government's between the end of the last War Loan drive and the next War Loan drive, as long as this deficit financing continues, and the expansion of the currency continues.

Senator MURDOCK. Under this present bill which we have been discussing, the Federal Reserve bank increases the interest bearing collateral behind the Federal Reserve notes; the gold certificates that are used as a reserve behind the Federal Reserve notes draw no interest.

Mr. ECCLES. Yes; but the securities do.

Senator MURDOCK. When we reduce the gold reserves from 40 percent to 25 percent, then that difference between 25 percent and 40 percent—15 percent—from now on will be represented by interest bearing either Government's or other eligible paper?

Mr. ECCLES. Yes.

Senator MURDOCK. So that it should very materially increase the earnings of your Federal Reserve, should it not?

Mr. ECCLES. The Federal Reserve bank will not buy Government securities except as the member banks sell Government securities.

Senator MURDOCK. I did not mean that.

Mr. ECCLES. It will enable the Federal Reserve to support the Government security market to the extent necessary, because they can use Government's as collateral back of the Federal Reserve notes, as they expand. Without this provision we would be estopped from carrying on this war financing operation.

Senator MURDOCK. Correct.

Mr. ECCLES. And to the extent that the financing operation continues the ratio goes down. By the way, that is only permissive, of course, it does not mean that the ratio will necessarily drop to 25 percent.

Senator MURDOCK. Excluding the part above that, and considering the part between 40 percent and 25 percent that has to do with the financing which will be brought about by means of the contingencies with which you will be faced, as you assert, the profit from the use of Government's on that particular portion of it will go to the banks, and the earnings of the banks will be increased to that extent.

Mr. ECCLES. That is right. It will increase the earnings of the Reserve banks to the extent that the investment in Government securities increases. But, that is not the important factor, because the Reserve

System, although its stock is owned by the member banks, is not like any other corporation, because the stock has no voting privilege, except in selecting six directors, it cannot be traded in, it is a compulsory requirement that the member bank must subscribe 6 percent of its paid-up capital and surplus for the stock of the Federal Reserve bank. It gets 6 percent only. It gets no chance of getting any more or any less return on that stock.

Any liquidation does not affect it as it would other stocks. In liquidation it gets only the principal, so really what it amounts to is a certificate of membership which costs them so much money, upon which it gets 6 percent.

Now, any earnings in excess of that—and that, by the way, is a small part, about \$9,000,000 per year is the total amount of dividends paid out to the member banks—that is all it amounts to.

Senator MURDOCK. Will not that increase?

Mr. ECCLES. No; it does not increase.

Senator MURDOCK. What will happen to the increased earnings of the Federal Reserve, if the Federal Reserve earnings increase?

Mr. ECCLES. They pile up and go into a surplus fund of the Reserve System.

Senator MURDOCK. A surplus belonging to the member banks?

Mr. ECCLES. No.

Senator MURDOCK. To whom does it belong?

Mr. ECCLES. To the Government.

Senator MURDOCK. To the Government alone?

Mr. ECCLES. Yes. And the Government took \$140,000,000 of it away in 1933 to set up the capital for the Federal Insurance Deposit Corporation, and any time the Government chooses to take the surplus away from the Federal Reserve banks, it can do so.

Senator MURDOCK. What I had in mind is, the Government did have a claim on the Federal Reserve banks, or that section of it?

Mr. ECCLES. No, the Government has never had a claim. The Government can appropriate the money any time it wishes. The Federal Reserve banks, of course, do not have a very large capital and surplus. As a matter of fact, it is a comparatively small amount, when you consider the size of the operation.

Its investment in Government bills is about \$12,000,000,000, at three-eighths of 1 percent.

Senator MURDOCK. Isn't this true, if this bill goes through in its present form, that it will cost the people of the United States a greater interest burden to supply the war financing than it does under the present system of 40 percent gold and 60 percent for the remainder?

Mr. ECCLES. No. It will not cost them a penny more. It will not have any effect, not a penny.

Senator MURDOCK. In the event the people have to pay the interest on that difference between 40 percent and 25 percent, it will cost them more to that extent?

Mr. ECCLES. You are issuing the same amount of bonds whether it is below that figure there or not, but it will not affect the deficit financing in any way.

It does this, it makes it possible for the Federal Reserve to support the deficit financing. It will cost the people far more if this bill does not go through, because by going through it puts the Federal Reserve

System in position to support the Government market and very largely to control the interest rate structure.

If this bill does not go through then there would be no support given the Government market and the interest rate would shortly go up, and it could be a very disastrous thing.

This bill will permit the Treasury to control the interest and rate structure. This bill is absolutely essential if you want to keep the cost of Treasury financing down.

Senator MURDOCK. Coming now to your suggestion, Senator McFarland, that is increasing the monetary value of gold, instead decrease the ratio of gold reserve, I would like to ask Governor Eccles what he has to say about that.

Mr. ECCLES. What do you have in mind?

Senator MURDOCK. In your discussion of this proposed bill you referred to three points but you made no mention of the fact that your purpose could be accomplished by increasing the value of gold, which is now held by the Government and everybody knows, if it were handled as it was handled in 1933, the Government, instead of paying additional interest on its war financing, would make a profit, would it not, by increasing the value of the gold holdings?

Mr. ECCLES. So would the foreigners, because they would make about \$8,500,000,000 if you were to increase the price of gold to the same amount, that is, to the amount necessary to equal the 25 percent requested here.

So, while you could do that, it would be the equivalent of reducing the ratio from 40 percent to 25 percent, and, in other words, if you increase the price of gold to that point—

Senator TAFT. Which I believe would be about \$50.

Mr. ECCLES. The equivalent of reducing the ratio from 40 percent to 25 percent would be \$55 approximately. It would influence all the rest of the world market, because they own \$14,000,000,000 of gold, and it would give to them a profit of \$8,500,000,000. They would derive that amount of profit immediately on the gold they have.

You would not only give them a profit of \$8,500,000,000 on their gold balance, but you would enable them to turn over gold to the extent of \$8,500,000,000 more than it is now worth, and taking away from us valuable goods, because they would have released to them those goods for something that has no real value, and something that we do not need at all.

We are practically the only country that is on any such basis of a gold backing for its country's money.

The English and the Canadians do not reserve any gold; they have no such requirement of a gold backing for their currency. We are the only country left that still has the archaic idea of maintaining a gold reserve back of the currency.

Senator MURDOCK. We find that all these other countries, notwithstanding your statement that it is an archaic system, are very anxious to accumulate gold.

Mr. ECCLES. Certainly; because they know we have to buy it, and if the price is raised we have to pay for the increase, and they profit thereby, with very little effort on their part.

They have more need for the dollars the gold will buy and for the goods that the dollars will buy than for the gold itself. It is the goods they want, in the end.

If we increased the price of gold, as you suggest, then this \$5,500,-000,000 of deposits they now hold would immediately be converted into gold, and they would be put at a great advantage over us.

If we were to get to talking about this, if there was the slightest indication that there would be any increase in the price of gold, why, then all the official foreign balances would be earmarked, and instead of having \$4,000,000,000 you would probably have \$3,000,000,000 added onto that which would give them an added profit of nearly \$2,000,000,000.

Senator MURDOCK. May I just ask one further question on that: Suppose, Governor Eccles, that instead of extending that increase in the price of gold to foreign countries, that we applied the same formula to gold purchased and produced here in the United States, that we did to the domestic production of silver. Such a course would stimulate production of gold here in this country, instead of what in my opinion has been a very absurd attitude toward gold established by the War Production Board, of stifling production here in the United States, and buying it elsewhere, it would increase employment a great deal, would it not?

Of course, increased employment is not an argument right now, because we are short of manpower, but by the time you reach a position on gold reserves that you indicated, we may be confronted with an unemployment problem, it seems to me that an increase at least in the price of gold for domestic production here might be beneficial in the way of spreading employment when it is needed.

Mr. ECCLES. A pretty expensive subsidy for employment, I would say. For the same money we could subsidize other things; for the same money that you would use to subsidize the gold miners you could give a very large amount of employment on public works, or some other way. I cannot imagine a more useless way of giving or stimulating employment than to increase the price of gold so as to stimulate the production of gold, to give a few gold miners employment.

Senator MURDOCK. Gold in this country is largely produced, is it not, in connection with lead, zinc, and copper? This is certainly true in Utah.

Mr. ECCLES. I thought I would be asked that question, so I got a few figures.

The gold that is produced in Utah is practically a byproduct. There is almost as much gold produced now in Utah as at any other time because it comes out as a byproduct of copper.

So a change in the price of gold would not affect the gold production of Utah at all because it is not produced merely because of the price of gold but because of the copper and other things that are in the ore. It is a byproduct strictly.

Senator MURDOCK. I think that is a wrong conclusion.

Mr. ECCLES. It is not a conclusion. Those are the facts as I have gotten them. If it were not for the price that they got for the Utah copper, the gold would not return a profit on its production unless you were paying simply fabulous prices. This gold that is produced in Utah is produced along with copper, and the copper is the thing that they want.

Senator MURDOCK. I think, if you will investigate, you will find that the earnings are far in excess of their total gold earnings, even at the bottom of the depression—this operation there.

Mr. ECCLES. That is the point. It is a combination of the gold with the byproducts; or rather, the gold byproducts with the copper that makes it possible to mine copper in a process extracting copper ore of less than 1 percent.

I think that they would produce a maximum amount of copper, irrespective of the price of gold, unless gold were fabulously high, as I said before.

In the State of California they get gold directly rather than by bringing in any other metals, mostly by placer mining.

In South Dakota that is also true.

In Alaska that is likewise true.

In Nevada that is also the fact.

As I say, in Utah, that is possibly the one exception.

I say the price of gold would no doubt stimulate the production of gold in all of the States with the possible exception of the State of Utah. The thing that would help the production of gold in Utah would be a better price for copper, a higher price for silver so as to increase the production of silver and copper, perhaps that would be true, but it would not result in an increase in the production of gold in the State of Utah. I doubt very much if the higher price of gold would help out very much, so far as any production of gold in Utah is concerned.

Senator MURDOCK. I would like to see it tried, Governor Eccles, to see what would happen.

Mr. ECCLES. It seems to me that we have had an example here during the war that ought to serve some purpose.

At a time when there was never a need for a greater volume of money or credit than is now needed throughout the world, it was determined that one of the most useless activities was gold production, that gold absolutely served no useful purpose in connection with this great need for money and credit to finance the war throughout the world. It was determined that what was needed most were men and material. Therefore, there being a shortage of men and material, it was determined to stop gold production insofar as that would contribute to the war effort.

Senator TAFT. It was done here, but was that determined in South Africa?

Mr. ECCLES. South Africa was not involved in the war extensively.

Senator TAFT. They have turned out quite a bit of gold at \$35 an ounce, just as fast as they could turn it out.

Mr. ECCLES. They certainly have.

Senator MURDOCK. We have shipped them the machinery for doing it, instead of utilizing it ourselves.

Mr. ECCLES. It would have made no difference for South Africa if South Africa had done exactly the same thing as we. We would have financed the war irrespective of gold production.

Senator MILLIKIN. I suggest that that determination was that it was easier to run a printing press than a gold mine.

Mr. ECCLES. After all, I do not think there is any relationship whatsoever. We do not have gold in circulation.

Gold does not serve any purpose in circulation today. You have to have some form of printing-press money, whether you have gold or not.

The volume of currency issued and in circulation in relationship to the supply of gold simply does not mean anything any more. It

is useless to spend time debating over a thing which really has ceased to exist, I want to say in all sincerity.

The British and the Canadians have done that. The British have maintained no gold standard for some time, and neither do the Canadians, and they have not had any more, and in all probability, less inflation than we have. Whether they have a gold reserve or do not have a gold reserve in no way affects the amount of inflation or lack of inflation that takes place.

By the same token, the fact that we have a gold reserve in no way affects the amount of inflation that we have, or the lack of it.

Senator TAFT. As far as increasing the price of gold, it seems to me the profit to us would be purely a paper profit, whereas the profit to people who have gold, any other person, a foreigner, would have a real profit which they could cash in on to our disadvantage and to their advantage.

Mr. ECCLES. They would have the goods that they could get with this gold, and we would have the gold, which would not be worth anything to us.

Senator TAFT. We would merely have a paper profit.

Mr. ECCLES. It is not only that, but to change the price of gold would mean that we have obligated ourselves for practically an indefinite period to buy the world's gold at whatever increase in price we fix, or to buy gold from the American miner at whatever the increased price was, and that would be paying dollars for a product we do not need, that serves no useful purpose except as it may be used to settle international balances. That is the only purpose that gold serves, and we have little occasion to use it for that purpose.

Senator TAFT. The difference between this amount and \$35 an ounce represents a very high profit for the gold producers, does it not?

Mr. ECCLES. The difference between the price at which gold is mined and produced through the world generally, as well as in the United States, and \$35 an ounce represents a very high profit to the gold producer. If we increase the price of gold above \$35 an ounce, then that profit is going to be commensurately increased.

Senator TAFT. I had a client who had gold stock that I know increased in price two or three times during the past 10 years because of the fact that \$35 was a very profitable price at which to mine gold.

Mr. ECCLES. What would we do with the increased amount of gold? It would represent merely a subsidy to foreigners.

The higher price paid for foreign gold production and foreign gold reserves sent to this country would constitute a subsidy to foreigners. We would be paying premiums for gold that we do not want. We already have more gold than we need for purposes of international settlement. A creditor country such as the United States with a strong balance of international payments could easily settle any deficit that may develop in its international transactions with half the gold that we now have. Gold is not needed for domestic circulation; and it is needed as reserves against notes and deposits only to the extent that we choose to impose requirements on ourselves. The British, the Canadians, the French, and others have eliminated required reserves altogether.

Senator MURDOCK. Do you advocate, Governor, that we could very well in this country suspend the reserve requirement altogether?

Mr. ECCLES. Very, very well. I feel that we certainly do not need to impose on ourselves these reserves, and if we did not choose to impose reserves we could suspend the reserve requirement altogether, such as the British and Canadians and every other country in the world has done, and they have done it very successfully.

Senator MURDOCK. I doubt it very much.

Mr. ECCLES. Very well, I would like to see it done.

However, since we have the gold, I am perfectly willing not to argue the logic of it, but to pay that much respect to orthodoxy, but if we can get 25 percent gold reserve it will take care of the needs for some time to come, and it is acceptable generally to bankers and people who have an idea that there is some mystical form of security in gold.

Therefore, I see no reason to disturb our equilibrium any more than is necessary, but just enough to meet the requirements of the situation.

Senator TAFT. Governor Eccles, I do not want to take issue with your paper-money idea, but I would like to get to the general question of a certain amount being fixed here, and beyond that to the purpose of the gold reserves, because the purpose of the gold reserves, after all, has been to prevent inflation. That has been the main purpose—it is to prevent inflation, the fear that we had of inflation. We find however that whether we amend this or do not amend it, we find ourselves in a situation where we do have inflation to a certain degree, and we find that the inflation is now due to the fact that there are too many dollars in the purchasing power of the people today, whereas there are too few goods in the stores with which to use those dollars which constitute this purchasing power, and it seems to me under those circumstances that it would be proper to inquire if you have any ideas as to how we can overcome this situation, or how it came about?

Mr. ECCLES. To answer your last question first, that is due to the appropriations of Congress. That is where inflation comes from, not in the banking system.

The cure will have to come from the same source, and in the form of a wise and proper and strong enough system of controls having to do with prices, priorities, equitable distribution of goods, and so forth. Again, it will not come from the banking system. Any attempt to arrive at it in that manner will certainly fail.

Senator TAFT. Since this inflation was due to, or at least the increase in these deposits is due to, as I see it, two things; first, increased volume of business, and national income which will justify an increase in deposits; that first premise is correct, is it not?

Mr. ECCLES. That is correct.

Senator TAFT. Secondly, in addition to that, it is due to the fact that we have had a deficit of \$50,000,000,000 or \$60,000,000,000?

Mr. ECCLES. It is due to this tremendous increase in deficit which has come about by reason of the appropriations of Congress, which has brought about this increase in the matter of purchasing power.

Senator TAFT. If you get an increase in business you would require and use an increase in deposits, but if we got back on a basis of paying cash, we could stop unsound inflation of deposits?

Mr. ECCLES. If I understand your question, if you could get back on the Budget, certainly and get back on a more or less of a cash basis, you would not have anything like the situation which now presents itself.

Senator TAFT. Is it not also true that to the extent that you can sell your bonds to investors, it also would decrease this amount of money which is causing this trouble?

Mr. ECCLES. It would.

Senator TAFT. When you get back to the fundamental causes, this progressive increase in these deposits and notes is due to the fact that under the system we have pursued, the banks have bought a large volume of Government bonds which have created deposits far greater than ordinarily would be expected?

Mr. ECCLES. Quite true.

Senator TAFT. Instead of decreasing these reserves—and admitting that we have to go on with this inflation of deposits and notes—is there any possibility of stopping that increase and stopping this inflation?

Mr. ECCLES. There are two things that would do it; further increased taxation would be one.

Senator TAFT. Taxation, increased taxes would be one.

Mr. ECCLES. That would be one. It would be very important to absorb, of course, the excess cash that people have.

Senator TAFT. And what is the other?

Mr. ECCLES. The other would be getting the people to put more of their savings and more of their surplus money into Government bonds, instead of holding them in bank deposits and holdings of that type.

Senator TAFT. Hasn't there been a tendency as we have gone on in the drive to reduce the percentage of bonds forced on the banks?

Mr. ECCLES. No; the percentage of bonds held by the banks is about the same.

Senator TAFT. What percentage of the total increase would that be? The increased debt has been about \$50,000,000,000 or \$60,000,000,000 a year?

Mr. ECCLES. I think I have here the figures to which you have referred.

About 45 percent of the public expenditures are paid out for taxes; 55 percent is to be borrowed; 60 percent of the 55 percent is borrowed from the public. That is 60 percent of the 55 percent.

Senator TAFT. That leaves \$22,000,000,000?

Mr. ECCLES. \$22,000,000,000 is borrowed from the banking system; in other words, 40 percent, after the 55 percent, which is the deficit, is borrowed from the banks, so that equals about—

Senator TAFT. \$22,000,000,000.

Mr. ECCLES. \$22,000,000,000, last year it was \$23,000,000,000.

Senator TAFT. That is inflation.

Mr. ECCLES. \$23,000,000,000 of it is inflation.

Senator TAFT. If we reduce this reserve to 25 percent does the Federal Reserve have any discretionary power to increase it again?

Mr. ECCLES. We do not raise it, we just leave it at 25 percent.

Senator TAFT. No matter what the future circumstances would be?

Mr. ECCLES. It would not have to go down that far.

Senator TAFT. There has been some discretion in the past?

Mr. ECCLES. I do not know about that. It has been 40 percent or 30 percent, there is no discretion connected with it at all.

Senator TAFT. I thought there had been some discretion as to that?

Mr. ECCLES. It has been a subject of some discussion in some of the hearings, I believe, but there has never been any discretion at all.

Dr. GOLDENWEISER. You are thinking of a member bank.

Senator TAFT. There has been some discretion in the case of the reserves of the member banks?

Mr. ECCLES. There has been some discussion as to the member banks, I will put it that way; we can double member bank reserves.

Senator TAFT. Doubling the member bank reserves would have the effect of requiring more gold, because it would require deposits in the Federal Reserve bank?

Mr. ECCLES. That is correct.

Senator TAFT. So any effect then, if you reduce it to 25 percent, would be what?

Mr. ECCLES. You can affect it slightly, but that is not an important item.

Senator TAFT. It is not a big enough percentage?

Mr. ECCLES. It is not a big enough percentage.

Senator TAFT. To have that effect?

Mr. ECCLES. That is correct.

Senator TAFT. I do not know that we can get away from this proposition of decreasing this reserve at the moment, but I have in mind the question whether there should be some provision for the return of this reserve to a higher figure if conditions should warrant it.

Mr. ECCLES. It will automatically come back. That is automatic.

Senator TAFT. It seems to me, after the war, the moment you stop this excessive spending you are going to have a real danger of inflation because we will want to do everything, no doubt.

Mr. ECCLES. This will have nothing to do with inflation. Inflation can only be gotten around by increasing the supply of goods to meet the demand of the public. That is the sole means.

Senator TAFT. You can hold the banks down; you can cut the loans down. Now, everybody is of the opinion that everybody should have a loan who wants it. That seems to be a general idea that anyone who desires a loan should receive it.

Mr. ECCLES. You cannot hold them by tightening the interest rate, without wrecking your Government bonds. The idea of stopping the banks from lending money, as long as they hold 75 percent of their assets in Government securities is not a very sound one, and I can see no reason for it, because the banks would be selling Government securities in order to make loans, and you would not get anywhere.

The only way you can stop the banks would be by a direct control, as you have in the securities market, by the Securities and Exchange Commission.

The only way you can stop the banks from extending credit would be the power to stop them, but not by any monetary action. That is physically impossible. That is out.

Senator TAFT. Unless you get at it through the Government bond market.

Mr. ECCLES. They would still sell Government bonds in a declining market, and use that money for the purpose of making loans.

Senator TAFT. I still think that we face a serious problem here, and at least I would like to know that the Federal Reserve Board had some

power to restore the check, at least a check of some kind, upon this possibility.

Mr. ECCLES. This is merely a matter of minima, this 25 percent is a permissive minimum, that is all.

Dr. GOLDENWEISER. What it says is that the ratio may be permitted to fall to 25 percent, not that it must go down to 25 percent.

Mr. ECCLES. The thing that makes it go down is the deficit financing.

If the deficit financing is stopped, then you do not need to worry about the Federal Reserve. There is nothing we can do about it.

Senator MURDOCK. Why not extend this temporarily, just 2 or 3 years?

Mr. ECCLES. Then you have always the answer from the standpoint of the Government bond market being upset, and if the people say, as they will say, that maybe Congress will want to change it, then Government bonds are going to be faced with these periodic spells of selling, and it will have a very bad effect. The people will say that they do not know what is going to happen.

There are some people today who will not buy a Government bond because they do not have confidence that the bonds are going to be supported in the future.

And the very fact that the Federal Reserve would have to come to Congress every year or two to determine whether or not they can continue to support the market would leave an uncertainty over the situation which I think is extremely undesirable.

That is why I suggest that the putting of collateral back of Federal Reserve notes be made permanent so there will not be any question of whether in the next 2 years Congress will abandon the situation, and get us into difficulties. I think you would lose a lot of strength in your Government securities otherwise.

The public cannot have confidence in the Government bond market if they have to depend every 2 years on the way Congress will look upon this situation.

Senator MURDOCK. So far as the amount of Government's as collateral, if we place on that a ratio of 25 percent or 40 percent, and if we extend that for 3 years, or, temporarily, with the idea that certainly if it works out successfully, Congress will permit its continuance, would that not answer the situation?

Mr. ECCLES. What difference does it make whether you have a gold reserve or not? Just for the sake of argument?

Senator MURDOCK. I do not know; you are here to tell us about it.

It is the orthodox way to do it, as you say.

Mr. ECCLES. That is correct.

Senator MURDOCK. The bankers have followed it generally.

Mr. ECCLES. A good many do not believe in it, but most of them do not understand.

Senator MURDOCK. I am sure you have converted a lot of them, but there are still a few that believe in it.

Mr. ECCLES. I suppose so; I think they are gradually coming around to a proper view of it.

Senator TAFT. I do not know whether we can get away from this or not, but it seems to me that we ought to consider not only the immediate

needs for the year 1945-46, but also means to prevent inflation when that time is over.

You remember, of course, the report of the Federal Reserve Board made at the time they were afraid of inflation. At that time they made a number of suggestions as to what the requirements should be and stated why. For instance, they recommended that the statutory reserve requirements for demand deposits in banks be increased; that the Federal Open Market Committee be given power to make further increases of reserve requirements. They also proposed that the power to issue \$3,000,000,000 greenbacks be repealed and that further monetization of foreign silver should be stopped.

There was a recommendation that the power to issue silver certificates against the seigniorage should be repealed. There are many others, and I am just sketching through them.

In other words, if we are going to take the brakes off in this respect, should not we consider what measure should be put in which would have the effect of putting the brakes on?

Mr. ECCLES. Of course this was a report in 1940.

Senator TAFT. Four years ago.

Mr. ECCLES. But there was no war financing then, and the public debt was about \$40,000,000,000, and now you have an entirely different situation.

Senator TAFT. I was suggesting that that situation might be repeated at the end of this war, and we may then be concerned with stopping inflation, and if we are now going to take off the brakes, it seems to me that we might accompany it with some arrangement which would be of a protective nature.

Mr. ECCLES. It cannot be done by any monetary means now, because inflation has already been created potentially, when the public debt expanded from around \$40,000,000,000 to \$240,000,000,000, and possibly will go up to \$300,000,000,000, and when deposits and currency have more than doubled since 1940. Currency has nearly quadrupled. You already have in the hands of the public in the form of cash or its equivalent Government securities, bonds, and currency, a potential inflation, already created. It is already there; it is in existence. Anything we do here about gold or silver or bank reserves can have little or no effect on the potential inflation.

You must deal with the inflationary picture that you have in front of you now.

Senator TAFT. This shows that on December 1, 1944, there was \$190,000,000,000 total liquid assets in the hands of individuals and corporations; \$190,000,000,000 in comparison with \$83,000,000,000 3 years before, and I suppose probably less than that the year before. So you have had an increase of more than three times.

Mr. ECCLES. That is correct.

Senator TAFT. So you have, then, a tremendous purchasing power turned loose, with but little means afforded to take care of that purchasing power. I do not know the answer. I am only asking as to whether or not, when we are moving in the direction of making this thing looser in one respect we ought not to tighten it up in another respect.

Mr. ECCLES. You cannot tighten it up by such a provision as you have suggested, unless you want to increase the interest rates, which

would increase the earnings of the banks by giving them a higher return on their Government bonds.

And it would increase the cost to the Government in interest demands, and it would increase the deficits or taxes with which to meet interest payments.

So the only thing that we can do is to create a restrictive monetary policy, which would be ineffective by itself, no matter how restrictive it was, in dealing with the inflationary picture which has already been created through the huge volume of credit as a result of the war, and not having enough taxes to do a better job than we have done. It is really unfortunate that we have not had taxes high enough to drain off that money. That is something which is a matter of policy, with which, of course, I am not concerned.

We have to deal with the inflation problem as another matter and in another way, and that way is to maintain price controls and rationing and allocation until such time as the supply of goods gets into relationship with the demand and thus protect the purchasing power of the dollar.

Senator TAFT. Yes; but you have this tremendous demand in the meantime, and your price control may break down.

Mr. ECCLES. If it does, then you have inflation, if your price controls should break down, and I take it that is what you refer to. But if you do not maintain these controls, direct controls, you have no way of checking this thing.

You must deal with it by direct means. You must also maintain export licensing so the foreigners cannot come in and spend money and take goods out. That must be controlled. It is useless to try to control the domestic markets and not control the foreign markets.

Senator TAFT. Perhaps you can stop that by lending them no money?

Mr. ECCLES. They have already got \$20,000,000,000 in the way of purchasing power set aside for that, I understand, and if you changed the price on gold they would have another \$8,500,000,000 with which to upset your domestic economy.

Senator TAFT. My question is, of course, whether with this \$20,000,000,000 it is the right thing to go on lending money abroad?

Mr. ECCLES. You cannot maintain control unless it is an all-over control. You cannot maintain rationing and price control for domestic buyers and open it up for foreign buyers. That goes without saying.

Senator TAFT. I agree with you.

Mr. ECCLES. So it seems to me that the public has got to be made to feel that the purchasing power of their dollars will not diminish, because inflation is not the price of gold; inflation is not the price of silver.

Senator TAFT. Ultimately, of course.

Mr. ECCLES. It is neither of those two things. It is price of things people want to buy. We had the greatest depression in the history of our country when gold was worth \$35 an ounce.

We had a great inflation, a stock-market inflation, at any rate, in 1929 when gold was worth \$21 an ounce.

Senator TAFT. Let me ask you one other thing: In order to counterbalance this thing, perhaps it would be well to cancel out the power to issue Federal Reserve bank notes. I notice you discuss as one of

the possibilities the power to repeal the right to issue Federal Reserve bank notes. It occurred to me that while we were reducing the reserve, then as a counterbalance to that we might as well cancel the power to issue those notes. How would you feel about that?

Mr. ECCLES. We would have no objection to it.

Senator TAFT. We did pass a bill to that effect in the Senate once, but it was stopped in the House.

Mr. ECCLES. That authority was given for the purpose of coming out of the bank holiday, and although we had the power to do it, and now have the power to do it, we can issue Federal Reserve bank notes, which means we can issue bank notes without any gold reserve requirement at all, under that power, but it was our feeling that we would have two kinds of notes, one would be the Federal Reserve notes without any gold reserve, and then we would have the other type of notes, and we preferred not to do that.

Senator TAFT. As long as the Attorney General says the emergency of 1933 is in effect, you could do it.

Mr. ECCLES. That is true, but it was our feeling that the law was passed to do something else.

We felt that we could not appropriately issue Federal Reserve bank notes to meet this situation unless Congress chose to authorize us to issue Federal Reserve bank notes instead of Federal gold reserve notes.

We prefer to decrease the gold requirement in the reserve rather than to issue Federal Reserve bank notes as an alternative to that, because then we would be putting out two kinds of Federal Reserve paper in circulation, the Federal Reserve notes which require 40 percent gold reserve, and the Federal Reserve bank notes which do not require any reserve. We do not feel it desirable to have two different kinds of notes out. Therefore, we did not do it.

Senator TAFT. You would not object to the repealing of that provision?

Mr. ECCLES. No.

Senator MURDOCK. When were those notes brought into circulation?

Mr. ECCLES. The power was granted in 1933.

Senator MURDOCK. Who issues them?

Mr. ECCLES. The Treasury printed them.

Senator MURDOCK. The Treasury issues them in what manner?

Mr. ECCLES. The Treasury prints the currency, all currency, but it is done upon the request of the Federal Reserve banks for the currency.

The currency is actually printed by the Bureau of Printing and Engraving on orders that go in from the Federal Reserve banks to the Treasury and from the Treasury to the Bureau of Printing and Engraving.

Federal Reserve banks keep a stock of all bills on hand in various denominations such as \$1, \$2, \$5, \$10, \$20, 50's, 100's, and so forth, all the various denominations, on hand so as to be prepared to supply the banks with currency as they request it.

Senator TAFT. How do the banks get hold of these Federal Reserve bank notes? What I would like to have is an explanation from you as to the difference in procedure of getting Federal Reserve notes into the hands of member banks and Federal Reserve bank notes into the hands of the same banks.

Mr. ECCLES. There is no difference. The only difference is that one requires a gold reserve and the other does not require a gold reserve but requires securities.

Senator TAFT. Federal Reserve notes are based on gold Government securities?

Mr. ECCLES. That is right. The other is a 40-percent gold reserve.

Dr. GOLDENWEISER. They ask for the currency and they take whatever currency is given to them. There is no distinction so far as they are concerned.

Senator MURDOCK. Under your system you would have interest-bearing collateral behind your Federal Reserve notes upon which they would receive a percentage of interest as compared with the gold reserve upon which no such interest would be paid?

Mr. ECCLES. That is correct. On one there would be a payment of interest upon the interest-bearing collateral behind the Federal Reserve notes; on the gold reserve notes it is simply the amount of gold that is behind it.

Senator MURDOCK. So that you would save the amount of this interest by utilizing gold as a reserve for it?

Mr. ECCLES. If you wanted to, you might very well issue them without anything back of this currency, anything back of the Federal Reserve note, as I have advocated for a long time. When the Banking Act of 1935 came along I urged that we eliminate the collateral. It passed the House at that time.

We are practically the only country in the world that requires collateral. So, if you want to, why not cut off the collateral, the Government bonds back of the money and go ahead as almost every other country in the world does. It is a serious waste of money and an entirely unnecessary one.

Senator MURDOCK. I am not arguing the point with you. I just wanted to get the point clear.

Mr. ECCLES. Why have gold or collateral, Government bonds back of your currency? This is the currency of the United States Government, and they are the backers of that money. Why have any collateral back of that?

Senator TAFT. Mr. Eccles, there may be some other controls that might be exercised here to limit this thing in some degree; I would like to inquire as to what you think as to the feasibility of limiting credit.

Mr. ECCLES. I do not think it is feasible at all through monetary action.

Senator TAFT. But through controls?

Mr. ECCLES. It depends on whatever power Congress gives.

Senator TAFT. You certainly went out and limited the sales on installment credit.

Mr. ECCLES. Yes. There was a limitation to the terms of sales and the time allowed for payment on installment accounts.

Senator TAFT. I would so much rather have credit control even through drastic and arbitrary action than control of prices of commodities; I think it is something that should be considered here.

Mr. ECCLES. There is no point, however, in having further credit controls at the present time.

If credit begins to expand, and there is an extension of existing purchasing power by further credit expansion, then of course author-

ity could be given to the Federal Reserve, I suppose, to deal with mortgage credits and tighten up on the terms of mortgages and things of that character.

Senator TAFT. Of course, today we have rationing and we do have price controls. Those have been established and set up by other laws which have been enacted by the Congress. Perhaps through some other agency an over-all control could be set up that can be used to prevent inflation of credit. I think that you are going to have far more danger 5 years, 10 years, or perhaps 15 years after the war than right after the war. It seems to me that there should be a careful effort instituted to avert that very thing.

Mr. ECCLES. I agree fully that the real danger is inflation, during possibly the first 2 years after the war, maybe longer, but I think may-be 2 years after the war, when we get complete reconversion, and with our great power to produce goods, and with the vast manpower that we will have released from the war plants and from the Army, that within 2 years or 3 years we will be able to produce pretty largely most items, and I do not believe there will be any shortage in the majority of the items that the public will require.

On the other hand, there may be some such thing as automobiles and some other things that you may sell only upon the basis of their being rationed, but the supply will pretty largely, in my mind, meet the demand factor. That is the only way in the end to meet inflation—that is, for the supply of goods and services to be equal to or in excess of the demand.

When the demand and the purchasing power are in excess of the supply there is only one way you can deal with it, and that is directly by price control, rationing, and allocation.

Senator TAFT. You can increase the demand by a series of inflationary actions.

Mr. ECCLES. You can increase it by deficit financing. What we should think of is approaching a balanced budget as we get reconverted. Nothing would be more helpful to prevent inflation developing than to have a balanced budget shortly after the war, certainly as soon after the war as possible.

Senator TAFT. Do you put that balanced budget ahead of putting people back to work?

Mr. ECCLES. No. But I think you ought to be able to do both.

Senator MURDOCK. The important thing, as I see it, is to see that men come back and reconvert to peacetime business after the war is over. After all, if men are employed, I cannot think that we will have very much danger from inflation.

Mr. ECCLES. I agree that if you have a lot of unemployment you cannot balance the budget, because your national income will not be sufficient to do so. You must have employment and you must have a balanced budget as well.

Senator TAFT. You may have full employment and very high inflation also.

Mr. ECCLES. Yes.

Senator TAFT. It may be employment on things that can not be permanently produced.

Mr. ECCLES. Employment should be in the production of products and services that the public wants to buy all the time.

Senator MURDOCK. We certainly should have a movement in the direction of a return to full employment, full reconversion, and no unemployment.

Mr. ECCLES. Yes. A movement in the direction of full employment, and that will be by balancing the budget, among other things.

Senator BUTLER. Would you say it was a mistake to not have proper taxes?

Mr. ECCLES. I think we should have had higher taxes. We talk about eliminating profits and putting people at home on the same basis with the soldiers overseas, but I am afraid we have not done it.

Senator BUTLER. Do you think it would still be worth while to do anything about that?

Mr. ECCLES. I think it is a little late to get it done. I think it should have been done 2 years ago.

The CHAIRMAN. It is never too late if it should be done.

Mr. ECCLES. That is probably true, Mr. Chairman, but I do not think this is the time now.

Senator BUTLER. Is there not more talk of lower taxes in order to encourage business?

Mr. ECCLES. High taxes will not discourage industry.

Senator TAFT. I think the present excess-profits taxes has caused them to be discouraged so far as the post-war development is concerned, is that not so?

Mr. ECCLES. I would not eliminate excess-profits taxes, I would reduce them. But I would also reduce proportionately the normal taxes along with them.

The CHAIRMAN. You would also have price control?

Mr. ECCLES. Good, firm control of prices, and rationing, as long as is necessary. That is a vital thing.

I did not finish the statement that I originally intended to make. It may have come out in this discussion so that I do not need to go into it any further.

The CHAIRMAN. Please go right ahead, Governor Eccles. I know that all of the members of the committee are very much interested in this matter.

Mr. ECCLES. I mentioned before the fact that there were 12 member banks, and it is, therefore, not possible to get it down to 40 percent as to each one of the banks, because, if the average was down to 40 percent, some individual banks would tend to be below the legal minimum. As a matter of fact today we are adjusting the holding of Government securities between the various Reserve banks almost daily to try to keep their reserve ratio as nearly equal as possible, but due to many factors that is very difficult. Now, we would like to do it, but it involves an awful lot of bookkeeping unnecessarily, and also, it throws the earnings of one bank out of relationship to the others. We feel that this 25-percent figure is necessary before we can get down to a reasonable figure for the banks as a whole. We would like to have them all at 40 percent, that is, for the system as a whole, but that is quite difficult.

There are several ways to meet the situation, all of which have been carefully considered. One way would be to issue Federal Reserve bank notes, which require no reserves, in place of Federal Reserve

notes; another way would be suspension of reserve requirements by the Board of Governors of the Federal Reserve System, which is authorized by law, and a third way would be a reduction of reserve requirements by the Congress. Other devices, such as issuance of currency by the Treasury, or reduction of member bank reserve requirements, have been reviewed and found to be inadequate or inappropriate. Reduction of the ratio by law, which is proposed in the bill, is the most clear-cut method, as well as the most consistent with the responsibility of the Congress to regulate the country's monetary policy.

Senator TAFT. This bill which proposes that the first sentence of the fourth paragraph of section 16 of the Federal Reserve Act, as amended, is amended by striking therefrom the words "40 per centum reserve hereinbefore required" and by inserting in lieu thereof the words "25 per centum reserve hereinbefore required to be maintained against Federal Reserve notes in actual circulation." In addition to that, do you have any objection to the repealing of this provision that these Federal Reserve bank notes to which I referred awhile ago, may be repealed?

Mr. ECCLES. We have no objection to the repeal of the provision providing for the issuance of those notes about which we have been talking.

Senator TAFT. I will offer that as an amendment to the bill.

Mr. ECCLES. I hope we do not get too many amendments on it.

I should like to refer now to this table concerning the reserve ratio of each Federal Reserve bank on the 15th of the month from July 1944 to February 1945, which is given in percent.

For instance, you will notice that Atlanta, in February 1945, had 52.1 percent reserve; Cleveland had 43.6 percent reserve; San Francisco had 51.3 percent reserve; Minneapolis had 44.8 percent reserve; Dallas had 44.1 percent reserve.

They shift all the time. If we did not have 12 banks, with their varying requirements, and if we had it all in one place, then of course it would be easier to get closer to the 40 percent than it is where you have 12, and the 40 percent applies to all of the 12.

So, when we look at the reserve, we look at the aggregate reserve, and it is a little bit deceptive. Here is Cleveland with 43 percent, whereas we have a total of 48.8 percent for the total of all the 12 banks.

Issue of Federal Reserve bank notes in their present form was authorized by the Emergency Banking Act of March 1933, and the authority will expire when the President declares that the emergency is over. The need for the lower ratio may continue beyond that date. Furthermore, the difference between Federal Reserve notes and Federal Reserve bank notes gives rise to misunderstanding, and it would be simpler and less confusing to the public if Federal Reserve currency were all of one kind. It would be best at a time like this to have a Federal Reserve ratio that indicated to the Congress and to the people the amount of gold certificates held by the Reserve banks against their total deposit and note liabilities of all kinds.

Senator MURDOCK. The two notes have the same redemption clause?

Mr. ECCLES. They are both guaranteed by the Government, of course.

Senator MURDOCK. Both redeemable in what is called lawful money?

Mr. ECCLES. That is correct.

The authority in section 11 (c) of the Federal Reserve Act to suspend reserve requirements does not appear to be the best method of meeting the situation, because the power was not designed for a situation like the present which is of indefinite duration. Suspension must be for a period not to exceed 30 days, renewable at intervals of 15 days. It also requires a penalty in the form of a progressive interest rate, to be determined by the Board, and added to the discount rate of the Federal Reserve banks. At a time like the present, when the discount-rate changes must fit into the general rate policy adopted for war financing, this would not be the best procedure.

Consequently the bill provides for a direct reduction of the required ratio. Such an action would be entirely consistent with the changes in conditions which have occurred since the ratio was first established by Congress. The original purposes of the ratio were to assure adequate resources for the Reserve banks to meet demands for gold—at that time, if you will recall, gold was in circulation—or lawful money by depositors and noteholders, to limit the expansion of Federal Reserve bank credit, and to assure the public that there was at least 40 percent in gold back of the Federal Reserve notes which were then being introduced for the first time.

The first purpose is no longer compelling since gold redemption is now not permitted for domestic use, and gold can be exported only under license. While the country's aggregate gold reserves are ample to meet any conceivable foreign demand, a reserve ratio high enough to meet possible demands for both domestic and foreign use is no longer appropriate under present conditions. The second purpose—limitation of Federal Reserve bank expansion—is not relevant at a time when expansion of the Reserve banks is essential to the needs of war finance. Thirdly, confidence in Federal Reserve notes is well established, and whether the amount of gold back of the notes is 40 percent or 25 percent makes no practical difference. As a matter of fact, the public accepts and has accepted Federal Reserve bank notes without any differences.

Senator MILLIKIN. That does not discount the fact that the public may have accepted them, those notes, because there is gold behind them.

Mr. ECCLES. I do not think that makes any possible difference. It is what they will buy. If the price of 1 pound of butter is \$5 and the price of a pair of shoes is \$50, and if your Federal Reserve notes were entirely backed by gold, the purchasing power would be just the same, and the fact that gold was behind it would not be important.

Senator MILLIKIN. I must take issue with you, I think, Mr. Eccles, when you argue that the monetary unit, whatever it may be, can be pushed around in the stratosphere independent of its own value, that you are arguing—I say most respectfully—economic nonsense.

Mr. ECCLES. You mean independent, not of its own value; you mean, independent of the value of gold?

Senator MILLIKIN. Whatever the value of gold in itself may be as a security or collateral; it has that value.

Mr. ECCLES. But the value of gold is based in terms of dollars, and Congress determines how valuable gold is, by fixing the price in dollars.

Senator MILLIKIN. Regardless of what Congress determines it to be, gold has some inherent value, and people like it for that reason.

Mr. ECCLES. They like it only because it is convertible into money that will buy something. That is all.

Senator TAFT. They cannot eat it, but they like to have it.

Mr. ECCLES. They like it because of what it will buy, and what it will buy depends upon the willingness of this country and other countries to fix its value.

Senator MILLIKIN. Mr. Eccles, the quickest test would be to make your money redeemable in gold, and see how fast the people would want it.

Mr. ECCLES. We have had, certainly, no less inflation than other countries that did not have gold back of their domestic currency at all.

The Russians have possibly done the best job of any, and have financed the war pretty well, and they have gone along with little or no debt expansion. They do not consider gold as necessary at all in the financing of the war. They like gold because of our willingness to pay for it.

Senator MILLIKIN. I suggest that the reason for all of that is that the inherent values in Russian money are obscured by wartime controls.

Mr. ECCLES. The British have done a pretty good job in managing their inflation. Their currency expansion has been less in proportion than ours. I think that is also true in Canada, and neither one of them has any gold backing, or any government security backing. They are issued by the Governments and they become of value by reason of the fact that they have to be back of their currency, and the fact that we have securities or gold back of our currency, I think that in no way aids this country in the issuance of its currency.

The fact that we have back of our currency gold or securities in no way aids this country. Whether or not you have backing to your currency in no way restricts the issuance of the currency. I want to emphasize that.

Senator MURDOCK. Would this be a fair inference that this is just a step toward ultimately the adoption of the Bretton Woods proposal, and that we are now decreasing our own gold reserve requirements so that there will be more gold available for distribution for other countries so that that can be put into effect?

Mr. ECCLES. No; I think the Bretton Woods agreement did not have anything to do with the amount of gold in this country; it will not take gold out of this country. In my opinion we are likely to get a big influx of gold just the minute we are willing to ship goods. Our gold is likely to be expanded, while we will ship the goods over, and we will take some of the world's gold, which is \$14,000,000,000 at the present time, plus about a billion and a half production, and we'll take that gold and ship goods just as soon as the goods can be shipped and the ships are available in which to ship them.

Senator TAFT. Bretton Woods proposes that we put about \$6,000,000,000 of our gold into a fund, does it not?

Mr. ECCLES. I think that the plan is that we shall put in \$1,800,000,000.

Senator TAFT. It will be about the same thing in the end, will it not? That will be just the beginning?

Mr. ECCLES. We do not put it in. There is no part of this gold that is expected to be made available to Bretton Woods at all. The gold proposed in the bill on Bretton Woods is the stabilization gold, which has never been in our monetary system. There is \$2,000,000,000 of stabilization gold, and it is proposed to put in \$1,800,000,000.

Senator TAFT. There is gold that goes into the bank, besides that?

Mr. ECCLES. Yes.

Senator TAFT. How much?

Dr. GOLDENWEISER. About 2 percent.

The CHAIRMAN. Governor Eccles, can you come back this afternoon? There are several members that are very much interested in this thing, and since we have to attend to some other matters, we would very much like to come back at 2 o'clock.

Senator TAFT. Could you make it 2:30?

The CHAIRMAN. Could you come back at 2:30?

Mr. ECCLES. I will be very glad, of course, to do whatever the committee desires. My time is yours.

The CHAIRMAN. Then the committee will stand in recess until 2:30.

(Thereupon, at 12:15 p. m., a recess was taken until 2:30 p. m. of the same day.)

AFTERNOON SESSION

(The committee resumed at 2:30 p. m., upon the expiration of the recess.)

The CHAIRMAN. The committee will resume its hearing on S. 510. Governor Eccles, will you continue with your statement on this bill?

STATEMENT OF MARRINER S. ECCLES, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, WASHINGTON, D. C.— Resumed

Mr. ECCLES. Mr. Chairman, I almost finished this morning reading this statement. I would think, perhaps, it would be better if the committee reporter would put the complete statement in the record at the beginning rather than piecemeal.

Senator McFARLAND. What is this statement I have before me?

Mr. ECCLES. I think that is the statement placed in the Congressional Record with the bill; and I have merely added to that statement to meet some questions I thought might be raised at this hearing.

Senator McFARLAND. I should like to have a copy of the statement you are now reading.

Mr. ECCLES. We now furnish to you, and will be glad to furnish any other member of the committee who does not happen to have one, a copy of this statement.

Senator McFARLAND. Thank you.

The CHAIRMAN. You may proceed, Governor Eccles.

Mr. ECCLES. I now resume at the bottom of page 6:

War conditions have caused all belligerents to reduce or abolish central bank reserve requirements. Mechanical limitations on the ability of a central banking organization to extend credit must in-

inevitably give way in time of war to the paramount obligation to support the war effort.

A reduction to 25 percent is proposed because it would be sufficient for all foreseeable contingencies. It would enable the Reserve banks to meet such additional demands for currency by the public and for reserve balances by member banks as are likely to occur. The currency supply and the bank deposit structure could nearly double before the legal minimum would be reached.

Senator TAFT. If that is so, it might be that 30 percent would be sufficient. How about that?

Mr. ECCLES. Well, it might be, but what difference does it make, because if the gold is here, as this chart on the easel shows, it will be covered 100 percent. If it is not here then the Congress would merely proceed to reduce it. There is no way that we as the Federal Reserve System could use this excess gold.

Senator TAFT. The existence of a limit that might have to be changed again is a sort of warning that Congress might have to do something about some other things that we could do something about.

Mr. ECCLES. If you should have unemployment and needed to meet that problem you would either meet it by deficit financing, just the same as you do in war, or by some other method. You will not let a mechanical reserve stand in the way any more than you will in a war period.

Dr. GOLDENWEISER. If you want a warning, any decline in reserves would give you that warning.

Senator TAFT. Yes; perhaps so. But nothing gives us a warning until Governor Eccles comes down here and asks us to do something.

The CHAIRMAN. You may proceed, Governor Eccles.

Mr. ECCLES. The bill provides for elimination of the distinction made in the present law between reserves required against notes and against deposits both as to percentage and as to composition of the reserves. Since the two liabilities are interconvertible at the option of the owners, the same requirements should apply to both. The provision in the bill that legal reserves should consist only of gold certificates would also eliminate controversy as to what constitutes lawful money, and whether the Federal Reserve banks could, if so minded, use their own notes—Federal Reserve notes or Federal Reserve bank notes—as reserves against their own deposits.

Senator TAFT. Why was that put in? I am talking about this lawful money business.

Dr. GOLDENWEISER. It was thought that if the individual deposit holder knew the liability would be met by currency, that would be satisfactory.

Senator TAFT. Lawful money at that time was exchangeable for gold.

Dr. GOLDENWEISER. Most of it was. By law it was, and in fact most of it was.

Mr. ECCLES. It is a small item. The term "lawful money" used here means probably between three hundred and four hundred million dollars. It is a very small matter. It only represents what would be called the stock that the Federal Reserve banks would carry on hand from day-to-day transactions. It is not an important item, and I think it would clarify the law if it were eliminated.

The CHAIRMAN. You may proceed with your statement.

Mr. ECCLES. A clean-cut uniform requirement of gold certificate reserves of 25 percent against both notes and deposits appears to be the best solution of the problem.

In conformity with the proposed reduction of the ratio to 25 percent, the bill decreases proportionately the levels of the ratio at which the imposition of the different penalty rates provided in the law when reserves are suspended would be prescribed. In other words, there is no change on that except the penalty applies exactly the same way except that it would apply below 25 percent as it does now at the present rate.

Senator BUCK. Is it not barely possible that the Government will have to freeze Government bonds after the war that are in the banks? That is, make them nonnegotiable?

Mr. ECCLES. I would not think so. I think you have to have Government bonds with a market value.

Senator BUCK. Where will you find a market for them?

Mr. ECCLES. The Federal Reserve would supply the market. .

Senator BUCK. Do you mean you will buy them in, if necessary?

Mr. ECCLES. Either that, or the public will buy them. You may have a huge shift of deposits, and then you will——

Senator BUCK. Do you think the Government will buy them in?

Mr. ECCLES. I think insurance companies and mutual savings banks will buy them. There is a serious question as to what they can find to put their savings in. If we maintain the national income there will be such a huge volume of savings for investment that there will arise the question where to put such savings.

Senator BUCK. You do not think interest rates will continue where they are now, I mean after the war, do you?

Mr. ECCLES. I certainly do. I am perfectly sure that interest rates will not go up. There will be much less demand for money when the war is over than we have had at any time in the past. I do not think we will have any increased demand for money. I say that because the statements of most of the corporations today show that they have a volume of bank deposits and of Government securities beyond that which ever existed before. It has gone up from \$23 billion in 1940 to \$66 billion as of last November. So that the liquid condition of corporations is way beyond what it ever was. There has been nothing like it in the past. In my opinion, the need on the part of most companies to borrow money will be very minor, and in the case of most of the big outfits it will be nonexistent.

Senator BUCK. Do you not think the only reason a market may be created for Governments after the war will be because there is nothing else to buy?

Mr. ECCLES. Do you mean in the way of new corporations being organized?

Senator BUCK. Yes.

Mr. ECCLES. There will be some, of course, but not enough, in my opinion, to absorb the huge volume of savings that we will create, or certainly not if we have full employment. The banks should, of course, have a free market for Government securities.

Senator BUCK. And that is going to be the trouble?

Mr. ECCLES. They help stabilize the market. That does not mean that they will be the only buyers. What will you do without stability in the market? You may have either a great rush to sell or a great rush to buy. The Reserve System acts as a stabilizing factor in both buying and selling, so that you do not get the momentum of no market. If there is no market people would want to sell; you always want to sell when you think you cannot.

The important thing is stability of the market. When the buying exceeds the selling, the Federal Reserve would sell. As gold comes back into the country the reserves of the banking system would build up, and deposits would build up. In that case the Federal Reserve would sell some of its securities to absorb the excess reserves. Our portfolio would go down, just as our portfolio now goes up as currency expands and as gold leaves the country. If gold comes back and currency would come back, the reverse would be true—our portfolio would be reduced.

So that the function of the central bank is that of a stabilizer. There are a great many banks in the country. If we had a branch banking system, then as money shifted from one part of the country to another, money would merely go from one branch to another and not change the structure. That is, as to the financial status of the bank.

But in our country, with fourteen-thousand-five-hundred-odd banks, there may be, and in fact will be, a huge shift of deposits from one area to another. As banks located in war industry centers have gained deposits, some of them as high as 500 percent, and even 1,000 percent, and as the war industry closes in a particular area, the deposits there will go down and will go to banks somewhere else. A particular bank would have to sell its Government bonds as its deposits shift. On the other hand, banks somewhere else, as their deposits go up, would be in the market to buy Government bonds. And the Federal Reserve is necessary to help perform that stabilizing function. It would be a great mistake to try to freeze—in fact you could not very well freeze Government bonds in banks because banks losing deposits must be in position to dispose of Government bonds.

Senator BUCK. The Government could redeem them.

Mr. ECCLES. But why redeem them merely to go out and borrow from somebody else to get the money with which to redeem them?

Senator BUCK. In regard to any difficulty about holding the price up, all right. I should think a flood of bonds on the market would give you trouble.

Mr. ECCLES. It is not a matter of a flood of bonds coming on the market. I think you will find the banks are in the market continuously for Government bonds, and they will drive the price up. The price of Government bonds is being driven up today by bank purchases.

Senator MURDOCK. So when we hear the expression "Bonds are being forced on banks," it is erroneous?

Mr. ECCLES. It is entirely erroneous. The central bank is creating a condition which tends to make banks buy bonds; that is, we are creating a favorable market in which to buy, but are not forcing them at all.

Senator HICKENLOPER. Are not banks being forced to buy Government issues today because there is little or no need of money in private

enterprise? In other words, individuals and corporations not being in the market to borrow, the only place to turn for the investment of savings is the Government.

Mr. ECCLES. I would not say that is the only source. But I would say that private enterprise has so much money; that merchants and farmers have such a large volume of business and have had such profitable operations, that they have not been required to borrow. And they have paid off their obligations to a very considerable extent.

Senator HICKENLOOPER. Doubtless that is true, and by the same token the market for money a bank has had is gone. The only place to put money is in Government bonds.

Mr. ECCLES. Well, the Government created the money in the first place. The reason a man has money to loan to the Government is that the Government created it by selling bonds in the first place.

Senator TAFT. But if the banks did not buy Government bonds you would have to make them buy them.

Mr. ECCLES. No. We would not have to make them buy them. The Federal Reserve could buy them.

Senator TAFT. And that would be still worse. Do you mean the effect is the same?

Mr. ECCLES. The difference is that if the Federal Reserve bought them the profit would go back to the Government.

Senator TAFT. But the condition is such that we have failed to sell enough to private sources, so that if you finance this war the banks will have to buy them. It may be to their advantage to do so, but if it were not, you would still have to make them take them or the Federal Reserve would have to take them.

Mr. ECCLES. In other words, the amount of financing that the Government has done—or I mean, the amount of spending the Government has done has required the sale of bonds either to the banks or to the Federal Reserve banks, because the amount collected in taxes and the amount of Government bonds bought by individuals and corporations other than banks has not been sufficient.

The last war was financed, if you will recall, at an increasing interest rate. That war started out at 4 percent, I think. Is that not so, Dr. Goldenweiser?

Dr. GOLDENWEISER. The first bond issue was at less than that; I think 3 1/4 percent.

Mr. ECCLES. But not much was sold at 3 1/4 percent, and it finally went up to 4 3/4 percent. By the end of the last war the Government was paying 4 3/4 percent for money totally tax-free. That same condition could exist today if it were not for Federal Reserve management of the money market.

When the war was over, the Federal Reserve adopted what was known as the tight-money policy. They raised the discount rate to 6 percent. They had no open market operations at first, because there was no open market committee.

Senator TAFT. They began open market operations in the twenties, did they not?

Mr. ECCLES. In 1923. It was optional with each bank; that is, each Reserve bank decided whether or not it would buy or sell. One might buy while another was selling, and one could nullify the action of the other. They had a voluntary open market committee to determine policy, but the banks were not legally obliged to comply with its

decisions. It was not until the Banking Act of 1935 that we got a System open market committee, which in effect is one central bank, so far as open money market operations are concerned. As a result of that, we have been able to create a favorable condition for the Government in the matter of financing at low interest rates; and it was determined at the time this war started that we would finance the war on approximately the interest rates that were in effect at that time; that we would not finance the war on the basis of increasing interest rates, which would mean decreasing bond prices for those that had been previously sold. That in itself, of course, would have created an unfavorable situation with the investor—if he saw his bonds declining, bonds that he had purchased at one rate and the rate went up later.

Some of you will recall that after the last war, with the tightening of the money market through the operation of Federal Reserve banks, Government bonds went down to 83. I believe a 4-percent or 4½-percent bond was selling in the 80's. That was, of course, an intolerable situation, to ever have permitted such a thing to exist. Certainly under the situation that exists now—but, first, I should say then there was a total of \$26 billion of Government bonds, at the peak, whereas we are likely to have \$300 billion of Government bonds out by the time we get through with this deficit financing.

Certainly with that sort of situation it would be disastrous not to manage the money market so as to prevent a rise in interest rates. A decline in Government securities would create a catastrophic situation in your financial markets; a substantial decline in Government securities when the insurance companies and the trustees and the banking system have from 50 to 75 percent of all their assets in Government securities. That would create a psychology of fear and a financial panic, which of course must not be permitted. There is absolutely no need of it being permitted. The control can be completely exercised; such a condition can be absolutely prevented by proper central bank management.

All that we are asking here today is that you put us in position to take care of the situation by enabling the Reserve banks to take currency, to continue Government bonds back of Federal Reserve bank notes, and to reduce the gold reserve requirements, so that we may be in no way hampered in meeting this management job, not only now but in the post-war period. That will be to the end that the financial community, that understands something about this operation, will not have any doubts as to the ability of the Reserve System to do this sort of job.

Senator HICKENLOOPER. Mr. Eccles, under the theory that it will not disturb our money system to reduce the reserves to 25 percent, is it your position that it is just as logical to say that if money goes beyond that it won't disturb our money system to take off the 25-percent reserve entirely?

Mr. ECCLES. I do not think it would.

Senator HICKENLOOPER. Then your position is that the gold reserve is not essential to the proper management of our currency.

Mr. ECCLES. That is correct. It has had no relationship to it. Whenever it got in its way, you have changed it.

Senator HICKENLOOPER. Then your position is that it does not make any difference whether it is 40 percent or 25 percent?

Mr. ECCLES. It makes this difference, that as long as the law requires that there shall be a reserve higher than can be maintained without the sale of Government securities or without a tight money market, it does make a difference.

Senator HICKENLOOPER. Then you are advocating this 25 percent because the law requires a gold reserve and not because you think it is essential?

Mr. ECCLES. The law requires a 40 percent gold reserve against Federal Reserve notes and 35 percent against deposits. We are suggesting that it be made 25 percent against both, because that would be ample for a considerable time.

Senator TAFT. Then am I to understand your answer to Governor Hickenlooper's question to mean that you are willing to have the 25 percent as a concession to archaic prejudice?

Mr. ECCLES. Exactly. We have no objection to it but it is not necessary. I stated that in part this morning. I think there is plenty of evidence in the British operation, as well as the Canadian operation, and the French operation, and every other central bank practice, that when they have gold and the gold is used to settle international balances, that is all right, but it is not permitted in any way to hamper the domestic management of their currency.

Senator HICKENLOOPER. Then it is not a real prop to the internal value of their currency?

Mr. ECCLES. No; because the currency is not convertible into gold. As long as you maintained the international gold standard throughout the world you had a very different situation. But you have not now an international gold standard. Currencies are not convertible into gold, and therefore the gold reserve requirement has not the same effect at all as it would have if the currency was convertible into gold and we had what we call the international gold standard.

The law was put into effect, and the theory of the gold reserve being effective in curbing undue expansion, of course, was based upon the operation of the international gold standard. When a country lost gold, the interest rate or the discount rate of the central bank would go up, the idea being that interest rates going up in a country would attract money into the market and bring gold back. In other words, it was an automatic theory that never did work automatically, because the British managed the gold standard, but there was the theory at least that as the gold reserve got low through loss of gold, rates would go up and would tighten the credit expansion, and would induce foreign capital to come into the country and bring gold in and reduce the credit.

Now, of course that operation has not been in effect for a long while. Therefore, this provision of the gold reserve requirement is archaic, and the 25 percent is archaic; but inasmuch as we have it and the public would feel better by having some gold reserve, I have no objection to it.

Senator BUTLER. That leads me to propound this question: How long do you think it will be before you will have to take off the 25-percent requirement?

Mr. ECCLES. I do not think it will ever be necessary; I doubt if we will ever get to the 25 percent. I think the war will be over and gold

will start coming into this country in payment of exports before we get to the 25 percent.

Senator BUTLER. Then we will automatically have gold.

Mr. ECCLES. We will have whatever it is. We had a 100-percent gold coverage a while ago. The fact that the minimum requirement was 40 percent did not stop us if we had the gold. And the fact that it may be 25 percent as a limit to which it can go without coming up to you people again, should easily cover the situation; and before it gets to that point it may go up to 40, 50, or 60 percent. But certainly the fact that it is 25 percent is merely a minimum to which it can go without a change in legislation.

Senator TAFT. Do you think the present level of currency and deposits is permanent?

Mr. ECCLES. I think the level of deposits is permanent. I think it is not only permanent but that there is a probability of a marked future growth in deposits.

Senator TAFT. I believe there is an article in the February bulletin of the Federal Reserve System suggesting that deposits will not change after the war.

Mr. ECCLES. They may go up.

Senator TAFT. I think the only change would be brought about by a reduction in the public debt, that that might help to bring down deposits.

Mr. ECCLES. Yes, sir.

Senator TAFT. With the present level of Government debt, the deposit level will be about the same, or if there is less hoarding, the currency will come back to the banks.

Mr. ECCLES. With gold imports and currency coming in, deposits on the one side will go up, and bank reserves on the other will go up, in which case Federal Reserve banks would reduce their holdings of Government securities. Otherwise the banks would have a huge excess of reserves, and would bid up the price of governments beyond what they are now.

Senator TAFT. You could increase the ratio.

Mr. ECCLES. Very little. It is up to the limit now with the exception of New York and Chicago, the two central reserve cities in which the reserve could be increased to 26 percent from 20 percent. That is the only further increase that we could make.

Senator TAFT. And that is not material.

Mr. ECCLES. No.

Senator BUCK. Will there be as much of this currency in use after the war is over?

Mr. ECCLES. In my opinion that will depend upon the job the Congress and the country do in preventing inflation. If we keep price controls on, and rationing, and allotments, and export licenses, and we control our cost of living until the time comes when the supply of goods is sufficient to meet the demand, whenever that is; if we do it until that point, then I think the volume of currency will come down. But certainly if we let prices rise then both the volume of deposits and of currency, in my opinion, will continue to rise.

Senator BUCK. I presume if it has the same purchasing power it ought to run right on.

Mr. ECCLES. Yes.

Senator TAFT. I have a little doubt that you can manage to restrain inflation after the war merely by price control. It seems to me there are other elements that tend to break that down. Take inflation of stocks, inflation of real estate, cannot such things build up inflation that may make it still more difficult to maintain price control of commodities than today?

Mr. ECCLES. I am glad you mentioned that. That is the one door we have left open, is the capital-goods market. There isn't anything to keep existing cash, or Government securities from being converted into cash, or future cash that people get, from being spent to buy farms and homes and stocks. Whenever you cannot buy goods and services because of manpower shortage and allocations and priorities, there is nothing to stop the stock market or the real-estate market or the commodities that are not controlled from going to any height that the people are willing to bid them.

The CHAIRMAN. How can you control that?

Mr. ECCLES. If that should develop as a result of credit, then, of course, you would restrain private credit. But what development has now gone on, and it has been considerable—take, for instance, farms, and they have advanced since 1940, 60 percent. Urban residence property has advanced 40 to 50 percent since 1940. Listed securities since the low point of 1942 have advanced 80 percent. Now, with the huge volume of money there is, of course, nothing to keep those assets from being bid higher if people are willing to pay the prices. But the danger—

Senator TAFT. And a control of stock prices would be very difficult to enforce. For instance, I think a bootleg market in stocks might be brought on overnight.

Mr. ECCLES. The Reserve Board has the power to put the stock market on a cash basis. If we raised margin requirements to 100 percent, it would put the stock market on a cash basis.

Senator BUCK. Is it on the basis of 50 percent now?

Mr. ECCLES. Yes. It has not been lower than 40 for years. The expansion, however, up to the present time has not been based upon credit, except Government credit, which finally shows up in the form of cash in the hands of individuals and corporations. It is that money that is going into these things. The farm credit situation actually shows a substantial reduction in credit continuously over the past several years. That is also true in the case of home mortgages. There is less outstanding credit today on home mortgages than there was several years ago. People are paying off debts on both homes and farms, so that this credit expansion has not been enough to offset credit contraction. On balance there has been some small contraction of credit. These operations—a great many of them—are on a basis of cash by speculators—people who feel, I suppose, that they can buy these securities now and sell them later at a higher price. They have a capital-gains tax that is only 25 percent, whereas their income tax goes up as high as 90 percent, and this is a door for avoiding that tax. These capital gains, in my opinion, are just as much a war profit as any other profit.

Certainly farms would not be valued as they are, stocks as they are, and homes as they are, if it were not for the terrific war expenditures. They are just as much a war profit as any other form of profit, and

yet a person can buy those assets, or a corporation can buy those assets, and if they hold them 6 months and sell them the profit they make is subject only to the 25 percent capital-gains tax, whereas other profits are taxed up to 95 percent, if they are excess profits of a corporation, and 91 percent for an individual. So that people and corporations in the high bracket are certainly inclined to go in and buy up these various forms of assets and hold them for a speculative profit, and there is only one way you can deal with that profit, and that is to put a special excess-profits tax on securities that are purchased for that purpose.

Senator TAFT. It seems to me the money for housing, for instance, comes from individuals who want houses, and for farms from individuals who want farms. I doubt very much if it is a question of speculation in most cases.

Mr. ECCLES. There is a great deal of speculation.

Senator TAFT. On the stock market, of course. That is a different situation, but even in the stock market I don't see much evidence in any corporation's statement of buying and selling stocks.

Mr. ECCLES. But you have a lot of holding companies or personal corporations and investment trusts.

Senator TAFT. Yes. They are probably speculating.

Mr. ECCLES. You have numerous investment trusts and holding companies and—

Senator TAFT. It seems to me that speculation is only an evidence of the increase in value created by the demands of real money to ultimately buy.

Mr. ECCLES. That is right.

Senator TAFT. You cannot stop it by just stopping speculation.

Mr. ECCLES. But if this 20 percent—it may be that extra 20 percent demanded in excess over the supply can create an awful inflation of prices, so that even if 80 percent are normal and 20 percent are excess, it may well be you would have no excess if you eliminated the speculation. I don't know.

Senator TAFT. I doubt it.

Mr. ECCLES. But certainly a very substantial part of the purchasing of homes and farms is speculative. A great many of the farms are bought by city people who do not live on them, who do not operate them. A farm today can be purchased even with this 60 percent advance—I am told that many of them even at today's prices with the 60 percent advance, can be bought and leased on a basis so as to yield as high as 8 percent on investment.

Senator TAFT. I question whether people are buying farms on the chance they may be able to sell them for more, a year from this time.

Mr. ECCLES. Well, you have the G. I. bill that you passed, that encouraged 8 or 9 or 10 million soldiers to think that they could get a home and a farm with Government help. You encouraged them to think that. Now, that in itself would indicate that there is going to be a very excellent market for farms and for homes. Certainly, with the millions of men wanting farms and homes, it seems to me there is some obligation on those who passed the G. I. bill to protect the values of homes and farms as part of the G. I. bill. Merely to make the money available to buy, without providing protection as to the price, means that the soldier comes in and buys a home or a farm

at the inflated price. Then the same thing may happen to him as happened after the last war, when the collapse occurred in the farm market.

The CHAIRMAN. What protection do you suggest for the boy that is going to buy a farm?

Mr. ECCLES. I think you have to take the speculator out of this field. I think the speculator in farms and homes and stocks, or whatever it is in a war period, should have to pay a war-profit tax. I don't think he should be free to take advantage of a normal capital-gains tax. I would not disturb the regular capital-gains tax. You cannot make it apply to what people bought 3 or 4 years ago, or 2 years ago. What I am talking about is what was bought, well maybe from now on, or from the first of the year, or whenever it is, but it would be something that would be applicable for the war period or a short time after the war, so as to take out the possibility of shifting from many needed things with the idea you are going to be able to convert it later on at a capital gain which is subject to a small profit.

Senator TAFT. I do not say the idea is not sound, but I don't think it is fundamentally going to prevent inflation in homes and stocks.

Mr. ECCLES. I don't say that it would completely stop it, but I think it would be a big curb. Then credit could come as a secondary matter if we find that in spite of the cash speculator putting the market up, that the legitimate operator was also putting the market up through use of credit, then of course you could restrain credit if credit was expanding in any of these fields. That would be supplemental.

The CHAIRMAN. You said he ought to be protected. Now, have you some specific program?

Mr. ECCLES. I am saying the only way you can protect him is by putting a special tax on these profits.

Senator TAFT. Really the only way you can stop speculation, in the long run, is to get back to a balanced budget.

Mr. ECCLES. That is a very important part of it, certainly. There is another way of putting it. I don't like to say that a balanced budget could stop speculation. The best way to stop speculation, of course, is to build enough homes, provide enough goods and automobiles, and so forth, to meet the demand. That is the surest way to get a balanced budget. I think they go together. I think full employment and the balanced budget, one is a corollary of the other.

Senator TAFT. The other is the corollary of the one, perhaps. However, they do go together. On that I agree with you. May I ask—this morning we had a reference to the foreign balances. This quotation from the November Federal Reserve Bulletin says:

Gold and dollar reserves of foreign countries amounted to some 17 billion dollars at the end of September 1944, as compared with 7 or 8 billion dollars in 1928, before disintegration of the gold standard set in.

I wanted to ask you how that 17 billion dollars was made up, how much gold it includes. Does it include gold in this country and not gold abroad?

Dr. GOLDENWEISER. I think that 17 billion includes all the gold that these foreign countries owned, whether earmarked here or whether they hold it abroad, plus their holding of official dollar balances in this country.

Senator TAFT. There was some suggestion this morning that the gold alone was—

Dr. GOLDENWEISER. 14 billion dollars.

Senator TAFT. That would not be included in this 17 billion?

Dr. GOLDENWEISER. Yes. It is 14 billions of gold and 3 billions of dollars.

Senator TAFT. I wonder if you would check up on that.

Dr. GOLDENWEISER. I would like to check up, Senator. I may be mistaken.

Mr. ECCLES. The dollar balances are \$5,432,000,000 as of November 1944.

Senator TAFT. That contradicts Dr. Goldenweiser's statement.

Mr. ECCLES. Private balances are \$2,253,000,000.

Dr. GOLDENWEISER. That excludes private balances.

Senator TAFT. "Gold and dollar reserves of foreign countries," it says. I don't know whether that means foreign nations. It says foreign countries, amounted to some 17 billion dollars.

Dr. GOLDENWEISER. I think what that means is they are held as reserves of the central authorities.

Senator TAFT. I would like, if you could, to have you give us as much of a break-down of that as you can. I would be interested to know how it is held as between countries.

Dr. GOLDENWEISER. I don't believe, Senator, that that figure is at this time available, under war restrictions.

Senator TAFT. Perhaps that is true.

Mr. ECCLES. Here is what we have. The gold under earmark is \$3,891,000,000 as of November. You have the total of gold in this country, Doctor, but I understand the gold outside of the country is approximately—I don't know what Russia has, for instance—but the best estimate of the amount of gold owned by foreign countries is about 14 billion. Now, \$3,900,000,000 of that is earmarked and held in safekeeping for those countries, so that it would be about 10 billion held outside of this country by other countries. Now, in addition to that, there are official balances outside of that gold of 3 billion; that makes your 17 billion. Now, if you want to add private balances, you add to that another \$2,250,000,000, which would give you \$19,250,000,000 of gold and dollar balances. In addition to that you have got investments of foreign countries in this country in the form of stock and bonds.

Senator MURDOCK. Is the 10-billion figure you gave, is that monetary gold.

Mr. ECCLES. Yes; outside of this country.

Senator MURDOCK. Do you consider that gold synonymous with dollar balances?

Mr. ECCLES. It can be converted into dollar balances at any time they want. They do not use it for bank reserves, so it is not monetized. All these countries use that gold to settle balances. Therefore, it is available, you see, to sell to us to buy goods, because they do not use any part of its as backing for their currency.

Senator TAFT. Or they could come over and borrow on it if they wanted to?

Mr. ECCLES. They could borrow on it if they wanted to and they do, at times; that is right. You have got in addition to those foreign

assets, currency. Nobody knows how much currency is held by foreigners, or held abroad, but certainly a substantial amount of it.

Senator TAFT. I suppose the spending abroad of soldiers is building up foreign balances all the time.

Mr. ECCLES. Very materially. In England, Italy—in fact, it is partly responsible for a lot of this—Australia and elsewhere. Now, in addition to that, of course, there is considerable real estate held in this country by foreigners, and other long-term investments. You could be safe in saying they have what could be converted into a claim on us of 25 billion dollars.

Senator MURDOCK. Let me ask you this question. Isn't it a fact that your dollar is probably the most desirable or coveted of all exchange today throughout the world?

Mr. ECCLES. Yes, I think that is true.

Senator MURDOCK. Isn't that partly attributable to the fact we do have gold behind it?

Mr. ECCLES. No, I don't think that at all. I think it is because the dollar is used to purchase goods and the things that the countries need. That this is the only place that normally, with dollars, they can get the things that are so necessary for them. It became extremely necessary, as the war started in 1939, and we were not in it until, you see, 1941, so there was half of 1939, all of 1940, and nearly all of 1941 in which there was a scramble to get dollars so as to be able to buy planes and ships and munitions of war, which we sold to France, which we sold to England, before lend-lease developed. There was a terrific demand for dollars for that purpose, not because it had any relation to gold. It was merely because it would buy things they needed.

Senator MURDOCK. You don't think gold plays any part at all in the fact today that the dollar is the most desirable exchange?

Mr. ECCLES. I don't think so.

Senator MCFARLAND. What has been the history of the value of exchange among the countries that have gone off the gold standard?

Mr. ECCLES. Do you mean where they didn't settle their international balances?

Senator MCFARLAND. Well, take Mexico, for instance.

Mr. ECCLES. Every country has been off the gold standard for years. The British have—

Senator MCFARLAND. Yes, but what was the history of the exchange of the money? What was the condition of the exchange of Mexican money when they were on the Mexican gold standard and immediately thereafter?

Mr. ECCLES. It was not because they went off the gold standard. It was because they had an adverse trade balance. As long as they had gold to settle their balances they had a stability of currency. When they had adverse trade balances their currency depreciated in terms of the dollar. That would be true of any country, when its trade balance is adverse with the rest of the world, if it cannot get credit to offset the adverse trade balance, or if it hasn't got gold to offset the adverse trade balance which would be accepted as money, then its currency would depreciate and it is forced off of gold because of the adverse trade balance.

Senator McFARLAND. And it did change from a ratio of about 2 to 1 to 5 to 1?

Mr. ECCLES. That was not because of gold. It was because of its adverse trade balance in relation to the dollar.

The CHAIRMAN. Are there any other questions of the distinguished Governor?

Senator FULBRIGHT. May I ask a question? I am not sure it is relevant here, but the purpose of this monetary fund that is proposed is really to deal primarily with that question you just mentioned, isn't it?

Mr. ECCLES. Yes. I was just going to say that, this morning. The question of the increase in the price of gold being a way to meet this shortage of gold reserve requirements was suggested, and this is a memorandum or a portion of a memorandum that I would like to read in connection with that suggestion.

To lower the value of the dollar in terms of gold—

which means increase the price of gold—

might tend to depreciate it in the exchange market—

That is, in relation to other currencies. It certainly would—

and create unsettled conditions in that market at the very time when we are trying to get the nations of the world to agree together on policies of exchange stabilization. The depreciation of the dollar would tend to jeopardize the Bretton Woods program or any other program of stabilization. If we wish to add to our money supply it is far better to do so through an expansion of Federal Reserve credit which can later be withdrawn should inflation threaten, than to do so by creating added billions of dollars in ways that add nothing to the offsetting powers of the Federal Reserve System.

This means that if the Federal Reserve System creates credit by purchase of Government bonds and puts reserves into the banks it can at a later date reverse the action and sell those Governments and absorb the excess reserve that might develop as gold comes back in—or as currency returns from circulation—then we can reverse the action just as we have had to as currency went out and as gold went out of the country. Now, when the reverse occurs, we could reverse the action and sell Governments. Whereas, if you meet the problem through changing the price of gold, the only way you could reverse that action would be again to decrease the price of gold, which would mean that the Government would have to appropriate billions of dollars to pay off the loss created through depreciation in the price of gold, just as they created billions of dollars by increasing the price of gold, and I can hardly see Congress ever decreasing the price of gold and appropriating the money. Therefore the reverse action in the situation is impossible, which is another good argument against changing the price of gold.

Particularly when those added dollars are created through subsidizing foreign gold production or paying more for existing foreign gold reserves, they represent a drain on this country's productive resources, which they would be exchanged for. Nor would foreigners be pleased if our action unsettles the exchange markets and makes it necessary for foreign countries to depreciate their own currency to meet our action.

Now, the countries that produce gold, and they are a small number—Canada and South Africa are the principal ones—but of a total gold production of \$900,000,000, around \$800,000,000 of it is produced out-

side of the United States and Alaska, and the great bulk of it is produced in South Africa and Canada.

Senator FULBRIGHT. And Russia?

Mr. ECCLES. That is right. And Russia. But aside from that, very little is produced. Those countries, it would be helpful to them, of course, to increase the price of gold, because they are sellers of gold as a commodity.

Senator TAFT. Don't you think the fact that Russia, England, and the United States have all this gold is the reason that they are the predominant countries today?

Mr. ECCLES. What is that?

Senator TAFT. You don't think we can attribute the present power of those three nations to the fact they are producers of gold?

Mr. ECCLES. Oh, no. The reason is because they produce men and goods and leadership, but certainly the countries that do not produce gold would not like to see us change the price and upset their exchange in relation to ours.

Senator FULBRIGHT. In that connection, you were describing the function of the Federal Reserve System as a stabilizer. Would the operation of the monetary fund be a very similar matter, only as between nations, to the Federal Reserve System as between the central banks over this country? Is it a very similar operation?

Mr. ECCLES. Well, I think it is quite different from that sort of operation. It would be designed, of course, to stabilize the currencies, to maintain a fixed relationship, leaving some flexibility, as provided in the agreement. But the open market committee of operation in the Reserve System tends to stabilize the Government bond market. It does not stabilize the price level of goods and services at all. It does not stabilize the purchasing power of money.

Senator FULBRIGHT. It stabilizes the cost of money—I mean the interest rate.

Mr. ECCLES. Yes. It can do that. It can stabilize the cost of money, that is right, but a high money rate does not necessarily mean deflation any more than a low money rate means inflation. We saw in 1929 a very high money rate, and in 1928, all during the 1920's, we had a very high money rate, and discount rate. I think the lowest discount rate the Reserve Bank had was 4 percent, and it went up to 6, a very high money rate. It did not stop your market situation from developing. We had, from 1931, at the time the banks started to close, we had a very low money rate, commencing with 1931, and it did not stop the decline nor did it bring about a recovery. All a money rate can do is to create a climate favorable for expansion or a climate that tends to bring about contraction, but it is minor in actually bringing about either one. It merely is a negative factor—well, it is neutral, not negative. It is largely a neutral factor. A high money rate in a deflationary period would only make the deflation worse, and a low money rate is not going to stop it and bring about inflation.

Senator TAFT. What is the power that is complained about—I haven't investigated it myself—that the Treasury may buy gold at any price it may choose to fix without any further action by Congress? It has been suggested that the Treasury could go out and buy gold at \$40 or \$50 an ounce and thereby carry out the same thing as suggested here as a remedy, without any legislation. I haven't gone into it very deeply, but is that your idea of the law?

Mr. ECCLES. It is not mine. I have never had an idea that the Government would pay more than \$35. There was a time when it could have gone up to \$40, I think, but Congress repealed that right. I thought they were limited to the present price.

Senator TAFT. It was suggested to me that there was some other statute that does give the Treasury Department that right.

Senator MURDOCK. I think it is in the Thomas amendment to the Agricultural Powers Act.

Dr. GOLDENWEISER. There is a clause in the law which permits the Secretary of the Treasury to buy gold under any conditions he considers in the public interest. It is quite independent of the power to devalue the dollar. Devaluing the dollar or changing the gold content of the dollar, that has been limited, but the power to buy in the open market at any price is still the law.

Senator MURDOCK. Is that in the Thomas amendment?

Dr. GOLDENWEISER. It has been in the law ever since the Civil War, and it was reenacted in 1934.

Senator TAFT. That wouldn't change the gold value of the dollar.

Dr. GOLDENWEISER. No. It wouldn't change the gold content of the dollar.

Senator TAFT. And the Treasury would just have a lot of gold. Nor would it raise the value of the gold in the hands of the Federal Reserve bank or anybody else.

Mr. ECCLES. Or any foreigner. That is right.

Senator TAFT. So, in effect, he would have a lot of gold that he had paid more for than it was worth?

Mr. ECCLES. Yes; and he would have to come to Congress for an appropriation.

Senator TAFT. There is only one other provision that occurred to me. That is the Thomas \$3,000,000,000 greenback amendment. Is there any need for that if we increase this—drop this from 40 to 25?

Mr. ECCLES. I have never felt there has been any need for it at any time.

Senator TAFT. I remember in 1941 the Federal Reserve bank recommended the repeal of that provision.

Mr. ECCLES. You mean the creating of the Federal Reserve notes. We have demonstrated that you don't need the Thomas amendment. We create five billions every year. There is no limit to the amount of notes that the Federal Reserve can create except the limits that Congress can place on it. So why have the Thomas amendment creating one kind and the Federal Reserve creating another? It merely means under the Thomas amendment you could create \$3,000,000,000 of notes. Certainly there would be no Government securities or gold back of this. That would be the guaranty of the Government. Not that they would be worth any less than the Federal Reserve notes from that standpoint, but it would mean of course that the Treasury would be financing on a pure currency issue basis, and of course from that standpoint there are some people who argue that the whole \$300,000,000 could be financed in that way. There would not be the slightest inducement for the public to put any money in Government securities. They would have it all in currency. There certainly would be much more effort to spend it than if they had it in Government securities.

Senator MURDOCK. If I have followed your statement, Governor, on the fact we need nothing behind our currency other than the guaranty of the Government—if that is true, and your further statement made just now that you can see no difference so far as value is concerned in currency issued under the Thomas amendment and Federal Reserve notes, then what is the reason why the Government should not do that very thing and stop paying interest?

Mr. ECCLES. There is this very good reason, that if currency was issued in the \$300,000,000,000, as I say; the public would have nothing but currency. There would be no Government bonds and there would be an attempt to get rid of that currency and you would likely get a terrific inflation.

Senator MURDOCK. Well, we could control prices just like we do now.

Mr. ECCLES. You would have much more difficulty than you have today. The black markets, the pressure on markets, would be nothing to what it could be if you gave these people currency in lieu of their Government bonds. I am sure you will all agree with that, and in addition to that you would have this situation in your banking picture—currency would come back into the banks and you would find there were deposits on the one side and on the other side you would find that the banks had excess reserves piled up in the Federal Reserve System. That is what you would have. Now, the banks, with those huge excess reserves, would be under terrific pressure to be using those reserves. You would possibly drive down the interest rate almost to the vanishing point. You would have an effort to get people to borrow at one-tenth of 1 percent, at a time of inflation, and in a situation such as you have now. You would also have the banks in this position, where they had this huge volume of currency to handle, with the expense involved, without in any way being able to invest or offset the deposits, and you would therefore have a bankrupt banking system. I mean the banks could not possibly survive, because they would have this terrific volume of business, as they have today, on the one hand, and they would have no source of income.

Senator MURDOCK. Don't we come right back to the simple point that all bankers, including yourself, are very much opposed to the issuance of currency by the Treasury, because of the fact the interest is reduced to a minimum?

Mr. ECCLES. That is right.

Senator MURDOCK. And on every dollar of Federal Reserve notes that comes into circulation there is, regardless of how much, a certain interest rate that goes to your banking system?

Mr. ECCLES. No interest at all. When Federal Reserve notes go into circulation the banks lose, because the depositor chooses to take money out of the bank and put it in Federal Reserve notes. As far as the banks are concerned, they would very much prefer that the Federal Reserve notes were not issued and the money remain in the bank as a deposit. It is actually the reverse of what you say; that every Federal Reserve note that is issued means that the deposit leaves the bank, and it goes into Federal Reserve notes, so that the bank has to sell its interest-earning governments in order to be able to provide currency.

Senator MURDOCK. I don't mean actually taking the currency out of the bank, but the only way you can get Federal Reserve money into circulation at all is through the creation of debt. We have no money coming into circulation except through that route.

Mr. ECCLES. The only way you can get bank deposits is the creation of debt.

Senator MURDOCK. Yes.

Mr. ECCLES. And the way you get Federal Reserve notes into circulation is creating debt.

Senator MURDOCK. Somebody going into debt?

Mr. ECCLES. That is correct.

Senator MURDOCK. So that when it comes into circulation in the way of money, whether it is a Federal Reserve note or I write a check, it is created out of debt.

Mr. ECCLES. That is right.

Senator MURDOCK. And your banks are getting some interest on it.

Mr. ECCLES. That is right.

Senator MURDOCK. Now, if the Government, say, in the financing of the war, would make up its mind—well, here, the reason that this money is accepted is because of the guaranty of the Government, there is really no need for the Government to be paying this interest, we will just pay it off in currency—

Mr. ECCLES. It wouldn't make much difference. Then the banks would charge huge service charges for handling the currency. They would charge you every time you got a check cashed. They would charge whatever was necessary. So what would really happen is that the public would pay, if they had the benefit of a banking service, whatever it took.

Senator MURDOCK. That is what Congressman Patman is agitating, as I understand it, is that our Federal Reserve bank, or banks, for that matter, insofar as Government financing is concerned, that they be paid for the ministerial work that is done, or the clerical work that is done, instead of paying an interest rate. I don't say that I agree with him.

Mr. ECCLES. I have had this up with Mr. Patman off and on for a good many years, so I know all about that issue. Mr. Patman advocated that all Government financing should be done by issuance of currency at one time, and then he got afraid of the inflationary effect of it, and he changed his advocacy to a financing by issuing bonds to the public to absorb the excess purchasing power to the fullest extent possible. He was willing to pay the interest on the bonds that were sold to the public in order to absorb that excess purchasing power and prevent inflationary pressure, but then in addition, he wanted the Federal Reserve banks to furnish the Government the additional credit without interest, or with such interest as it took to pay their expenses, but prohibiting the private banks from buying any Government securities.

You will be interested to know that if the banking system had no Government securities at all, taking the banking system as a whole today, they would be in the red about \$250,000,000. Now, in that case, of course, the banks would not be in existence.

In the next case, if they did not make a return on the risk capital that goes into the banks, then—the financial system would have to be owned by the Government, and as Mr. Lenin, the founder of the communistic system, wisely said, the first move toward communism is for the government to take over completely the credit system. Then you have taken a big step in that direction.

So that I think you are much better off to have a private banking system—in fact, I think you must have a private banking system, subject to close government supervision and control, if you are to have a democracy. I think they are synonymous. I think if you get rid of your private banking system, then you get rid of the free enterprise system. Then you have complete regimentation and your democracy is out the window. So it is just a case of choosing here what kind of a system you want.

I think that your banking system, like your railroad system and other institutions that are fraught with great public interest, must be controlled and supervised, and they are. But certainly to undertake to eliminate them by exercising control that is going to make them so thoroughly unprofitable that they would go out of existence would force the Government into the field of taking over the entire credit function.

Senator MURDOCK. On this question, if it was done through currency, you say there would be much more danger of inflation, but with the present system any person that has a bond in his possession can after holding it, I think it is 60 days, walk into a bank and exchange it for currency to the full amount he has paid for it. That is right, isn't it?

Mr. ECCLES. That is right, as long as the market supports it.

Senator MURDOCK. I haven't seen any statistics on it, but I don't think there has been any great bolt to exchange bonds for currency, has there, under the present system?

Mr. ECCLES. The amount of financing, as I stated this morning, over the year, that is done by the banking system and the Federal Reserve banks and the private banks, is about 40 percent of the deficit. Out of a total amount of over \$100,000,000,000 spent in 1944, about twenty-two to twenty-three billions of that came from the Reserve System and from the private banking system. Now, you may recall this, if the private banking system makes too much money out of Government bonds they get into the 90 percent excess-profit tax bracket, so the Government recaptures the profit they get out of Government bonds if their earnings get excessive.

Senator BUTLER. You don't get renegotiated, do you?

Mr. ECCLES. Well, if we did, I suppose it would reduce the amount of profit, so it doesn't make much difference. It is a question of bookkeeping.

Senator MURDOCK. I don't think you got this last question of mine. There is no effort on the part of individuals, is there, to buy bonds and just as soon as they can, to convert them into currency?

Mr. ECCLES. No; the amount that the banking system bought during 1944 was approximately the same as they bought in 1943, and the amount that the public took each year was about the same, so that there is no—there are always a lot of people selling securities, just as there are a lot of people buying securities, but on balance the public are buying as many securities and holding them now as they ever did.

Senator MURDOCK. Well, that answers my question.

Dr. GOLDENWEISER. What the Senator wants to know is that the redemption of bonds has not increased very much.

Senator MURDOCK. Yes. Although they have a right to hold them 60 days and then have the right to go to the Treasury—I think they can go to the banks now—and exchange those bonds for the exact

amount that they paid for them, plus whatever the accrued interest is. If I understand you, there is no great tendency to do that. People are holding their bonds notwithstanding their exchangeability for currency.

Mr. ECCLES. The dollar amount is increasing because the total volume outstanding is increasing, but the percentage is not increasing. Naturally as the volume outstanding increases there would be some increase in redemptions.

Senator FULBRIGHT. One reason is that they bear interest. Of course, if they did not bear interest—

Mr. ECCLES. If they did not bear interest they would not take them in the first place. You see, that interest is cumulative. It is very low—in fact, there is no interest the first 60 days, and then that interest goes up in the last year or two, the rate is better than 4 percent.

Senator MURDOCK. I think you stated that the reason we have been able to finance the present war is because of the banking legislation passed in 1935.

Mr. ECCLES. And the policy of the open market committee.

Senator MURDOCK. Along, of course, with the very efficient administration by the Federal Reserve Board.

Mr. ECCLES. Well, there is credit certainly due the Treasury. The Treasury have arranged to finance the war at the rates in existence at the time we went into the war. That is, that we would not finance the war on increasing interest rates. There was an arrangement that we made with the Treasury and we agreed with the Treasury we would support their financing policy so they could be assured that they would not have difficulty selling their securities at the going pattern of rates.

Senator MURDOCK. You do attribute in part the successful financing of the war to the banking legislation that was passed by Congress?

Mr. ECCLES. That made it possible.

Senator MURDOCK. I get considerable comfort out of that.

Mr. ECCLES. It made it possible to do that, and without that it would not have been possible. I do not mean to say if the legislation had not been passed—I am perfectly sure by the time we got into the war similar legislation would have been passed. It was inevitable with the open market operations that had to be carried on. You had to have a central open market committee. It could not be left up to the discretion of 12 banks as to whether they would buy or sell, or what they would buy and sell, and the amount they would buy and sell.

The CHAIRMAN. Are there any other questions of the Governor? (There was no response.)

The CHAIRMAN. You have been very kind and patient, Governor.

Mr. ECCLES. Thank you. The committee has been very patient, listening to a lot of conversation on my part, I must say.

The CHAIRMAN. I don't think so. I thought it was very valuable to all of us.

Mr. ECCLES. I only hope now that they will report this bill out without the amendments, and will get it through before they get into a discussion of Bretton Woods and some of these other pieces of legislation that may be more controversial.

The CHAIRMAN. We will now have an executive session.

(Whereupon, at 4:15 p. m. the committee went into executive session.)

REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

WEDNESDAY, FEBRUARY 28, 1945

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met, pursuant to adjournment on February 20, 1945, at 10:30 a. m., in Room 301, Senate Office Building, Senator Robert F. Wagner (chairman) presiding.

Present: Senators Wagner (chairman), Barkley, Radcliffe, Murdock, McFarland, Fulbright, Tobey, Taft, Butler, Buck, Millikin, and Hickenlooper.

The CHAIRMAN. The committee will come to order. We are considering again S. 510.

Mr. Burgess, you are familiar with the bill and have asked to appear before the committee, and we would like to hear from you, giving us your attitude and that of your association.

Mr. BURGESS. Thank you, Senator Wagner.

The CHAIRMAN. You may proceed.

STATEMENT OF W. RANDOLPH BURGESS, PRESIDENT, AMERICAN BANKERS ASSOCIATION, NEW YORK, N. Y.

Mr. BURGESS. My name is W. Randolph Burgess. I am president of the American Bankers Association, and we are glad of the opportunity to say a few words about this bill. If you will bear with me I would like to read a very brief statement of three pages. I have copies here that I will be glad to furnish the committee.

The CHAIRMAN. Just pass them around to the members of the committee, if you please.

Mr. BURGESS. I will do so.

Senator TAFT. Mr. Burgess, you might state, if you would, your past experience in connection with the Government and the Federal Reserve banks.

Mr. BURGESS. For 18 years I was with the Federal Reserve Bank of New York City. The last 8 years of that period I was deputy governor and vice president—and they changed the title in 1936, you will remember—in charge of open market operations for the Federal Reserve System. In 1938 I went with the National City Bank of New York as vice chairman of the board. I have had some interruptions over the term, 2 months' service with the Treasury Department in the fall of 1939, when war broke out, and another interruption to serve as chairman of the War Finance Committee of New York State for the

third and fourth loans. So on this bill I have three allegiances, so to speak: the Reserve System, the Treasury, and banking.

The CHAIRMAN. You may now proceed with your statement.

Mr. BURGESS. There are two reasons for the restraints on Federal Reserve action which are contained in the legislation you are discussing; that is, restraint on the pledging of Government securities on Federal Reserve notes and the percentage of reserve required against deposits and not liabilities.

First, to place some limitations on the very great power which the Federal Reserve Act puts in the hands of a few people.

Second, to serve as red lights when a huge expansion or credit takes place, for such credit expansion is dangerous.

We are in the process of going through red lights. In addition to the bill before this committee, a bill raising the debt limit is before Congress, and that also means passing a red light. Inflation usually shows itself in rising interest rates, and we have suppressed by Government control, not the inflationary forces themselves but their danger signals.

The danger signals are being passed but the inflation is going forward. The money held by the people, both in currency and bank deposits, is piling up in unprecedented amounts. We now have the same forces at work, but in exaggerated degree, that gave us the inflation of 1919 and 1920 and the crash of 1921. It took years for the farmer to recover from that boom and crash that carried wheat prices up to \$3.50 and down to \$1; that doubled the price of farm land and then dropped it back again.

The same forces later caused the real estate and security inflation of 1927-29 and the later depression of the thirties. It took the war to pull business and labor out of that slump.

There are many signs that these inflationary forces are vigorously at work today. We see them in city and farm real estate and in all uncontrolled prices, in black markets and lower quality of goods. The amount and quality of food, clothing, shelter, and service that the citizens can buy for his dollar is steadily declining.

We bankers are working with the Treasury in selling Government bonds to the people. We have put on a lot of pressure and incurred, I believe, a moral obligation to those people to keep their dollars sound. After World War I the prices of Liberty bonds dropped 15 percent, but their buying power in goods dropped more than that. Today, the savings bond fortunately can't drop in price, but its buying power can fall and, in fact, is now falling.

This bill before the Senate removes certain automatic checks on credit expansion.

Senator TOBEY. And ergo, it follows from your first statement to the effect that we are going through red lights, that it is a necessity to go through red lights.

Mr. BURGESS. We have to; yes, sir. To do so is a wartime necessity, but it means we must be increasingly alert. We ought to review where we stand on the inflation problem and take what steps we can to put the brakes in working order.

We, therefore, make the following definite suggestions:

1. That the bill be amended so that at the same time that the use of Government securities for Federal Reserve notes is made permanent,

the 1933 emergency power to issue Federal Reserve bank notes and the power to issue greenbacks under the Thomas amendment of 1933 shall be repealed.

2. That the committee consider whether it may not be better at this time to lower reserve requirements to 30 rather than to 25 percent. Thirty percent is likely to take care of the needs for many months; and if it then proves inadequate, it will be because credit expansion has gone to a point where congressional review may be desirable.

3. That every proposal for Government post-war spending be scrutinized with great care. Government spending is the chief cause of inflation. We agree wholly with Chairman Eccles' statement that "Nothing would be more helpful to prevent inflation developing than to have a balanced Budget shortly after the war." I am quoting from the text of the statement I saw. It was not a corrected text, and whether it has been corrected or not, or changed, I do not know. No campaign among the people and no price controls will be adequate to curb inflation unless the Government itself sets an example and puts its own house in order.

4. That the committee request the Federal Reserve Board to make a comprehensive report to Congress on the dangers of inflation and proposed methods for its avoidance.

I might add, Senator Wagner, to apply this to the bill—we would propose as to the part of the bill relating to collateral for Federal Reserve notes—to make that permanent so they would not have to come before you every 2 years for action. It is the suggestion that at the same time you repeal these two emergency provisions, the provision for Federal Reserve bank notes—and that was a part of the Banking Act of March 1933—and the provision that \$3,000,000,000 of greenbacks—and that was a part of the Thomas amendment to the Agricultural Act of May 1933—should be taken care of; that they be repealed. With this provision for Federal Reserve notes, these two other emergency proposals are not necessary, and we think their removal would be an indication to the country that you gentlemen had in mind inflation dangers, and to do that would be a gesture or psychological help in any lack of confidence.

Senator MURDOCK. Mr. Chairman, could we ask the witness to elaborate a little more?

The CHAIRMAN. Certainly, Senator Murdock.

Senator MURDOCK. Mr. Burgess, would you elaborate a little more in your distinction between Federal Reserve notes, which you seem to think are the best method of currency expansion, and the issuance of Federal Reserve bank notes, and why there is any necessity for repeal of the power to issue the latter?

Mr. BURGESS. When the Federal Reserve System was established, as some of you will perhaps recall, it was provided or was drafted with the provision that national bank notes should be retired. That was regarded as an unwise method. There was a provision for Federal Reserve bank notes, and that was provided to be retired. Federal Reserve bank notes provided for in the emergency legislation of 1933, and which were practically never used, were provided because we thought there would be a huge demand for currency when the banks reopened. It did not prove to be the case, and only \$200,000,000 or \$300,000,000 were ever issued, at that time. It was more as a matter

of a symbol rather than of any particular value they had. A few were issued about a year ago simply because they had some on hand and wanted to use them up. Experience so far has demonstrated there was no need for that. All has been taken care of adequately, and it is a very much simpler thing to have one kind of currency, and it is a better currency because it is secured definitely with 100 percent collateral of Government securities and gold. It has the Reserve percentage back of it. It has had 40 percent back of it, and under the bill it would have 25 percent back of it.

Senator MURDOCK. And now may I ask this question: What is the backing for your Federal Reserve bank notes which you ask to have issuance discontinued?

Mr. BURGESS. It would be any assets Federal Reserve banks might have.

Senator MURDOCK. Instead of having 40 percent gold and 60 percent eligible paper, which is the backing behind your Federal Reserve notes which you favor, all that we have behind Federal Reserve bank notes is eligible paper.

Mr. BURGESS. Yes; any assets that the Federal Reserve banks might have were thrown in there. Senator Glass used to refer to them as chips and whetstones; that is, it means under section 13 (b) loans, by way of discount, the member bank could use anything it might possess against Federal Reserve bank notes.

Senator MURDOCK. Is it a fair inference from your statement, Mr. Burgess, that you do favor a metallic base behind our money?

Mr. BURGESS. I do, Senator Murdock.

Senator MURDOCK. Then why should we make the move that is now requested in this bill, reducing that from 40 percent to 25 percent, or to 30 percent, as you have suggested?

Mr. BURGESS. We have not enough leeway now.

Senator MURDOCK. Do you mean that there is not enough gold?

Mr. BURGESS. No; there is not enough gold to cover all the bank notes and all deposits they will have. The present amount of gold would cover the 40 percent and the 35 percent Mr. Eccles estimates up to the end of this year. But if you should have a sudden demand for gold from abroad; if foreign countries would want to earmark two or three billion dollars of gold—and they have earmarked in gold at the rate of a billion dollars a year—they can turn their dollars into gold through earmarking.

Senator MURDOCK. We have, then, reached the point where our gold base is insufficient at the 40 percent requirement to support the expansion necessary in order to successfully finance the war.

Mr. BURGESS. That is correct.

Senator MURDOCK. If that is true, why not let the old law of supply and demand come into the picture, and instead of decreasing the percentage of reserve in gold, as compared to eligible paper, raise the price of gold? That would accomplish the same end, would it not?

Mr. BURGESS. That would have some pretty serious other implications. As I read the hearings, Mr. Eccles made some rather strong statements about that. I would not make them quite as strong as he did, but would say that—

Senator MURDOCK. Might I interpose with this: In Mr. Eccles, according to his statement as I understood it, we have a man who does not believe in the necessity for a metallic reserve behind our currency. I think he referred to it in his testimony as being archaic and a little absurd in the light of present-day conditions to have that gold backing. Now we have you, a man with wide and varied banking experience, telling us that in your opinion we do need, for a sound monetary system, gold behind our money. Believing you are correct, it seems to me that instead of depreciating gold—and I think that its what you would do here if the gold reserve requirement is reduced, although we do not do it in figures, but it has that effect—why not, if we must have gold behind our currency, protect the value of gold, and in this instance give it the value it is entitled to under the conditions you have related.

Mr. BURGESS. I would see three reasons: First, you would be fooling yourself. You would be cutting up your gold pieces a little finer and saying, "We have plenty of them." Secondly, in the long run you increase the amount of gold dollars, and your expansion of credit will catch up with it. That means higher prices, and these bondholders are going to have to pay through the nose. The third point is, our gold price is the thing on which our monetary stability hangs. I think the Treasury has done a fine thing in holding the price of gold steady since January 1934, with the passage of the Gold Reserve Act. Maintaining the price of gold at \$35 an ounce has been the peg on which all the moneys of the world have hung.

Senator MURDOCK. The legal peg of \$35 was created by a law enacted by the Congress. Certainly that law is no more solemn than would be a law pegging it at \$47 or at \$50.

Mr. BURGESS. I would like to use a curious illustration of this, if I may.

Senator MURDOCK. I would like to hear it.

Mr. BURGESS. You say, I have had large banking experience, but the thing I come back to in the long run, and the thing I think was omitted from Mr. Eccles' testimony, if I might say so, is the human reaction involved.

If the chairman will permit me I would like to say that when the Social Security Act was passed, providing for pensions and for unemployment insurance, millions of people throughout the United States were relieved from worry, were relieved from concern about their future, which is to explain that it had great human value.

Now, I want to suggest a very radical thing, and that is that gold, a firm price for gold, has a social security value, because it relieves people of worry, is a guaranty of the integrity of their money. It means that the bondholder knows his money at least has something back of it that is going to hold the price so it won't become worthless. I am a hard-money person.

Senator MURDOCK. I know you are, but I can hardly square your argument with your recommendation. It seems to me if it is so important that we have a gold reserve behind currency, the purchaser of the bond and the holder of the dollar and the holder of dollar securities should know that he has something behind his money, and if we go out and tell him that we have allowed the banks in this instance to

take away gold that is behind his bonds and dollars and securities, by reducing it from 40 percent to 25 percent, and substitute Government securities to the amount of 75 percent instead of 60 percent, all interest bearing, that that is going to have a demoralizing psychological effect on the holders of Federal Reserve notes. I wonder whether it is better to do that, or better to say to the man who believes in hard money: Our quantity of gold is not sufficient to support the credit expansion necessary in financing the war—so we are going to do the reasonable thing and the logical thing, and that is, to give gold the value it is entitled to under present conditions?

Mr. BURGESS. It seems to me there is only one flaw in your argument.

Senator MURDOCK. I am glad to hear you say there is just one flaw.

Mr. BURGESS. Well, I agree with a lot of it, and that is the protection that gold offers the human being, for the value of his money and the value of his savings depend on maintaining the value of the dollar at a fixed price of gold. The minute you wiggle it, he loses that confidence.

Senator MURDOCK. It did not have that effect under the power of the President.

Mr. BURGESS. I think it did. People come to my bank every day, from all over the world, and ask, "Is the dollar good?" The minute you start to change it, you have a greater lack of confidence.

Senator TAFT. Is there any question in their minds that the dollar is good?

Mr. BURGESS. Yes; I think there is.

Senator TAFT. You answered the Senator from Utah that Federal Reserve notes have gold behind them: And if you issue Federal Reserve bank notes, all that you have behind them are the assets of the Federal Reserve bank. In the last analysis all assets of the United States are behind this money.

Mr. BURGESS. Yes.

Senator TAFT. It is one of the assets of the Nation.

Mr. BURGESS. Yes.

Senator TAFT. And there are other important assets.

Mr. BURGESS. Yes.

Senator RADCLIFFE. When the power of the President to decrease the content of the gold dollar was eliminated, do you think there was any appreciable beneficial result?

Mr. BURGESS. I think there was. It is a long-run matter and we cannot judge it from the short run. But in the long run I think it is very beneficial. But I think there were those that were not quite sure we were going to stay hitched on that.

Senator RADCLIFFE. How did that show itself, if you can describe it?

Mr. BURGESS. You know, we do business all over the world. We had letters from quite a number of South American countries making inquiry about the dollar; they were afraid we were going to devalue the dollar. When that power was removed it helped us in answering inquiries.

Senator RADCLIFFE. Obviously you would see grave disadvantage in restoring that right to decrease the content.

Mr. BURGESS. Yes.

Senator BUCK. Senator Taft has suggested that 30 percent might be better than 25 percent. That would carry us through this period of the war and beyond safely, in your opinion, will it not?

Mr. BURGESS. Nobody can answer that. As you will notice in my opening statement, I have not been dogmatic as between 25 percent and 30 percent. I understand from Governor Eccles, in conversations with him, that the Federal Reserve System is pretty well agreed on 25 percent. On the other hand, as I look at the figures, the 30 percent would carry us a long way. I think I have the figures here, if you would be interested in seeing them.

The CHAIRMAN. We are interested.

Mr. BURGESS. A 25-percent reduction would leave you with \$9,000,000,000 of excess reserves in the Federal Reserve System. That means that much gold that was not needed beyond what was needed on 25-percent reserve against deposits and notes. The amount of expansion that might be based on that is \$36,000,000,000, expansion of currency and deposits of the Federal Reserve System. The present amount of notes and deposits is \$38,000,000,000, and a drop to 25 percent would leave you in position to double your whole structure, assuming you did not lose any gold. If you lost a billion dollars of gold, you could increase it \$33,000,000,000, compared to the present \$38,000,000,000. If you lose \$2,000,000,000 of gold, you could increase it to \$30,000,000,000. That is the position if you go to 25 percent. If you go to 30 percent you would have excess reserves of \$7,000,000,000. On that an expansion could be based of \$23,700,000,000, as compared with the present \$38,000,000,000.

Senator TAFT. A difference of \$2,000,000,000.

Mr. BURGESS. No. It would be 23 as compared with 36, Senator Taft. So it is about two-thirds as much expansion. If you lose a billion dollars of gold it would leave you with \$21,000,000,000 expansion. If you lose \$2,000,000,000 of gold it would be \$19,000,000,000 of expansion. It all depends on when the war ends. At the present rate of expansion that would carry you for perhaps 2 years. To my mind it is just a question of whether, with this terrific expansion of credit going on, you do not think you would like the Reserve System to come back to you for added authority before they reach that point. That is the whole question.

Senator MURDOCK. If you reduce it to 25 percent and we do not lose gold, then it amounts to nothing at all, does it not? We have the gold reserve there regardless of whether it is required.

Mr. BURGESS. I think the arguments are two: One is the question of whether it is desirable to have the Federal Reserve System come to you from time to time to review what they are doing in the face of the huge credit expansion, so that you may take a look at the picture. And the other question is the old psychological one of human reaction, as to whether this drop to 30 percent is a little less of a shock to people than a drop to 25 percent.

Senator TAFT. Right there I would like to ask you this question: If you create \$9,000,000,000 of excess reserves is it not a very strong incentive on the part of banks to buy more Government bonds, which will have the same effect, whereas you ought to be selling Government bonds to individual savers?

Mr. BURGESS. These are excess reserves of the System, not of the member banks. It would not get out into the banks until the Federal Reserve System bought Government bonds and paid it out. So there is no inflationary effect. It is still in the hands of the Federal Reserve System.

Senator TOBEY. Following up that statement, it is a fact that you recognize personally and officially that banks have to buy a lot more Government bonds.

Mr. BURGESS. Yes.

Senator TOBEY. And there is the probability that we will have to raise as much money after the war as before the war.

Mr. BURGESS. I hope not.

Senator TOBEY. I will make that prophecy. And in that condition the banks will have to take bonds.

Mr. BURGESS. Yes.

Senator TOBEY. And they will have to have the machinery to do it.

Mr. BURGESS. Yes.

Senator TAFT. Today we must reduce these reserves because as a practical matter we recognize while the war is going on it is going to cost \$50,000,000,000 of deficit a year, and we do not see any other practical method of meeting the situation. When the German war is over I think if the reserves were 30 percent you might have an alternative. The Government would be up against the question then of reducing the reserves from 30 to 25 percent or balancing the Budget at a time when balancing the Budget might be possible. It seems to me that is the best argument for the 30 percent, and that it will encourage the Government to stop a little sooner its deficit-financing policy than otherwise.

I agree with Senator Tobey. I do not think you are going to balance the Budget for 3 years after the end of the Japanese war. That is what the reports of the Joint Tax Committee seem to show. Still, that is a relative amount; I mean, it can be much less of a deficit than it might be under some other circumstances. I have the feeling that if it is put at 30 percent and we have to reduce it further, we will give more serious consideration to balancing the Budget.

Senator McFARLAND. As I understood Mr. Eccles' reason, he said no gold reserve was necessary there because it had the guarantee of the Government behind it.

Mr. BURGESS. Yes.

Senator McFARLAND. If that is true, why could not the Government just as well issue the money itself?

Mr. BURGESS. In theory you could. But history down through many generations is to the effect that people do not always trust their governments 100 percent, and they like to have safeguards.

Senator McFARLAND. If that is the trouble, let us look at the picture in this way : If you eliminate all of this gold reserve and all the Federal Reserve System has behind it is the bonded indebtedness of the Government of the United States, why haven't you reached the same proposition?

Mr. BURGESS. Well, you are moving in that direction.

Senator McFARLAND. If you accept Mr. Eccles' theory that all you have to do is to have the guaranty of the Government.

Mr. BURGESS. Yes.

Senator McFARLAND. If all that you have is the bonded indebtedness of the Government and you do not have any gold reserve, you have the same proposition as the Government issuing this money itself. If there is to be any advantage in Federal Reserve notes you have to have a metallic reserve, do you not?

Mr. BURGESS. I think it is of very great value, speaking for myself.

Senator McFARLAND. Along the line of Senator Murdock's theory, why wouldn't it be advantageous to encourage the production of more gold to keep up that reserve?

Mr. BURGESS. I knew that was coming. [Laughter.]

Senator TOBEY. You have really uncovered apparently what is in the air here this morning. You follow that with a metallic base, yellow or white, as the individual may desire.

Mr. BURGESS. Well, for that a lot of people will be much obliged.

Senator MILLIKIN. Do you not think it is about time that we took as realistic a view as possible of what our Budget may look like by having a rather fully developed exposé of the plans of the administration for spending money? The Bretton Woods Conference proposals involve a lot of money. I read that we are going to have to advance a lot of money to South America. We have bills pending in Congress which, if approved, would run into the billions of dollars. Would it not be a good idea in connection with this bill, and in connection with the things we are discussing, that we have all estimated expenditures assembled and take a look at them and see at just what point we can balance the Budget.

Mr. BURGESS. I would agree with that completely. I think the country is very anxious about the post-war Budget. I think it adds to inflationary fears. It means a great many people are trying to protect themselves by buying real estate, buying farms, or buying things, especially people who have come to us from abroad and who have been through inflation over there. They say we are getting set for the same kind of thing that happened in Europe.

Senator MILLIKIN. Aren't we apt to get ourselves into a position where it will be very difficult to work ourselves out? For instance, we have one bill for a billion dollars, and another bill for a billion and a half dollars, and so on, and we do not keep track of what the ultimate picture is. When we get the ultimate picture it may be one that is very discouraging indeed and one which is difficult of remedy. Isn't there some danger of that?

Mr. BURGESS. Virgil had a phrase describing that, in which he said, "Descent into hell is very easy, but to get out again is some job."

Senator TOBEY. He did not speak from experience, did he?

Mr. BURGESS. I think he did.

Senator MILLIKIN. Are there any profits or any loose funds around in our system which could be thrown into this picture now and make the proposed reduction of reserves unnecessary, or that would put us in a position where we could make a more minor reduction?

Mr. BURGESS. I heard the rumor that someone was going to suggest turning the stabilization fund back into the system, which would provide \$2,000,000,000. But that would not last very long.

Senator TOBEY. Are you referring to the stabilization fund in connection with the international monetary conference?

Mr. BURGESS. No. The rumor was to turn that stabilization fund back.

Senator MILLIKIN. If that fund were thrown into this picture, what effect would it have?

Mr. BURGESS. It would put off the evil day for a few months, but would not go very far.

Senator TAFT. I asked the question as to whether the argument that occurred to me was based on a sound basis, as to the advantage of having a 30-percent as against a 25-percent reserve as a warning when the war is over, as an alternative. Did you agree with that statement? You did not answer the question, and I wanted to have your comment on it, or your answer on the 30 percent as against 25 percent.

Mr. BURGESS. I think you ought to have at least 30 percent. I think you ought to give the Federal Reserve System a good leeway to operate in. My personal choice would be 30 percent, because I think that gives you an adequate margin. But I am not prepared to push that point. I think we do want—

Senator TAFT. I want to know whether my argument is valid or not; that is, as to a possible effect on the Government's deficit financing policy after the war.

Mr. BURGESS. My feeling is that perhaps that carries it a little far. It would at least give you a chance to review the situation here before this committee. I do not think you would get to the point where Government financing is actually impeded, and I do not believe you would want to get to that point in this way. I wonder if you do not have to tackle that head-on?

Senator TAFT. My only point is to bring it up. It accentuates that we might have to reduce the reserve again. I want to know if that is true.

Mr. BURGESS. It means that when you do reach a certain stage of expansion the Federal Reserve System would have to go to the Treasury and would have to come up here and explore various ways of meeting the situation. And that would bring up the Budget question.

Senator MURDOCK. Mr. Burgess, can you not visualize that those people who do not believe as you and I do, in a gold backing for our currency, are gradually, step by step, pulling us into a position of not having any metallic reserve at all behind our money? When they reduce it to 25 percent, then there will be some reason advanced by them to reduce it 5 percent more, and eventually they will convince the country that we do not need anything behind it. If we reverse the situation and take the stand that we must have gold behind our currency in order to keep it stable—not only throughout this country but throughout the world—and that the proper method of doing that, instead of letting them push us out of it entirely, is to say that we need more gold than we have now. The way to get it and to maintain the ratio that has been so successful ever since the Federal Reserve System came into being is to advance the value of the gold. That is what I am afraid of, that if we join them now in this march away from gold backing, that it is going to be very difficult to turn around if we find it necessary in the future to do that. Whereas right now, if we take the position we must have 40-percent gold even if the price of gold has to be raised, it is the proper step.

Mr. BURGESS. I agree with 62 percent of that. But I do not agree with changing the price of gold.

Senator MURDOCK. The other day when he was here before us I asked Governor Eccles this question, If the fact that the dollar is the

most desirable and the best money in the world today isn't largely traceable to the gold backing behind it? His answer was, as I recall it, that it had nothing to do with it. What is your position on that?

Mr. BURGESS. I think it is both things; both the gold behind it and the fact that we are the biggest and the best.

Senator MURDOCK. I think that is a correct answer.

Mr. BURGESS. There is our marvelous productive capacity and our democracy.

Senator McFARLAND. Do you agree that if we reach the point that we do away with all metallic reserve at all, the Government might still issue its own money?

Mr. BURGESS. Yes. I think that a part of the whole question is a drift toward totalitarian government throughout the world. One of the questions in connection with that is money management and exchange control; and if you can control that, you can control the lives of the people.

Senator TOBEY. In connection with Senator Murdock's inquiry about raising the price of gold, there comes to my mind three different points of view about the law. We have Frank Hague's eloquent remark, "I am the law." Then we have Chief Justice Hughes saying, "The Constitution is what the Court says it is." Now, we have this Government, represented by the Senate of the United States as one branch of the law-making power, passing a law, and we will assume increases the price of gold along the lines suggested. It then becomes the price of gold. Congress has stated it. It is a reality. What Mr. Burgess said, and I can see his point of view, is that you give out another piece of paper for the one you had before. The one that we had we put \$35 an ounce on it—

Mr. BURGESS. Let us stay where we are.

Senator TOBEY. I am using this as an illustration. If we raise it to \$52, as suggested, that then becomes the actual legal price of gold because the Government says it is. *Ipse dixit, ergo, that is where we are.*

Senator MURDOCK. Is there any way of fixing the monetary price of gold except by statute? If you do not do it by statute and let it revert to its intrinsic value, it might not be worth more than \$5 an ounce today.

Senator TOBEY. The Government is supreme, and when the Government says such-and-such is to be the price, that is the price of gold.

Senator MURDOCK. There is no question about that. If we can maintain, and we have maintained, the stability of \$35-an-ounce gold, then certainly we can do exactly the same thing, as I see the picture, with the great expansion we have had, if we say that gold is worth \$48.12 an ounce, and that is the percentage I have worked out here. If you make the same increase in the price of gold that is proposed for reduction of reserves, you would get a price of \$48 an ounce, unless I have miscalculated.

Senator MILLIKIN. Mr. Burgess, would you say this is correct: In countries which are experienced in monetary changes, where in normal times shopkeepers close their shops and overnight take a new inventory reflecting the change in the value of money; in that kind of a country you have an immediate reflection of the effect of raising or lowering the value of gold. In that sense you can get an immediate remedy if

you view that sort of change as a remedy. But in a country like ours, or in any country that comes into all sorts of economic control, you temporarily can obscure that, can you not, and that is apt to mislead the people into believing that the change is not taking place?

Mr. BURGESS. That is true. I think that is quite right.

Senator TAFT. Mr. Burgess, can you develop that thought? The thing I am interested in in connection with your statement about inflation, there being underlying inflation that has not exhibited itself; for instance, in 1929, as I remember it, prices of commodities did not go up. The people seem to think of inflation in terms only of an immediate rise in commodity prices, which is more or less prevented now. But in 1929 apparently there was a tremendous inflation without any increase in prices; could you comment on that situation?

Mr. BURGESS. That is the trouble. Anybody who studies the business cycle over a long period—and that is an almost outmoded term, "the business cycle."

Senator TAFT. I hope so.

Mr. BURGESS. It is an outmoded term but not an outmoded event. The thing that impresses one is that each one is so different from the other. Every inflation takes a different form. The 1927-29 inflation took an entirely different form from the 1919-21 inflation. That fooled us. For instance, there was a book written in 1928 indicating that we had now found the answer.

Senator TAFT. The New Era?

Mr. BURGESS. Yes; we had employment, and had apparently perpetual employment, and so we did not recognize the evils that were in the offing. All the time we had the stock market inflation, and we had real-estate inflation, and so on. If you raise the question of the market, how many people do you know who built or bought houses larger and more expensive than they could afford in the light of 1928?

Senator RADCLIFFE. That book was not written by a political writer of the dominant party, was it?

Mr. BURGESS. No.

The CHAIRMAN. That was in 1928?

Mr. BURGESS. Yes; it was a committee appointed by the President. I believe it was the committee on economic changes. It was a bipartisan group of distinguished economists.

Senator FULBRIGHT. Was that committee appointed by the same President that we have now?

Mr. BURGESS. It's hard to remember back that far, Senator Fulbright. The committee was appointed by President Hoover.

Senator TOBEY. Would you deduce from that statement that the views of economists are to be largely discounted?

Mr. BURGESS. With only a superficial survey they should be discounted. One has to take into consideration the underlying elements.

Senator TAFT. Any condition that creates activity or employment, such as the construction industry or foreign loans, which cannot be permanently maintained, is on a false basis. It builds up some activity that has to be suddenly discontinued, and that is inflation. And that may be reflected in different ways.

Mr. BURGESS. You can summarize them all by saying: Too much money—too much spending. That has preceded every depression I know of in the United States.

Senator TOBEY. And too much credit.

Mr. BURGESS. Yes.

Senator TAFT. That is what creates money and spending.

Mr. BURGESS. Yes; I know of no exception to that.

Senator MURDOCK. What is the remedy?

Mr. BURGESS. The remedy for depression is not to have a boom and to check it before it has gone too far.

Senator MURDOCK. I know of no way to get out of a depression except that way.

Mr. BURGESS. No, sir.

Senator MURDOCK. Do Federal Reserve banks themselves buy any Government bonds?

Mr. BURGESS. Yes; they do it.

Senator MURDOCK. Your previous statement indicated to me that member banks are the banks that buy bonds, not the Federal Reserve banks themselves.

Mr. BURGESS. We are all doing it.

Senator MURDOCK. When you say the banks are buying bonds, what banks do you mean?

Mr. BURGESS. Do you mean commercial banks?

Senator MURDOCK. Yes.

Mr. BURGESS. Yes. We get them in two ways; by subscription direct or by buying them in the market.

Senator MURDOCK. If I buy Government bonds I find after I have done that that I have parted with \$100 and I have the bond in its place. But that is not true of banks in their transactions with our Government.

Mr. BURGESS. Yes. We have the paper. We have them packed away in our vaults or leave them over at the Federal Reserve bank sometimes. It is not just a bookkeeping entry.

Senator MURDOCK. As I understand the procedure, you are not required to have any reserve at all against demand deposits on the part of the Government which are created exclusively by a bond transaction.

Mr. BURGESS. We pay for the bond. For instance, we put on our books \$1,000,000 for that amount of bonds.

Senator MURDOCK. If I come in and make a deposit in a bank—and in the case of a country bank I think the reserve requirement today is 14 percent.

Mr. BURGESS. Yes, sir.

Senator MURDOCK. You must have at least 14 percent in reserves against my demand deposit.

Mr. BURGESS. Yes.

Senator MURDOCK. But under the law that Congress passed—when was that?

Mr. BURGESS. About 3 years ago.

Senator MURDOCK. We said to the banks, you can buy bonds from the Government by the establishment of demand deposits without having one thin dime in reserves.

Mr. BURGESS. That is right.

Senator MURDOCK. When we say under that system that banks buy bonds, it seems to me to be very inaccurate. They establish demand deposits without putting a dollar in reserve. Then, of course, as the Government issues checks against such a deposit, in payment to con-

tractors or to anyone else, and those checks are returned in the way of new demand deposits by individuals or corporations, then of course you must establish a reserve behind them.

Mr. BURGESS. That is right.

Senator MURDOCK. But in the first instance in the creation of the demand by the bank for the Government there is no reserve requirement at all.

Mr. BURGESS. That was done at the instigation of the Treasury to encourage banks to buy bonds in the way they had to be bought in the early days. Whether that was wise or not, in view of the circumstances that developed later, I do not know.

Senator MURDOCK. The only reason I bring it up is that we hear so frequently—I do not say from all bankers, but from the more vociferous a great furor concerning the tremendous thing they are doing in financing this war. As an individual I would like to do a little of that sort of financing myself.

Mr. BURGESS. I do not think banks can take credit so much for buying bonds as for selling them. We have tried to sell them in every way we could to our customers.

Senator TAFT. On the general subject of these bonds being used as security: Under the present system Federal Reserve banks really have no assets except gold and Government bonds, have they?

Mr. BURGESS. Well, almost none. They have \$300,000,000 or \$400,000,000 in discount. That is, on loans to member banks. Those also are secured by Governments. They have, and I have forgotten the exact figure, but \$20,000,000 or \$30,000,000 of advances to business concerns that they made under section 13 (b) of the Federal Reserve Act.

Senator TAFT. If this bill were enacted into law, then all Federal Reserve notes would have back of them 25 percent in gold and 75 percent in Government bonds.

Mr. BURGESS. Yes, sir.

Senator TAFT. Securing the obligations of member banks; is that correct? Or can they put up their own bonds?

Mr. BURGESS. They can put up their own bonds. That is what this enables them to do. They could put up member banks' notes secured by bonds under the amendment passed in 1918. Members banks' 15-day notes secured by Governments. This enables Reserve banks to put up their own bonds purchased in the market.

Senator TAFT. Then it is fairly clear that the 25 percent of gold is gold, but the 75 percent is really no more than some Government obligation behind the Federal Reserve note. It practically removes any additional security behind Federal Reserve notes over and above gold.

Mr. BURGESS. Well, yes; pretty nearly.

Senator TAFT. It is in the form of an obligation.

Mr. BURGESS. It is a Government obligation, but it is in the form of a bond. It is mechanical, if you will, but it makes a little difference in the feel about it.

Senator TAFT. You see no way in the future to escape the necessity for that method of backing notes?

Mr. BURGESS. No. Of course, if one were going to make a prediction I think I would predict an increase in gold holdings after the

war, because there is a lot of gold stacked up in South Africa and in Russia that will come here, so they may get dollars to buy things with. And gold producers will begin to produce. The total gold production before the war was running close to a billion and a half dollars a year.

Senator TAFT. And we took it all because of the price of \$35 an ounce.

Mr. BURGESS. We will take a good deal of it. But being a hard-money believer, I want to say I think other countries will tuck away gold as fast as they are able to do so.

Senator BUCK. I do not quite understand that. If a member bank has \$50,000,000 of deposits it can set up its reserve itself to have cash.

Mr. BURGESS. Yes.

Senator BUCK. Was that your question?

Senator TAFT. They have to put up as collateral under this bill 25 percent gold and 75 percent of Government bonds, which we are now proposing to make a permanent provision of law. I was leading up to this: You see no reason to make that temporary any longer?

Mr. BURGESS. I think that might as well be made permanent. The fact is that the Federal Reserve System has had to come to you every 2 years since February 1932 to get that power renewed.

Senator TAFT. And it is no longer an abnormal condition.

Mr. BURGESS. I helped to draw that. You will remember that that was in the early stages, when Senator Glass was working on what became the Banking Act of 1933. This was lifted out of that act of February 1932 to meet the emergency, to enable the Federal Reserve System to go in and buy Government securities to ease the money market.

Senator TAFT. And it is a permanent position now.

Mr. BURGESS. It is a permanent position. The Federal Reserve System is shy some \$10,000,000,000 to have gold to put back of notes. It will take a long time to cover the notes.

Senator TAFT. It has no other assets, in the nature of commercial paper, for instance?

Mr. BURGESS. No.

Senator TAFT. You spoke of your experience: What was the origin of the open-market policy? When did that start?

Mr. BURGESS. As a system, do you mean?

Senator TAFT. Yes.

Mr. BURGESS. In 1922. In the early days of the System, each bank operated on its own in the open market. They found pretty promptly they were interfering with each other and doing foolish things.

Senator MURDOCK. You are now referring to the 12 Federal Reserve banks

Mr. BURGESS. Yes.

Senator TAFT. Will you go ahead with your answer?

Mr. BURGESS. In 1923 the Federal Reserve Board recognized that situation and drew up rules under which they would operate. So that since 1923 the System has operated as a unit with respect to the market. There have been changes in the details of the procedure. In the Banking Act of 1935 it was made more specific, and the control of the open-market committee was made precise. But the System has operated as a unit since 1923.

Senator MURDOCK. But operations were almost negligible until 1933.

Mr. BURGESS. Well, sir, looking back we thought that we were conducting large operations. The fact is the money market was on a fairly narrow trigger. You may recall that in 1924 we went out and bought \$500,000,000 of Government securities and money dropped 1 percent. In 1926 we sold some. In 1927 we went out and bought \$200,000,000 of Government securities and the money rate dropped 1 percent. So we thought they were meeting this situation.

Senator MURDOCK. Mr. Burgess, I want to ask you this question: If we pass this bill as proposed, does it not simply amount to this, that we reduce the gold requirement by about 37.5 percent, and allow the banks to reach over in their portfolios and replace it with interest-bearing obligations?

Mr. BURGESS. Reserve banks you are now talking about?

Senator MURDOCK. Yes. That is what happens?

Mr. BURGESS. Yes, sir.

Senator MURDOCK. So that the income of the 12 Federal Reserve banks will be materially increased by the passage of this bill?

Mr. BURGESS. No, sir. They already have these bonds. So they do not have to buy any more. So their income is not changed.

Senator MURDOCK. I realize that you hold bonds and that you draw some interest, but it places you in position to and you will materially increase your excess reserves, by several billions of dollars. The banks are not going to sit idly by and not use that.

Mr. BURGESS. You are talking about Federal Reserve banks?

Senator MURDOCK. About the entire Federal Reserve System including commercial banks.

Mr. BURGESS. Federal Reserve banks are not operated for profit. They are operated for the public welfare and their purchase of securities bears no relation to their excess reserves. This puts them in position so they may buy more Government bonds if there is occasion to do so in their operations in supporting the financing operations of the Treasury. But I can guarantee that in case of the Federal Reserve they will not buy a nickel more because of the passage of this bill. They will buy what is necessary for public operations at the time.

Senator MURDOCK. In your opinion the income of the 12 Federal Reserve banks will not be materially increased as a result of the passage of this bill?

Mr. BURGESS. No. The Federal Reserve banks are undercapitalized, and any profits would go into their capital and surplus. One hundred and thirty million dollars of their surplus was taken away for the Federal Deposit Insurance Corporation. I think they ought to have a chance to build up their surplus. But this will not do it.

Senator MURDOCK. There is no participation in Federal Reserve banks by the Government except in distribution in case of insolvency.

Mr. BURGESS. The law was changed some time back. I do not think it matters a great deal. Any extra earnings they have will help in their capital and surplus, and in my opinion they need improving.

Senator MURDOCK. The only way that could go to the Government is by insolvency of one of the banks.

Mr. BURGESS. Yes.

Senator TAFT. As a matter of fact, however, the continuation of Government policy of maintaining \$50,000,000,000 of deficit will increase the amount of bonds Federal Reserve banks will have to buy.

Mr. BURGESS. Yes.

Senator TAFT. And they have been increasing their holdings of Government bonds.

Mr. BURGESS. Yes, sir.

Senator TAFT. So that to the extent they have to buy—we will say \$5,000,000,000 more of Government bonds during the next year in order to support the general sale of \$50,000,000,000 to \$60,000,000,000 of bonds, they will increase their earnings to some extent.

Mr. BURGESS. That is right. But not as a result of this bill.

Senator MURDOCK. If you reduce the percentage of gold required as reserve it makes it possible for you to increase the number of bonds, the dollar value of them in use as a substitute reserve.

Mr. BURGESS. That is right.

Senator MURDOCK. As that is increased, then certainly the earnings of Federal Reserve banks will increase.

Mr. BURGESS. It will increase. You make it possible for them to go further.

Senator MURDOCK. You get no interest at all on the gold reserve behind either your deposits or the currency.

Mr. BURGESS. No. These Federal Reserve banks are funny things.

Senator MURDOCK. I think all banks are funny things, at least most bankers wear a big smile under present conditions and I don't blame them.

Mr. BURGESS. They do not operate for profit. In the early days that used to be a problem, and it was because the directors of those banks were used to sitting as their own board of directors, and they were pushing the buying of bonds. They operate as instruments dedicated to the public welfare. And they do a good job.

Senator MURDOCK. But I come back to this: We admit that if the 12 Federal Reserve banks increase their bond holdings they increase their interest-earning securities.

Mr. BURGESS. Yes.

Senator MURDOCK. And, of course, their income increases.

Mr. BURGESS. Yes.

Senator MURDOCK. If we keep the gold reserve requirement at 40 percent and raise the price of gold you still make it possible for the Federal Reserve banks to acquire just as many bonds as they could under the system sponsored by this bill, but the Government, which is the people or should be, under our system, get the difference between \$35 an ounce and whatever price we might increase it to on every ounce of gold in the Treasury.

Mr. BURGESS. Yes; that is true up to this point, that—

Senator MURDOCK. So in the one instance the banks increase their earnings by increased volume of interest paid by the people under the proposed bill.

Mr. BURGESS. Yes.

Senator MURDOCK. Whereas the people would make a profit under a rise in the price of gold.

Mr. BURGESS. A lot of foreigners would make a profit too.

Senator MURDOCK. Oh, yes; but I would rather let them share a little profit with us than keep doling it out to them as we now are.

Mr. BURGESS. Might I add one word right here?

Senator MURDOCK. Certainly.

Mr. BURGESS. That I would hope point 4 made in my statement would not be overlooked. I regard that as the most important suggestion we have made here today. The country, in my judgment, is moving very seriously in the direction of inflation. I think we have to think of ways in which we can hold inflation in check and keep the value of the dollar sound.

The CHAIRMAN. Have you any specific suggestion to make along that line?

Mr. BURGESS. It is point 4 in my statement, that this committee would ask the Federal Reserve Board or System, or the open Market Committee, to make a comprehensive report on the whole inflation situation. The Board is your agency. It is the one independent Government agency, or semi-independent, that understands this field, and might be in position to make you a very valuable report on the subject.

Senator BUTLER. Let me ask you this question on that point: When Mr. Eccles was here he spoke of the effect of the passage of the G. I. bill on that problem. Would your suggestion include a report on that?

Mr. BURGESS. I would include that in the request. I would include the various things that Mr. Eccles reviewed.

Senator TAFT. My impression is that Mr. Eccles was not at all unwilling to have that request made.

Mr. BURGESS. From conversations with him I have gathered that they could do it. I know that they have the facilities to do it, certainly as well as any agency there is. I think such a report would be very useful to you.

Senator TAFT. Mr. Chairman, I do not want to delay the committee but do wish to say that I have a letter from T. Jefferson Coolidge, who was Assistant Secretary of the Treasury in the first Roosevelt year, and he says this—I will read the letter and would like to have Mr. Burgess comment on it:

While there are various factors contributing to the probable depreciation of our money, one of the greatest is the very low interest rate caused by the bill-purchasing rate of three-eighths of 1 percent by the central banks. If there is anything generally recognized in the conduct of central banks, it is that their rediscount and buying rates should be raised when their liabilities and assets are constantly expanding, yet our reserve authorities continue their easy-money policy despite all past experience.

I will not argue at the moment whether or not the reserve should be decreased by law, but what I am suggesting is that the bill be so drawn that minimum rediscount and buying rates are set as the ratio decreases. For example, with a ratio of 60 percent the minimum might be 1 percent; at 50 percent, 2 percent; at 40 percent, 3 percent. The argument against raising the present rates is that Government bond prices would be depressed. This may well be so, but it is surely better to have sound money rather than unusually high bond prices and deteriorating money.

Mr. Burgess, do you care to comment on that suggestion about variable rediscount and buying rates?

Mr. BURGESS. I sympathize with Jeff Coolidge's concern about the situation, but I do not believe you can tie the hands of the Federal Reserve System, and of the Treasury, in dealing with the very difficult money-market problem. The three-eighths of 1 percent rate is not material as far as the market goes. That is, it does not affect the situation. The most of the bills are held by the Federal Reserve, and that does no particular damage. We all agreed that at the beginning of this war, the American Bankers Association took this position, that

this war should not be financed on a rising level of interest rates. That makes more complications in the market, and makes it more difficult to sell bonds. And that has worked out with the cooperation of everybody. I think you have to leave that within the realm of management.

Senator McFARLAND. If the reserve were reduced to 30 percent, how long did you say it would last?

Mr. BURGESS. No man can tell, but it would run a fair chance of going through without change.

Senator McFARLAND. And what about reducing it 5 percent?

Mr. BURGESS. There is always an emergency possible, such as large earmarking of gold, or a large demand by people to get currency for their bonds. I would give them a good deal of leeway.

Senator McFARLAND. They do not need it now?

Mr. BURGESS. Not right now.

Senator McFARLAND. And won't need it for 6 months?

Mr. BURGESS. No; probably not for 6 months. They do need this part of the bill, security for Federal Reserve notes. They need to have that by June 30. It is important to get that out of the way.

Senator TAFT. Mr. Burgess, you gave us figures on excess reserves, but Mr. Eccles' figures I think showed that the present 40 percent would run us through the year 1945.

Mr. BURGESS. To the end of the year.

Senator TAFT. Have you figured out any time showing, first, the general picture there, and how long 30 percent would last, and how long 25 percent would last?

Mr. BURGESS. That would be guessing. I think the figure 30 percent would—well, I better not make a guess.

Senator TAFT. I think he said to the end of 1946.

Mr. BURGESS. Something like that.

Senator BUCK. And if set at 30 percent it ought to take us through the war.

Mr. BURGESS. Yes; but I do not know when the war will end.

Senator RADCLIFFE. You have suggested that fixing it at 30 percent instead of 25 percent would bring in a better psychological factor. But fixing it at 30 percent rather than 25 percent might give the impression that the amount was somewhat inadequate, or some temporary thing, and therefore might be another psychological factor in considering the general reaction.

Mr. BURGESS. There is that possibility. You would have to think about that. I would think people would think it pretty adequate.

Senator RADCLIFFE. You would not have it otherwise than the 30 percent?

Mr. BURGESS. No, sir.

Senator FULBRIGHT. Mr. Burgess, do you think these other countries are going to return to the gold standard? Are they seeking to do so?

Mr. BURGESS. They do not think so.

Senator FULBRIGHT. But do you think so?

Mr. BURGESS. If I had to guess I would say they would come back to something that looked a good deal like it.

Senator FULBRIGHT. In fact, they are saying now they are not going to do it.

Mr. BURGESS. They are saying that very positively, the British more particularly. But the British have built up their position in world trade and in banking with the pound based solidly on gold, and that had a fixed value. If the United States of America pins its dollar to gold solidly, as I believe it should, the British are going to find that their position in world markets is slipping. So they will find themselves pinning their own pound to gold.

Senator FULBRIGHT. It has already slipped. That is due to the fact that we have it all and they cannot compete. And how about Russia?

Mr. BURGESS. Russia has a lot of gold.

Senator FULBRIGHT. Is not Russia going to send it to us?

Mr. BURGESS. Yes, to some extent.

Senator FULBRIGHT. Won't we need to buy international exchange? They will have the gold to ship if you raise the price of gold to \$50 an ounce or more.

Mr. BURGESS. Senator Murdock and I think there is something about gold that people will always want. I think there is a danger there.

Senator FULBRIGHT. Senator Murdock said the only reason gold was not worth \$5 was because of the act of Congress.

Mr. BURGESS. I think he went a little low on that.

Senator MURDOCK. There is no use fooling ourselves about the fact that the price of gold is maintained and has been maintained down through monetary history by statutory enactment of governments.

Senator FULBRIGHT. That is inconsistent with intrinsic value.

Senator MURDOCK. Is there any intrinsic value to gold except for use in filling teeth and making jewelry or something of that kind?

Senator FULBRIGHT. Perhaps not.

Senator TAFT. If you take \$100,000 of gold to Europe I believe you would be surprised how much you could get for it today.

Senator MURDOCK. I would like my colleagues here and the witness to agree with me. It seems to me we argue one way and act another. Are we afraid of gold? Are we afraid to give it the price it is entitled to, or must we go along with the man who says there is no necessity of having gold behind our currency? If we believe in the stability of gold money, right now we have a golden opportunity to put our belief into practice. It seems to me we are afraid to take the logical and reasonable step of increasing the value of gold and we jump clear over the hurdle and join the group who say gold as a monetary base is archaic. If we believe in gold and not in a wholly managed paper currency, why not say so to the world by giving it a deserved and logical value. Why pussyfoot around half in and half out. If Governor Eccles is right in his position that use of gold as a monetary reserve is archaic, I challenge the bankers of America to join him. If he is wrong, then it is the duty of bankers to say so by giving gold its logical value.

Mr. BURGESS. I would draw the opposite conclusion from your suggestion. I think the people who believe in gold might recognize that the great value in gold lies in stability of price. I think we hard-money men have our backs to the wall because totalitarian governments all over the world are trying desperately to get away from gold, and we think it has a social-security value, a value to give re-

assurance to human beings. I think the danger you suggest is important.

Senator MURDOCK. I think the statement of the witness that we have our backs to the wall is a good one, so instead of forcing them to meet us head-on we are letting them outflank us.

Senator FULBRIGHT. Is there some danger that we would get all the gold? If these other countries can find a way to get along without it, it would mean that they would buy goods and get our materials and we would end up with nothing but gold in return. Is not that a danger that is possible? If we uphold the right to use gold, and they oppose that right, I would not think there was a real danger. If they find no use for gold in ways other than the making of international balances, then that would be something else.

Mr. BURGESS. I can see now why they cannot commit themselves. If I were an Englishman I would not make commitments on exchange because they have a very hard problem to work out. We are leaders. We have the money and can lead the way, and if we lead the way we will find a lot of other people following us.

Senator FULBRIGHT. If we lead the way we must do a great deal of lending.

Mr. BURGESS. Yes.

Senator MURDOCK. You say it is going to take some lending?

Mr. BURGESS. Yes, sir.

Senator MURDOCK. Does not that bring us back to the point of your suggestion, that all countries holding gold would make a profit out of us if we increase the price of gold? I am wondering if it is not better to sustain their purchasing power and extend that aid by increasing the price of gold rather than lend them some more money.

Senator FULBRIGHT. That is just the difference between a gift and a loan.

Mr. BURGESS. It would seem so.

Senator MURDOCK. While I am giving them a profit on small gold holdings, I am making a profit on \$20,000,000,000 of gold held in the Treasury for the people of the United States. I might also suggest to the distinguished Senator from Arkansas that our foreign loans experience has not been too good. So bad, in fact, he and I voted to substitute lend-lease. But if we want to go to another system it might be different.

Senator BUCK. How much would you increase it?

Senator MURDOCK. To increase gold at the same ratio as the proposal to reduce the reserves. We reduce the reserve requirements by 37.5 percent if my figures are correct. If we would increase gold to that same amount it would be from \$35 to \$48.

Senator TAFT. Why not increase the price of silver by \$4 and put that in as a part of the reserves?

Senator MURDOCK. Now you are coming around to my position. That is the most enlightened statement made here this morning.

Mr. BURGESS. Mr. Chairman and gentlemen of the committee, I apologize for taking so much of your time.

The CHAIRMAN. I want to thank you, Mr. Burgess. You have been a great help to us.

Mr. BURGESS. I thank you for the opportunity of coming.

The CHAIRMAN. Our committee has to consider this whole question. We will adjourn this subject until 2:30 p. m. on Wednesday next, March 7. In the meantime we have the O. P. A. hearings to finish.

Senator TAFT. Do you say, Mr. Chairman, 2:30 p. m. on Wednesday, March 7?

The CHAIRMAN. Yes. And I hope every member of the committee will be present at 2:30 p. m. on March 7. We will now adjourn until 10:30 tomorrow morning, when we will resume our O. P. A. hearings. In the meantime I will ask Mr. Eccles to be prepared to give us some additional information on the subject we are here discussing.

(Whereupon at 12:05 p. m. the committee adjourned consideration of this subject until 2:30 p. m., March 7, 1945.)

REDUCTION IN RESERVE RATIO FOR FEDERAL RESERVE NOTES AND DEPOSITS

WEDNESDAY, MARCH 7, 1945

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
Washington, D. C.

The committee met pursuant to adjournment on February 28, 1945, at 2:30 p. m., in the District of Columbia Committee room, the Capitol, Senator Robert F. Wagner, chairman, presiding.

Present: Senators Wagner (chairman), Radcliffe, Murdock, McFarland, Fulbright, Tobey, Taft, Buck, Millikin, and Hickenlooper.

FURTHER STATEMENT OF MARRINER S. ECCLES, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WASHINGTON, D. C.

The CHAIRMAN. Mr. Eccles, the committee wanted you here because of the testimony of Mr. Burgess, not in opposition to the bill, but suggesting an increase from 25 to 30 percent, and the members of the committee felt that you being an expert on all those matters, together with the doctor next to you, would like to tell us whether it would make any difference whether the percentage was 25 or 30.

Mr. ECCLES. I think it would make a great deal of difference, and it would be a mistake not to reduce this reserve requirement to 25. Mr. Burgess said that—I will read from his statement—

No. 2, that the committee consider whether it may not be better at this time to lower reserve requirements to 30 rather than to 25 percent.

Mr. Burgess, in talking to me about the matter, had no strong feeling about it at all, as his statement would indicate.

Senator TAFT. Well, I don't think he did here, either.

Mr. ECCLES. He just said it would be worth considering, so I didn't think he had any strong feeling about it.

Thirty percent is likely to take care of the needs for many months, and if it then proves inadequate it will be because credit expansion has gone to a point where congressional review may be desirable.

Well, that is not the only reason that Congress may consider it. It is entirely a question of the loss of gold which would operate much more rapidly than the expansion of currency or deposits.

The reserve, of course, is a gold reserve back of the currency—Federal Reserve notes—and in back of the deposits of the member banks.

Now, it is true that before the reserve drops down to 30 percent, if we lost no gold, it would mean you would have to have a very substantial increase in both deposits and in currency.

Senator TAFT. You presented a table, Mr. Eccles, which showed that if the present tendency went on—I forget how long—40 percent would last until about the end of 1945, if the same tendency continues.

Mr. ECCLES. By the end of 1945. I have a table here, and that table is correct. However, that is only theoretical. As a practical matter that is not true. That table is a little deceptive as a matter of practical operation, for this reason.

I think I explained to the committee before, but in case you may not all have heard it I will repeat the way the reserve applies. We have 12 Reserve banks, and their reserves are not pooled. The banks are treated separately, from an operating standpoint. Whereas one bank may have a 48-percent reserve, another bank may have a 53-percent reserve, whereas the average reserve may be 48; so that what we must take into account here is not the reserve requirement on the average for all banks. What we have got to do is to meet the reserve requirement for every 1 of the 12 banks.

Senator TAFT. You have no way in which you can change that by taking their Government bonds?

Mr. ECCLES. That is right. We do. We have a way of adjusting it on the basis of Government bonds between banks, and that is exactly what we do and you can get down to within maybe 3 percent, but we figure the reserves on a weekly basis. You cannot figure them every day, but you figure them on a weekly basis, and one bank could drop during the week below the legal limit.

We would not think of letting the reserves get down within 3 percent of the legal limit because, as a matter of fact, it could then drop down possibly below the legal limit.

We have a bill-buying rate in which the Reserve banks accept upon request any Treasury bills offered to them. Now, certain States, particularly in the Chicago district—they tax money in banks and there is a terrific transfer, back and forth, of money out of banks into Treasury bills.

Senator TOBEY. What tax rate is that?

Mr. ECCLES. I don't know. So that these reserves can fluctuate 1 or 2 or 3 percent, and therefore with all the adjustment that we might make on a weekly basis we still must have, I would say, to have a practical operating basis and to be perfectly safe in not going below the legal limit, if the requirement is 40 percent, a reserve ratio of not less than 48 percent. Mr. Burgess apparently just didn't take that into account or think of the practical aspect of it.

That is one point I wanted to get across to you people.

Senator TAFT. May I ask this? That chart as drafted there, I suppose, is fairly correct as to the increase in deposits and notes—assuming that the present deficit continues—

Mr. ECCLES. That is based upon—

Senator TAFT. But the dropping off in gold is not predictable?

Mr. ECCLES. Very uncertain. Anything but predictable.

Now, the currency expansion, we have no reason to expect that the trend of it will likely change as long as we have got deficit financing and full employment and expansion, et cetera. Every indication is

that that would continue. A certain amount of financing to be done by the banks will likely continue and that is what will make for increased deposits and hence reserves.

Senator MILLIKIN. If it went to 30, Governor Eccles, how long do you think that would last you comfortably within the limitations you have prescribed?

Mr. ECCLES. Well, I would say toward the end—well, maybe a year and a half. It is now down to about 48. It has already gone down since that chart was made up.

Senator TAFT. A year and a half from now?

Mr. ECCLES. Yes. But here is the danger in the situation. Assuming that from now to the end of the year the currency expansion is in line with this chart, and that the deposits of the Reserve banks are also in accordance with that chart. That is, the expansion is that large. Then if we should lose this year, during this year—that is, from the beginning of the year to the end of the 12 months' period—if we should lose \$4,200,000,000 of gold we will hit 30 percent.

Now, the foreigners have in this country \$5,400,000,000 of earmarked gold and bank deposits. If they should get afraid of an inflation, a decrease in the purchasing power of our people, they may want to convert this into gold and move the gold.

Senator TAFT. How much of the dollars—you said 5 billion—that included earmarked gold?

Mr. ECCLES. No.

Senator TAFT. You have to take that out. That has been all transferred?

Mr. ECCLES. No, no. What I meant, the total dollar balances are \$5,432,000,000. Of that \$3,179,000,000 are balances of foreign governments and \$2,253,000,000 are private balances.

Senator RADCLIFFE. Who holds that?

Mr. ECCLES. All the nations of the world.

Senator RADCLIFFE. What are some of them?

Mr. ECCLES. Most of the South American countries, Cuba, Mexico, France, Belgium, Holland, Norway, Sweden, Switzerland, England.

Senator TAFT. You didn't mention England. I was wondering if you were going to mention them. I understand England has quite a large balance.

Senator MILLIKIN. Governor Eccles, are you sure the thing would happen that you say would happen under the circumstances you mention? Isn't it likely to go the other way?

Mr. ECCLES. No; the likelihood is we will lose gold. There is every indication of it. We have lost it continuously now for 3 years.

Senator TAFT. Would you think so if the German war ended? Then you would have a demand for exports.

Mr. ECCLES. Well, the point is they have all got more dollars here than we can possibly permit them to spend. We have over 10 billion dollars here now and we cannot permit them to export goods freely because, in the first place, there are not the ships to haul the goods in and, in the second place, we have such a shortage of goods ourselves we cannot permit it except by export licenses. Just when there will be freedom to spend those dollars is, of course, a question of how long it will take us to get reconverted, and what our demands are in the Japanese

war, and I wouldn't think we could rely on gold coming this way. I don't think we could, and that is why I say that reducing this only to 30 percent would leave us very close to the line, if we should lose any substantial amount of gold, and I think this country should keep in a position so that if the foreigners want to withdraw their money in gold we can pay them. It would be perfectly ridiculous for this country to be unable to give to these foreign countries the gold that we have purchased from them and we have gotten their dollars, if we are unable to reverse the position. I think it would hurt the whole idea of the value of gold. It would hurt the use of gold as a means of settling international balances if we were unable to permit the transfer of dollars and gold.

Senator McFARLAND. Could we do that right now under the present set-up?

Mr. ECCLES. Well, I don't know. No; we couldn't. I think if we lost that much now in gold—I don't think we could do it right at the moment. If they try to cash their balances with us, I think our reserves—I haven't figured it out, but I think our reserves would drop below our legal limit.

Senator McFARLAND. How low do you think it would drop?

Mr. ECCLES. Well, I would have to figure it out. It is a mathematical problem.

Dr. GOLDENWEISER. We have excess reserves of about $4\frac{1}{2}$ billions, or something like that. If they should withdraw 5.4 billion we would be 900 millions in the red.

Mr. ECCLES. Well, but as a practical matter you would be in the red when you got within 3 percent of the legal limit, for the reasons I just stated.

Senator McFARLAND. Governor, you could cash in for quite a length of time with a reduction to 30 percent, couldn't you?

Mr. ECCLES. Well, as I say, if we went to 30 percent it would take care of us possibly through the end of next year, if the gold loss is about as we have anticipated—it should not change—but if the foreigners should want their balances we would be in trouble before the end of this year.

Senator TAFT. The principal argument is that today if you ask us for a reduction we have no choice as long as we are pursuing a policy of 50 billions a year deficit. We have considered that well and we are set on it. We have no choice. But a year from now if you came before us again and said, "We must go down from 30 to 25," we might have a chance, we might say that shows this thing is getting beyond all safety. We might then have the choice of balancing the budget and we could perhaps go back and see if something could be done about it. We cannot do that now, but we might if the war were over. But that is the principal argument, that at that time we may have an alternative to reducing the reserves which we haven't got now.

The CHAIRMAN. We are going to export a good deal of goods aren't we, right after the war?

Mr. ECCLES. I don't think so.

The CHAIRMAN. You don't?

Mr. ECCLES. Not immediately. We are going to have to get reconverted first, to meet some of this backlog demand at home.

The CHAIRMAN. I mean if we do export, they might want to pay for that in gold and we could get some gold.

Mr. ECCLES. Ultimately we will. We have 10 billion now—they have—in dollars here and in earmarked gold—the foreigners have. So that they have got more money here now, and then add to that the lend-lease that you let them have, you add that to it, so you can supply goods to them to the extent that you are willing to and that at the present time seems to be the way foreign goods are supplied, is through lend-lease. But you have got \$10,000,000,000 in addition to that that they could spend before they begin to ship gold this way.

Now, the one thing that would, it seems to me, cause them to ship gold here would be an assurance that this reserve ratio is down to 25 percent and they could get it if they wanted it. A person always wants what he cannot get, and if they were given an assurance here that there was plenty of leeway, that we could lose a lot of gold without restriction, that it was free gold so far as our banking set-up is concerned, I think it would tend to establish confidence that we could part with a substantial amount of gold readily, and there would be less likelihood of the gold being drawn out if they thought it was readily available without congressional action. But as you get close to the requirement it is perfectly apparent that the amount of free gold that you can lose without congressional action is small. What does Congress do? Does Congress have to meet to adopt action in order to free gold so that the foreigners' dollar balances can be paid in gold?

That is not going to induce gold to come here, and it seems to me that it is a bad way to get at the budget question. I think there are much better ways of getting at it than disturbing the monetary situation.

Senator TAFT. We have a bill now to increase the debt to \$300,000,-000,000. That is another warning, so to speak, about which we can do nothing now. We have increased it every year as the need came. We haven't done it all at once, although we knew it was going to be \$300,000,000,000 before we got through.

Mr. ECCLES. That is right. The way to get at the budget picture is through your Finance Committee and your Appropriations Committee, where the money is appropriated. It does not seem to me you can get at that in the Banking and Currency Committee. If the Appropriations Committee appropriates the money, then the Banking and Currency Committee cannot say, "We are going to stop the banking system from any possible expansion in this thing because we are not going to make the money available to meet the appropriations of the Government." You have to stop it at the source, which is at the appropriations. Or, you have to be willing to levy taxes in the Finance Committee to meet the Appropriations Committee. We should not get at, it seems to me, through the banking set-up. That is certainly a back-door way to go at it. I would think that to go down to 25 percent is being conservative enough. If we lost, between now and the end of the year, \$6,400,000,000 of gold we would be down to 25 percent. You cannot go lower than 28 percent for practical operating purposes, so that if we lost five and one-half billion we would be about as low as we should be able to go. That is, if you go to 25. For practical purposes.

Now, the foreigner has, as I say, over 5 billion in balances.

Senator TAFT. You are going to give them about $2\frac{3}{4}$ billion in Bretton Woods on which they will be able to draw.

Mr. ECCLES. Well, I don't know. It depends on where those deposits are going to be made. There was an agreement that the account would be split up with Moscow, London, Paris, and other places. If that Bretton Woods agreement goes through—

Senator TAFT. That gold is outside of any of this you are referring to here?

Mr. ECCLES. One billion eight hundred million; that is right.

Senator RADCLIFFE. What is the prospect that the foreigner will attempt to draw on this fund outside of Bretton Woods in the near future?

Mr. ECCLES. Well, it depends on the extent of the inflationary developments in this country, and it depends on whether the foreigners believe we are going to change the price of gold. If we keep talking about increasing the price of gold these balances will come out in a hurry. We can lose this \$5,000,000,000 awfully, awfully fast. Certainly nobody wants dollar balances in a bank at \$35 an ounce if they can get them out now and get gold that is going to be increased to \$50 or \$55, or whatever it is. This entire \$5,000,000,000 foreign balance would be drawn out overnight if they really thought that we were going to increase the price of gold.

Senator TAFT. Has there been any acceleration in the drawing of dollar balances since the last meeting of this committee?

Mr. ECCLES. I don't know. It has only been a couple of weeks.

Senator MURDOCK. Evidently they are not taking very seriously the talk about increasing the price.

Mr. ECCLES. Well, I don't believe they are, to tell you the truth. I am merely saying that if they do, if we keep talking about it long enough, they might.

Senator MURDOCK. Every scintilla of evidence that has been introduced before this committee up to date is indicative without question that the gold base, that is, the quantity of gold in the world today, is not sufficient to supply our currency and credit system. You don't increase the gold base one bit by lowering your reserve requirement. The only way you can increase the gold in quantity, from a monetary standpoint, is to increase the price of gold. If you admit there is a shortage of gold in the world to support our currency and credit structure, there is just one answer and that answer is to increase the price of gold. I haven't convinced many people of that fact up to this point, but just as sure as we are sitting here we will come to it sooner or later. I make that as a prediction.

Mr. ECCLES. Senator, I would like to answer your statement in this manner if you will permit me to do so. If you increase the price of gold to \$56 an ounce, or to \$75 an ounce, there still would not be enough gold to support all of the currencies of the world on a gold basis, on a gold standard.

Now, we are the only country left in the world, practically, today that undertakes to support their domestic currency by gold and I think, as I said before, that instead of increasing the price of gold so that it winds up in giving the foreigner a terrific subsidy and therefore have enough gold to back our currency, the thing to do would be not to require gold back of the currency, because as I tried to bring out before the committee, it doesn't make your currency any sounder. It does not expand it or contract it.

The British and the Canadians and other countries, do not have to secure currency, and where we make the mistakes is in trying to secure the currency with gold when the currency is not convertible into gold. It is a fiction. We are practically the only country in the world that does that, and for us to get enough gold back of our currency by merely increasing the dollar price of gold in order that we will attract gold here from the rest of the world and attract an increase in production, would amount to a subsidy of 8½ billion dollars because the \$14,000,000,000 worth of gold outside of the country at \$35 an ounce would go to \$50 an ounce and would give them a very large subsidy, and the annual subsidy would be about \$800,000,000 a year that we would be giving in order to have stored in the vaults in Kentucky gold on which certificates were issued and held in the Reserve banks which is not available to the holders of certificates. That is about as foolish as anything I can think of.

Senator MURDOCK. May I just answer you? You are up here telling us that beyond any question we haven't enough gold. I think we can take it for granted that we do want to base our currency on gold. If we didn't want to do that, I think you would be talking something else. Now you tell me we haven't got enough gold to do the job. You tell me you are frightened.

Mr. ECCLES. No; I am not frightened.

Senator MURDOCK. Well, perhaps you are afraid?

Mr. ECCLES. No; I am not afraid. It does not make me afraid a particle.

Senator MURDOCK. I will change it and put it this way: You are apprehensive.

Mr. ECCLES. I am not apprehensive. I am merely trying to say that at the present trend, gentlemen, the ratio is going down to the legal limit and, therefore, I am recommending the reduction of the requirement.

Senator TOBEY. You believe that to be the trend?

Mr. ECCLES. I believe that to be the trend.

Senator TOBEY. Gentlemen, it seems to me that would affect the prices all along the line, if we should go ahead and increase it, but if on the other hand we would try to balance the national budget, I believe that would take care of the situation.

Mr. ECCLES. I think you are going to have to reduce this to 25 percent ultimately, and I believe this is the appropriate time to do it.

Senator TAFT. At any rate, it seems to me that it would undoubtedly depreciate the dollar and increase the price of everything in this country, and that is the one thing that we are trying to prevent by our whole stabilization policy. The whole thing there, in my opinion, is a serious proposition, a problem as to whether or not it will have an adverse effect upon the country. I think it will have a much greater effect in immediately forcing an increase in the price of goods brought in this country, and instantly imposing a much higher tariff against the importation of goods from abroad, unless they depreciate their own currency too. Of course, if they depreciate it too, that would be one thing, but we cannot be sure about that. I think it would immediately move all along the line.

Mr. ECCLES. I think this is a question which may come up, as a matter of fact, I've thought so before, and I would like to make a

statement of these seven points, which I believe to be important. They are:

1. The bill, in itself, would have no effect on the Reserve bank ratio—it would merely reduce the number of ounces of gold that the Treasury would have to hold back of the Reserve banks' gold certificates, and release the remainder of the gold—\$12,000,000,000 at the new valuation. This profit would belong to the Treasury and the gold would not come to the Reserve banks unless the Treasury chose to spend the equivalent of this amount or to deposit it with the Reserve banks. Of the increment resulting from the revaluation of the dollar in 1934—\$1,800,000,000 is still held by the Treasury in the stabilization fund.

2. When the Treasury spends the profit on the devaluation—this would add not only to the reserves of the Reserve banks but also to member bank deposits and to their reserves, thus aggravating the existing inflationary pressure.

3. The higher price of gold would also increase gold production both here and abroad. As this additional gold was sold to the Treasury by producers here and abroad it would still further increase deposits and reserves of member banks, and by an amount enhanced by the higher price of gold. This would not only encourage diversion of effort into the production of a nonessential commodity—but would also further aggravate inflationary pressure.

4. An increase of the price of gold to \$56 would increase the dollar value of the \$14,000,000,000 of gold held by foreigners by about \$8,500,000,000. This would increase their claims on our goods. It would be a tremendous gift to foreigners. It would also result in a larger flow of gold to the United States in terms of dollars and, therefore, would still further increase our inflationary danger.

5. The higher price of gold would be a subsidy—not only to our gold producers—but also to foreign gold producers, chiefly British, Russian, and Canadian.

6. Reduction of the exchange value of the dollar—which would result from an increase in the dollar price of gold—would aggravate the existing situation in making it still more difficult for foreign countries to compete with us in world markets. It would be a step diametrically opposed to the Bretton Woods agreements, which attempt to revive world trade by establishing fair and stable exchange values for currencies.

7. The number of persons employed in gold production in this country in 1941 was only 35,000. It would be far cheaper to subsidize them in some other way, if Congress saw fit to do so, rather than to make a move that would have all the disturbing consequences just stated—both in the United States and throughout the world.

Senator MURDOCK. You have given us these seven points, and I would say that if you could give us 10 or 12 more, that we would be glad to have them, if we can. As a matter of fact, the more I hear of this thing, the more I want to call the committee's attention to the fact that the Secretary of the Treasury was before this committee sometime ago, saying at that time that the President's power to decrease the gold content of the dollar was not important, and I told him at that time that it was my opinion he would, if he did no handle that proposition properly, that he would be back up here, along with the Federal Re-

serve people, and I made that prediction, asking for an increase in the gold basis. I think my prediction has come true, not in a request for an advance in the price of gold, but something which is actually the same thing, a decrease in the gold standard.

Senator MILLIKIN. How much gold have we lost in 1943 and 1944?

Mr. ECCLES. About a billion dollars each year.

Senator MILLIKIN. What countries principally has that gold been removed to?

Mr. ECCLES. I do not have that. The Treasury, itself, can give you that. It is not made available to the public, during the war.

Senator TOBEY. The impression I have is that it is mostly to the South American countries.

Mr. ECCLES. That is what the newspapers say.

Senator MILLIKIN. Is there any reason that has been made known to the public as to the reason why they have removed their gold?

Mr. ECCLES. They have removed it, and have transferred it from dollars to gold, rather, right along. I think it has not been because of a lack of confidence in the dollar at all. You see, we have paid cash for our imports. Our exports have gone out to a very large extent by lend-lease. So, we have not had an equal situation. We have, in effect, given our goods away, under lend-lease, but we have paid dollars for the goods that we have brought in.

Senator TAFT. It is an adverse balance of trade, and they have cashed in upon it?

Mr. ECCLES. Yes; it has been an adverse balance of payments. For that reason, not because of goods we have shipped have been larger than the goods we have purchased, but because we have purchased them and we have paid cash for them, whereas those that we have shipped, they have gone out under lease-lend; therefore, under the dollar standard, the rest of the world has accumulated a lot of dollars, they have accumulated a very large amount of dollars. As they went along they just decided that they did not want to carry everything in dollars, and would like to have some of that in gold, and they have turned around and have turned some of their dollar balances over and had them earmarked for gold, and there has been a continuation of that trend, and their dollars are still piling up here, and they keep trying, to keep a balance, you might say; as they get so high they try to turn them over for gold. They feel that they would like to have a little gold.

I think that is the thing, aside from their feeling that the price of gold may change, that they will continue to draw down their dollar balances in gold, as long as their dollar balances increase.

Senator TAFT. Perhaps we might cut out the lend-lease and let them pay cash. I do not see why they should not pay for it.

Mr. ECCLES. That would change the trend, and that would make it the other way around. Should they find their dollar balances are going down, there would not be that tendency, but there would still be a certain amount turned into gold.

Senator MURDOCK. I think the trend will be more and more.

Mr. ECCLES. When, after the war gets over, we may quit lend-lease and make them spend their money, and that will have some effect upon it.

We have looked ahead for 3 years after the war, and what worries me, Senator, is that we are ultimately going to get all of the gold.

We will have so much gold it will run out of our ears, just like we did before the war started, we will have most of the gold of the world here, because we will be the great exporting Nation, and they will not have the goods that we can or will take, and they will send us all the gold that they have, and after they spend their dollars and send us the gold that they produce, it will be a one-way street, in my opinion, to a very large extent on the gold. We will then have reserves so that with this 25 percent, it will look very small.

As I tried to bring out before the committee the last time I was here, this is just a minimum reserve, and it does not mean that our reserve will go down to the minimum. It is something which does not mean that. It does not mean that if we have that as a minimum that the reserve will go down to that minimum at all, or that that is the amount of gold that we have or that will be changed by fixing the reserve at that point at all.

I think the history of the thing has shown just to the contrary. We had, for a long period of time here, a gold reserve, for instance; in June 1939 our ratio was 85.4 percent, and we had almost enough gold to cover all of the currency, in addition to all of the deposits. It might have been higher than that in 1940. I do not have the figures for 1941. I think that it was around 90 percent, however.

The fact that we had 40 percent and 35 percent requirements did not prevent it from going up to 90 percent. The fact that we fix it at 25 percent does not mean at all that it will go down to 25 percent. There is nothing that the Federal Reserve is required to do that will bring it to that. On the other hand, there is nothing that the Federal Reserve is faced with that will prevent it from going up to 90 percent or even a hundred percent. As a matter of fact, I doubt if there is anything that could be done by Congress to stop it going up to a very high point.

Senator TAFT. Except balancing the Budget.

Mr. ECCLES. Except the approaching of a balance of trade.

Senator RADCLIFFE. When Mr. Burgess was testifying before the committee, he testified from time to time the psychological effect was adverse. I believe I asked him the question, That if you effected a reduction of the reserve requirement to 30 percent instead of 20 percent, whether there would be anything of an expression of an opinion that it was more or less of a temporary or inadequate sort of expediency, and whether there would be a psychological effect from that, and, what would be the result? I think his discussion of that was most informative, and indicated that he had a very decided opinion upon it. I take it you are familiar with that?

Mr. ECCLES. I am.

Senator RADCLIFFE. What can you say as to that?

Mr. ECCLES. I think it has an important effect; I think it is an important factor. I believe that you have placed your finger upon one of the very important things to be discussed, that is, taking it step by step, instead of doing it all at once. I think the more that you discuss and tinker with this, the more harm it will do.

Senator TOBEY. He also talked about the inflation possibility.

There has been some discussion of inflation from time to time. In fact, that is talked of almost continuously, isn't it?

Mr. ECCLES. Yes, Senator Tobey. I think that is much more general on the part of the people who have stocks and real estate and

things of that sort for sale. They are in the business, and doing anything that would affect them, is certainly something which would cause them to discuss that. That is a general subject, and it is open to a great deal of discussion. In the case of gold, that is a subject that, outside of a comparatively few people, is something that very little is known about. It is not a subject of general knowledge; it is not a subject which is discussed in the same manner and to the same extent as these other matters are.

Senator TOBEY. You suggested, in making your point, something along that line. Do you care to go further into that now?

Mr. ECCLES. Just let me answer Senator Radcliffe's question.

If you go to 30 percent now, and then within a year from now, or one and a half years from now, you go to 25 percent, I think that will be very bad. People will think that their currency is not as sound as it should be, that they are losing to the possibility of inflation, that is, they are losing ground and going closer and closer to inflation, by having the gold back of it cut down, while, if you do this all at once, you will obviate that. It will begin to have an effect upon and disturb the value of dollars, and I think that if you are going to do it, you should do it all at one time. It seems to me that the psychology of the matter is most unfavorable if you are going to take it step by step.

Senator RADCLIFFE. Do you think fixing it at 25 percent will be effectuating a stable policy, and do you think it will be entirely adequate from most of the general points of view; that is, from the standpoint of the general public, from the banks of this country, and from that of foreign countries also?

Mr. ECCLES. I certainly do, Senator. I think that is very well put. I think it will take us far into the post-war era.

We can meet any demand for gold made by foreigners. By that time we should be getting gold flowing into this country, and the war should have been far enough over so that the Budget set-up should be such that the deficit period should be largely over. I think we can carry through to that point. I think there is less likelihood that the 30 percent will actually have a sufficient elasticity to it to carry us through that, and I do believe we will require 25 percent, because we have gone all through this very carefully, and we have just figured that we must go back to 25 percent before we can come out of this thing.

Senator TAFT. I believe the only argument made by Mr. Burgess was the one that Congress should have another look at it in another year from now, and it might be a warning if we are moving in the direction of inflation, to do something about it.

Mr. ECCLES. If you modify it, it will have an adverse effect, if done in that manner. That is not a favorable way to do it.

Senator TOBEY. You suggested that we put a tax on capital gains, for instance, in the stock market, purchases to be taxed 90 percent for 2 or 3 years, and a redemption of 10 percent a year. Is that not something that should merit consideration right along with this thing?

Mr. ECCLES. I certainly think so. I think it is most important, Senator Tobey.

Senator MURDOCK. I think there is a lot of interest in this matter. I think we would like to have you elaborate on that. I know I would.

Senator TOBEY. That would defeat your own purposes somewhat.

When you go beyond a certain point, it is going to cause people to hold their securities, they will simply hold them, and there will be a freeze on them. They will not sell because of the tax and so the tax would reduce the fluid supply of stocks purchasable on a rising market and probably create a more rapid rise in security prices because of the scarcity of offerings.

Mr. ECCLES. Of course, there is a thorough misunderstanding of my proposal.

The tax was expected, as I proposed it, to apply January 1, 1945, to all capital assets acquired thereafter. It did not supplant and was not superimposed upon the capital stock tax in the sense you have suggested it here, but the capital assets which have been held by people up to that time, would not be influenced or affected by it.

It might be modified in such manner as the Congress might fix it but these capital assets acquired thereafter, that is, after that date, would be subject to the tax, which is quite a different matter, I think you will agree.

It is true, now that the old argument has been made a good many times, and this is made by the stock exchange people very effectively, that if you require the seller to pay a tax, you will retard the seller, because of a high tax.

Senator TOBEY. We have something like that—back in 1930?

Mr. ECCLES. In the 1920's when we had the boom there was not any retardation in selling.

We blew the lid off in 1929, without any restrictions. There were practically no restrictions and the argument would apply there, but there were plenty of sellers; but there were more buyers than there were sellers.

What my proposal would be—it would not be to put a deterrent on the sale of assets to those bought by people for a long period of time, or held by people as of a certain time, because you are not increasing the tax on them, and that would not be a deterrent from selling at an increased tax due to the deterrent effect upon buyers from buying, because of an increased tax.

And that is exactly what you want today. The only way you want to stop inflation in capital values is by stopping the buyers. Unless there are some sellers, more sellers than buyers, certainly you do not keep values from going up. Inflation comes when buyers are in excess of sellers, and if you decrease the buyers, or the number of buyers, so that the number of buyers would be less than the number of sellers, although there may be some sellers who are deterred by the tax, there will be some sellers who will not be deterred by any tax, when for that reason you say that you should have no capital gains tax of any kind—that would be just as logical an argument in view of the fact that it might affect some sellers—because, if you have a capital gains tax, then, of course, sellers will sell, but that does not mean that there will not be more buyers than sellers, because the buyer buys because he wants to be a seller, the same as my being both a buyer and seller, Senator.

Whenever they are sellers they are also buyers, because they buy with the expectation of selling, and sell with the expectation of buying.

This would not affect any person who bought the stocks or bonds to hold, particularly the stocks, because if he held them long enough,

it would not make any difference, and he would not worry about my tax proposal at all.

As I said, the buyer buys to sell. So there are going to be more buyers than sellers in a situation like we are confronted with now where there is more money piling up all the time. The only way you are going to stop this inflation is to have less buyers than sellers.

Senator TAFT. I suppose since this condition exists it does not make any difference what kind of tax you make, there will be more buyers than sellers, not because of anything here but because we have created an inflationary condition where there is so much more money than anybody knows what to do with, but the situation would not change very much in that regard. I do not think a very high tax itself is going to take care of the inflationary condition today—it will not take care of the condition that exists, but the condition is there, and I believe it will force up prices merely because there are more buyers than sellers, and it is just as effective whether it is speculation or not, the result is the same.

Mr. ECCLES. That is right. If it is going to do it, it would do it with the tax acting as a brake, because if a person wants to buy, he knows that he is going to have to turn it over in the form of excess profits, all of his profits, or most of them, and if it will still go up in spite of that, where will it go without that? I think that is an important question to ask.

Senator TAFT. It is speculative regardless of what way you look at it. The speculators who are engaged in that type of operation are trying to take advantage of the fact that people have money and are likely to force stock prices up regardless of anything you do, so these speculators want to get in on that rise. I do not see how we could change that.

Mr. ECCLES. Precisely. These people that want to buy permanently, I believe there will be enough sellers to meet the demand of the permanent buyers, if you take out entirely the speculators, the permanent buyer is a fellow who would have to hold it for a considerable period of time if he got a capital gain out of it, because otherwise, if he sold it at an early date, he would be subject to this heavy tax. Therefore the people who were interested in buying and selling quickly for the turn-over would lose interest immediately because they would have to pay this high tax, and if those people were out of the market, I am sure that you would find enough sellers to take care of buyers who were buying for the long pull.

Senator BUCK. Could you obtain control by increasing the margin?

Mr. ECCLES. We have studied that problem continuously, and I think we might temporarily deter them, the speculators, but I doubt if it would be effective for a very long time, because most of the trading is done in cash. It is not a credit operation. There is some credit, of course, but the volume of credit extension is negligible. It is my recollection, and the doctor just tells me that the broker's loans are less than a billion dollars. That is not a very great amount. They have not gone up, except, possibly, to a very limited extent.

Senator TAFT. They have not gone up, in general?

Mr. ECCLES. No.

Senator TAFT. There is no evidence of speculation at all by means of loans on an increasing scale?

Mr. ECCLES. No. It is done on a cash basis very largely. The buying and selling as well is done on a cash basis.

I would like to suggest that you read the March issue of Fortune magazine. I happened to have read it, and I think it is most important.

This is dated March 7, 1945. The March issue of Fortune contains an article entitled "The Wall Street Situation," which cites what is stated to be an actual case. This is an excerpt that was rather startling; it contains an article on the Wall Street situation, and it sets it out as being an actual case of a speculator who got in and out of the market on a number of low-priced stocks between 1942 and the end of 1943 that were moving upward along with the general trend of the market.

Senator TOBEY. Was that a hypothetical case? -

Mr. ECCLES. No. It is an actual case.

It shows how this speculator ran less than \$2,000 of his own money up to \$250,000 by the end of 1943, and that if he had held on to his profits to take advantage of the 1944 highs, he would have had \$1,200,000. The article states:

A speculator named Morris Blumberg, who has bought and sold in these and other stocks, says he has done much better, and modestly remarks that somebody else might have done better still. In other words, a few thousand could have been run up into millions.

What may seem even more remarkable, around 75 percent could have been kept after income taxes. The tax law since 1942 has said that money realized from the appreciation in securities held for more than 6 months is taxable not as income, sometimes over 90 percent, but as capital gain, at a maximum of 25 percent.

This was in the March issue of Fortune magazine.

Senator TAFT. Perhaps he should be taxed, but the very fact that he cashed in shows that he was a seller.

Mr. ECCLES. He was a buyer and a seller, both.

Senator TAFT. Can you say what effect his operations had on the price of the stocks?

Mr. ECCLES. In the first place—

Senator TAFT. If I may interrupt you, Mr. Eccles.

Mr. ECCLES. Yes.

Senator TAFT. I think in the case of the speculators they look ahead for 2 or 3 years, look at the conditions as they see them, and think what in their opinion there will be 2 years from now, and they buy or sell stocks based upon that idea. Is that not so?

Mr. ECCLES. That is quite correct. It seems to me that if you put a heavy tax upon the profits of speculators, and you define "speculators" as those people who buy and sell or buy or sell within any certain period of future time, then I think you would stamp out unwise speculation to a very large degree.

I am sure there would not be as much complaint all over the lot as there is on this thing, if people did not feel that it would be effective. I am sure from the letters and complaints I have gotten from the people engaged in this business, if they were not concerned about it cutting down their business that they would not have registered all of the complaints that I have received.

Senator TAFT. It would not effect an increase in prices over a period of 2 years?

Mr. ECCLES. I think it is simply a matter of curbing this kind of speculation.

Senator TAFT. I am not arguing the matter with you one way or the other, but I do not think it is a substantial element in the prevention of the rise of values of stocks. I think that condition has been created by the Government's deficit spending of 50,000,000,000 a year.

Mr. ECCLES. There is no question but that is the basic cause, and this statement here, Senators, remember, which perhaps I might put in the record at this point, being a statement by me on a capital gains tax, to curb rising prices of values [reading]:

"When questioned by members of the Senate Banking and Currency Committee last week as to what could be done to prevent further inflation of capital values, I reiterated by opinion that the most effective single instrument would be a wartime penalty rate on capital gains. Since the proposal, which was only briefly discussed before the committee, has been widely misunderstood and misrepresented in some quarters. I feel that I should outline what I advocated and why.

"I did not propose any change in the present capital gains tax. My proposal would apply only to the sale of capital assets (as defined under the present law) acquired during a period to be fixed by Congress. My suggestion was that this period be from January 1, 1945, until such time as inflationary dangers have passed, which might be 2, or possibly 3 years after the war. This special wartime capital gains tax would not be superimposed upon the existing tax, but would apply only to assets purchased during this period. It would not apply to real estate, stocks, or other assets acquired at any time prior to January 1, 1945. These assets, if sold, would continue to be subject to the existing capital gains tax. The special tax I have in mind would impose a 90-percent rate on capital gains derived from the sale, within 2 years, of capital assets acquired during the specified period; thereafter it would diminish by 10 percent, or more, annually until equal to the existing rate. Capital losses incurred on transactions subject to the special rate would be deductible against profits.

"The special tax, like any other anti-inflation control, should be discontinued when the need for it no longer exists. Since the purpose of the special tax is anti-inflationary, revenue is not the objective and the more effective the tax, the less it would yield. However, such yield as resulted would be based on rates in line with those imposed under the wartime individual and corporate income-tax structure.

"The reasons for such a special capital gains tax may be summarized as follows:

"1. Capital values, as reflected in current prices of homes, farms, business properties, and stocks, have increased sharply since this country entered the war, and are still increasing. If unchecked, this trend would undermine the entire price and wage stabilization program, with grave consequences to post-war reconversion. It would make war-financing problems more difficult and increase the cost of the war. It would make a mirage of the hopes of millions of war veterans who are counting on being able to obtain a home, or a farm, or to get started in business when they return from the front. Congress has encouraged this hope in the so-called G. I. bill of rights, and by providing dismissal pay and otherwise. Those on the home front

have an inescapable obligation to take whatever steps may be necessary to protect the values of homes, farms, and other necessities so that they will not be hopelessly out of reach of the veterans' purse. There are no war profits in that purse.

"2. While other sections on the home front have been protected by direct measures, such as rationing, allocations, price and wage controls, no effective controls have been applied to curb rising prices of homes, farms, stocks, and other capital assets. The wartime expansion of liquid assets presents a vast and growing danger to these unprotected sectors. Currency, demand deposits, and Government securities held principally by individuals and corporations are rapidly approaching \$200,000,000,000 and have nearly tripled since we entered the war. This huge inflation potential will continue to grow as long as deficit financing continues. Unless effective action is taken to prevent these liquid funds from increasingly inflating capital values, it will become more and more difficult, if not impossible, to hold the line against inflationary price and wage increases. Veterans of the last war, especially farmers, have not forgotten the inflation and the consequent ruinous deflation resulting from failure to control a relatively small volume of liquid funds in the last war. The present volume of such funds is already four times as great as it was in 1920. The national debt is nearly 10 times larger today and is still growing.

"3. The most serious gap in the line of defense against inflationary forces is the capital gains loophole in the wartime tax structure. While Congress has provided sharply progressive surtax rates, rising to a high of 91 percent on individual incomes, and a maximum excess-profits tax of 95 percent levied upon operating profits of corporations, no corresponding curb has been put upon capital gains, which continue to be subject to pre-war rates, with a 25 percent maximum. This huge differential in favor of the capital-gains tax benefits only the larger taxpayers. The bigger they are, the greater the inducement today to dispose of or refuse to put money into fixed interest-bearing obligations that return only a small yield and have little chance for a capital gain, and to put money instead into capital assets, which when sold on a rising market, yield profits subject only to a capital gains tax of 25 percent, or less.

"Yet these profits are just as much a result of war expenditures as are high individual and corporate incomes which are subjected to high wartime tax rates. The inequity of this situation is the more pronounced because the benefit of the tax differential accrues only to those in the higher income brackets. The smaller income taxpayers can derive no tax benefits from it. Large operators, however—so-called smart money—are taking more and more advantage of the opening, and this is a principal factor at present in bidding up real estate, stocks, and other capital values. It is not the bona fide investor or the small taxpayer who is applying this upward leverage to prices of capital assets. This is speculation—not investment. It is speculation in basic essentials such as homes, or farms, or in stocks representing business investments. It adds nothing to national wealth. Such forms of gambling as betting on horse races or playing slot machines do little economic damage. But speculating in the things that people need and use, speculation that leads to disruption of production and employment, is the worst form of gambling.

"4. The proposal I have in mind would simultaneously reach and discourage all such speculative transactions, whether in homes, farms, stocks or commodities, and whether based upon credit or cash—and would do so without interference with normal, nonspeculative transactions, whereas, if credit restrictions alone were applied, they would fail entirely to reach cash transactions for speculative purposes and would interfere with legitimate, nonspeculative credit transactions. The bona fide investor would not be deterred either now or in the reconversion period by the proposed tax, for he puts his money into a farm, or into stocks of existing or of new enterprise for the purpose of obtaining current income and for long-range appreciation of values. It is the speculator, not the investor, who puts money into capital assets in anticipation of a quick rise in price from which a speculative profit can be realized through selling before the price breaks. However, should the investor be obliged or desire to sell while the wartime rate is still in effect, he would not be injured, since he had not purchased in anticipation of selling in order to make a speculative profit. In any event, under the proposed tax, he would be permitted to retain a profit of 10 percent, or more, depending on how long he held the asset.

"5. To the extent that the proposed tax would discourage surplus funds from going into speculative fields, to which they will be attracted so long as prices are rising, there will be that much more available to go into Government securities where they should go to help finance this war. It would appear from criticisms expressed by some of the financial press and market operators that they fear the tax would be effective in greatly reducing buying activity that might otherwise develop. That is the purpose of the tax. According to these critics, the proposed tax would dry up the market because it would deter holders of capital assets from selling. But it need not deter holders of assets acquired prior to the effective date of the tax from selling, because it would not apply to them. It would deter the buying and hence the bidding up of capital assets while the tax is in effect, and that is exactly the result desired. It is the only way to keep the prices of these assets from being bid higher and higher until the bubble bursts. Nothing would be a greater deterrent to post-war reconversion than such an inflationary rise in prices, which would inevitably be followed by a deflationary collapse. Hence nothing would do more to wreck post-war programs for full employment and economic stability on which a lasting peace depends.

"6. The proposed tax is an essential wartime expedient, like price, wage, and other direct measures of control that deal with the effects, not with the causes, of inflationary forces resulting from huge deficit financing of the war. Had the public and hence the Congress been willing to deal with inflationary causes, deficit financing would have been held to a minimum by far higher taxes and by far greater economy and efficiency in war expenditures. Some of us urged that course from the outset, but since it has not been followed, the only alternative is to deal with inflationary effects by such expeditives as are necessary to hold the line so long as inflationary dangers exist. After reconversion, demand, which has so vastly exceeded supply in wartime, should be met by fully employing our manpower and material resources in peacetime production, and creation of further inflationary

forces should be ended by greatly reducing public expenditures and by maintaining such taxes as are necessary to bring about a balanced budget.

"I have received a few letters from civilians who fail to see why we should have either such disagreeable things as taxes sufficient to deal with inflationary causes or, alternatively, direct control measures necessary to deal with inflationary effects. On the other hand, I have also received a number of letters from men in the armed forces who hope, if their lives are spared, to buy a home or a farm. They do see, with a clarity that should be a warning, why those on the home front should do whatever is necessary to make this country's economic future secure, with all that portends for the peace of the world."

Further along that same line, I would like to read this letter of February 21, 1945, from San Francisco, Calif., addressed to me, which says:

I am writing this letter to you as a sergeant in the United States Army, who for many months risked his life for his country, and is now incapacitated with malaria.

As a patriotic soldier and citizen, it is my duty to bring to your immediate attention a most dangerous unpatriotic attitude on the part of many, many individuals throughout the country.

Since the war started every member of my family and myself has invested to the limit in Government bonds. However, during the past year, I was amazed to find that many persons I meet and talk to are investing all their funds in the stock market and not in Government bonds. These individuals believe the Government has failed to control the cost of living; that the value of the dollar is in a definite downward decline; and therefore, they say only stupid uninformed morons are buying Government bonds; they say intelligent and smart money is going into the stock market, where tremendous profits are being made. They say that inflation is a certainty, and therefore, Government bonds are the worst possible investment.

A wealthy, retired individual I know told me he made \$200,000 in the stock market in 1944. He said he kept 75 percent or \$150,000 for himself and paid the Government 25 percent or \$50,000. He said if his regular income were \$200,000, he would only keep about \$50,000 for himself and give the Government \$150,000; just the reverse of what he did as a result of his stock profits. He said International Telephone went up from \$1.50 per share to \$24 per share, or 1,900 percent rise; Willys Overland from \$1.50 per share to \$20 per share, or 1,500 percent rise; Studebaker from \$3.50 per share to \$24, or 700 percent rise. He said many stocks have gone up from 300 to 2,000 percent.

Many individuals all over the country believe with the stock market "booming," with people getting rich in stocks, why should they throw their money away on 2½ percent Government bonds?

Is this attitude fair to the millions of servicemen like myself who have risked and are still risking our lives for our country. If you can use your good office, or your influence on the President, or Congress, or other authorities to put a stop to this stock market gambling, where billions of dollars are going instead of into Government bonds, then the servicemen will feel that the Government and the people at home have not broken faith with them.

This is signed by Sgt. George Wilson, of the United States Army. I think it is a rather important letter. I think it illustrates these things as well as I could put them myself.

After all, the thing which has caused the difficulty here is the matter of this deficit spending which has taken place during the wartime. That is the basic thing that is behind it all. In other words, back of it all is the essential, wartime expediency of spending a great deal of money, of having rationing, of limiting the amount of goods which people can buy and yet, at the same time, permitting them to accumulate large sums of money thus building up a very large potential of buying power.

What we have been talking about here has been the effects. Everything I think deals with the effects, not the basic causes in this war situation. We are dealing with the effects, not the causes.

Inflationary forces result from huge deficits.

But the public still would not have felt these inflationary causes of deficit financing and they would have been held to a minimum by far higher taxes, and by far greater economy and efficiency in war expenditures than has taken place.

Some of us urged the Congress, from the outset to do that, but since it has not been applied the only alternative is to deal with inflations factors by such expedients as are necessary to hold the line, so long as inflationary dangers exist, a condition which has existed, I believe in wartimes, and which should be met by fully employing our manpower and material resources in building up production, and the creation of further inflationary forces should be ended by gradually reducing public expenditures, and by maintaining such taxes as are necessary to bring about the balancing of the Budget. That these are necessary, and that this is the effect, I think it is clear to all of us. In that connection, I would just like to read a letter that I have received this morning from a real-estate broker and appraiser and analyst of urban properties in Los Angeles, in which he says:

This is just a note from a man on a subject which, I have been informed by mutual friends, you are very much interested in, to wit;

The status of realty prices which will confront the veterans when they prepare to buy after being discharged.

Let me say now that I have been the regularly employed contract appraiser for the local office of the Reconstruction Finance Corporation since its inception in 1932; also for the Home Owners' Loan Corporation and other State and Federal agencies. I therefore talk from a strictly well-informed basis.

I say to you that if something is not done to turn back heavy profit taking on all kinds of real property right away, that the boys will not have a chance for their benefits to function.

Houses which I personally sold as late as February 1943 at around \$6,000 are now held (and are selling) at \$12,000. Whether or not any way can be found to correct this, I do not know. It would seem that retroactive would be the stumbling block.

However I suggest this plan. Let the seller sell for a net profit of not to exceed 15 percent absolutely free but tax him 90 percent on all profits over and above 15 percent.

I know personally one speculator who has bought up 55 houses. He wants from 80 to 100 percent rise in price.

I will be glad to do anything to help any way I can.

Senator TAFT. It would be wonderful for the real-estate brokers. They would turn over these things five or six times a month.

Mr. ECCLES. They are not subject to that. The real-estate broker is not subject to that particular thing.

Senator TAFT. He would have the individual business. I do not think that is very practical. Each time a real-estate man would effect a transfer of the property, he would get a commission on it.

Mr. ECCLES. If he kept on selling it. I do not know if he would.

Senator TOBEY. Mr. Eccles, one of the things that I did not have an opportunity to take up with you before, I wish to take up with you now.

Mr. ECCLES. Yes?

Senator TOBEY. As you know, one of the things that troubles a good many of us is the fiduciary obligation of men toward other people's money. I understand that one of the large brokerage houses has about

\$80,000,000, and that other accounts run anywhere from that amount down to around \$5,000,000 or \$6,000,000. I recently received a letter from a friend of mine in the banking business in which he says, in part, as follows:

* * * we all know that deposits in banks and trust companies are surrounded with all kinds of protections. These consist of frequent reports and examinations and very definite limitations as to what the institution shall hold in its portfolio. There is no such control of what banking houses shall hold against their deposits. This seems to me entirely dangerous and unsound. As a matter of fact, they can hold speculative securities against their customers' deposits as they see fit. Other people's money is dynamite as you and I know, but a lot of amateurs don't seem to realize it yet. A large bank balance is a tempting thing to speculate with, but when it consists largely of what is really sacred money, it immediately becomes exceedingly dangerous for all hands. I personally think that all such money which has been on deposit for over 30 days should be segregated. As a compromise, I would suggest that it be surrounded with the same protections which it would enjoy if it were deposited in a bank.

Mr. ECCLES. There is a lot of protection and segregation.

Senator TOBAY. What segregation is there, is under the rules of the Federal Reserve?

Mr. ECCLES. No.

Senator TOBAY. Is it in connection with the securities and exchange commission?

Mr. ECCLES. The S. E. C. have a lot to do with that. We have a matter of margin requirements, and to the extent that they have credit balances which protect and segregate—I have forgotten the exact amount. It is a very complicated, legal requirement and regulation. We have required certain balances, but I do not know what the balances, credit balances, are at the present time.

Senator TOBAY. It must be a great temptation to use that money to speculate with. We are trying to save the customer, and to save the brokers from themselves.

Mr. ECCLES. The experience of 1929, when the brokers had that same situation, and we have given them that protection now.

I cannot give you exactly the detail of what that protection is, but I do not feel that there is anything else that can be done that we have not already done. I think that I could check up and find out what the requirements are, and let you know, if you wish. We do know that those funds must be protected, and they are policed by the S. E. C.

The S. E. C. acts as a policeman of the brokers. They act just as the bank examiners act on the banks, inspect them and check up on them.

Senator TOBAY. Assuming that their work is effective, would you go so far as to agree with the writer of this letter, in his suggestion that they should have the same protection that the depositors have in a bank?

Mr. ECCLES. I do not think you could do that. I think that you could not give them deposit insurance, unless there was some special provision made for that. You cannot give them all of the advantages when the liabilities are different.

These brokers pay interest on the balances, and the bank is prohibited from paying any interest on balances, daily balances.

Senator TOBAY. You mean that the protection has nothing to do with the chance that they take, and the possibilities of income?

Mr. ECCLES. That is correct. There is a little difference in them, and I think that difference is accounted for.

Senator TOBEY. Do you think that the safeguards are commensurate with the risks?

Mr. ECCLES. Yes. What happens with a lot of these people is that they put their money with a broker, and they buy stocks and they use up the credit, and then they also borrow money and they run over, and borrow money.

Senator TOBEY. There are many of them that have large accumulations.

Mr. ECCLES. That is correct. They wait until they can get back into the market. Those accounts are largely put there by people who are operators, and they put the money into the market, and get it and use it, and they have these balances that are kept with these brokers. There are some exceptions, and there have been people who have made brokers' loans. If you will recall, in the twenties, when brokers' loans ran up to such terrific points, brokers' loans got up to around \$10,000,000,000 and in the 1929 crash, over \$5,000,000,000 crashed at that time, and this was credit by others. In other words, corporations, foreigners, people from all over the world, and wealthy individuals. True, other money outside of the banks was loaned to these brokers, some of the brokers, but the law now prohibits that.

Senator TOBEY. But they can get hold of credit balances?

Mr. ECCLES. They must borrow from banks. They can borrow from banks under certain circumstances. What they do, they fix a margin, we fix the margin that must be paid on those borrowings from the banks, either the broker or the individuals, on the registered securities, and we determine the margin, unless it is for the purpose of building houses where we have a certificate and they may borrow money for that purpose. That is in a different class.

Those bank loans, loans made by the bank to brokers, are subject to the margin requirements. The brokers' loans, individuals, or individual loans, are subject likewise to the same requirements. In other words, when money is loaned to the brokers it is at a certain margin.

The broker can loan to the customer on a certain margin, whether it is the customer's credit balance or the bank's money, but he cannot lend that money to buy stocks or bonds of the customer except on margin.

As a matter of fact, we can put that up to 100 percent, and maybe we will do it. We can keep them on a cash basis, put them on it and keep them on it tomorrow. If you put that tax on, the margin, I think, would be quite effective.

Senator TOBEY. Do you mean the margins on the loans?

Mr. ECCLES. It will slow it up some. It will put the cash operator at an advantage over the credit operator. The credit operator will operate at a very severe disadvantage. I do not think, over any length of time, it would continue. It may have a little effect at first, but it would die off.

Senator TOBEY. In the first flush of the announcement, it will create a reduction and cause some hesitation?

Mr. ECCLES. If we do that, it will have that effect for a time, at least, and it would act as a deterrent to sales on the market and activities of that kind. That is, credit activities. I would say at this time that

about half of the market activities are on credit today. One-half of the number of shares is moved on credit.

The brokers would not like it, because it would knock down their volume. I doubt if it will affect the prices much, if any.

Senator TOBEY. In what way?

Mr. ECCLES. I do think it will affect the prices a little, but I think that it would be very small, if any, and I do think that the proposed tax will very seriously effect speculators. I think the farmer can still buy his farm, but he cannot buy it to sell, he can buy it to use as a farmer.

I think this fellow out here in Los Angeles that bought 55 homes for speculation, this real-estate market out in Los Angeles would not be inflated, and would not be built up to double its previous rate if we had this situation.

The stock market would not have gone up as much as it has. It has gone up more than it should have, and I think that it is having an effect on this country which is not advantageous. I think if this tax is put on it would have a very beneficial effect upon it. That is the reason that I am so strong for it. I say that if this goes on everything else will go on with it, and the whole thing will blow up. Our country will really be in a very bad state if that comes about. I am serious about that, and I know it will happen.

Then, as far as ever getting ourselves adjusted to that situation, I do not know that we would ever completely do so, and I think that we would have great difficulty in bringing it about.

Senator TOBEY. Do you mean, if the stock market goes, you think everything else will go with it?

Mr. ECCLES. I certainly do.

Senator TOBEY. And do you believe that it will be difficult to readjust thereafter?

Mr. ECCLES. If everything else goes, and it is gone, then as far as ever getting ourselves readjusted back even partially to the old scheme, I think it would be most difficult, trying to get business back on its feet again, I think it would be the most difficult thing we ever tried to do.

As a matter of fact, I feel that the Army and Navy here have no consciousness of what they are spending.

We are gradually now getting less and less civilian goods for sale, and we are cutting civilian goods down, and people are getting more and more money to spend and they are having less and less goods to buy, and the result is inevitable—inflation and crash.

Senator TOBEY. The importance of this matter is that it was written by a man in the banking business, and he wrote it to me having a very high sense of the right of the thing. I think it is a very healthful sign.

Mr. ECCLES. I think we need more of it.

The CHAIRMAN. We will take this up tomorrow morning when we meet at 10:30.

(Whereupon, at 4 p. m. the committee adjourned to meet again tomorrow, Thursday, March 8, 1945, at 10:30 a. m.)

(The following letter was later received for inclusion in the record:)

THE AMERICAN MINING CONGRESS,
Washington, D. C., March 8, 1945.

Re: S. 510.

HON. ROBERT F. WAGNER,
Chairman, Committee on Banking and Currency,
United States Senate, Senate Office Building,
Washington, D. C.

DEAR SENATOR WAGNER: The American Mining Congress has given careful consideration to the legislation pending before your committee under which the minimum gold reserve requirements against Federal Reserve notes and deposits would be reduced to 25 percent. We believe this proposal, which constitutes a departure from a principle adhered to for over 30 years, is of serious concern to our future monetary policy and the stability of our currency.

In the event your committee concludes that a reduction in the reserve requirements is imperative at this time, we respectfully urge:

(1) That such reduction be limited to a 2-year period, at the termination of which the existing gold reserve requirements, of 40 percent against Federal Reserve notes and 35 percent against deposits, will be automatically restored.

(2) That any reduction at this time be limited to 30 percent.

Since a reduction in the gold reserve requirements is proposed as a result of emergency conditions arising from the war, it is fitting that the term of such reduction be limited to a fixed period. Many precedents for such a limitation exist in recent wartime legislation, as well as in the monetary legislation of the past decade. If at the end of 2 years the emergency has passed, such a measure as you are now considering should be allowed to expire. If the emergency still exists, we submit that a matter of such great public importance should be subject to review by the Congress, to determine what action may then be required. In either case, the long-established 40 percent and 35 percent requirements should be maintained as a part of our permanent monetary structure; any departure from them should be temporary only and should not be enacted in the form of permanent legislation.

Reduction of the reserve requirements to a figure no lower than 30 percent is in accord with testimony by Mr. Eccles to the effect that a 30-percent minimum requirement would take care of any foreseeable contingencies through at least 1946. We see no valid reason at this time for going beyond the needs of the next 2 years.

Basically, we believe in a sound monetary system, with adequate metallic backing. Reduction of the gold reserve behind our money is a step toward a managed currency with all its evils, and away from sound and tested monetary principles. We should go no further in this direction, and for no longer a period, than absolutely necessary. We disagree strongly with the view of Mr. Eccles that a gold reserve is "a concession to orthodoxy" and that the pending legislation is a "technical matter," on which the Treasury had been consulted but as to which "nobody else would be familiar with it or would be interested in it." We submit that this legislation is of the most far-reaching consequence to the future economy and prosperity of our country, that the utmost caution should be observed, that if we go through a "red light" set up by the Congress and scrupulously observed for 30 years, we should keep the brakes in sound working order. We should not, under the stress of emergency, take any action that might disturb confidence in the integrity of the American dollar, or jeopardize the protection to our currency afforded by an adequate gold backing.

Very respectfully yours,

THE AMERICAN MINING CONGRESS,
JULIAN D. CONOVER, *Secretary.*