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MONEY AND PUBLIC FINANCE

9 September 1952

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DR. REICHLEY: Your first introduction to this subject actually was given to you yesterday morning about this same time. You recall, there was a little discussion about money. Today we are going to hear about money--its place in our economy and how public fiscal policy operates. To discuss this subject, "Money and Public Finance," we have called on a man who has spent practically his entire life in this area; he has received outstanding recognition as an authority in the field of money and public financing. It gives me great pleasure to welcome back the Professor of Banking at New York University, Mr. Raymond Rodgers.

MR. RODGERS: Admiral Hague, staff, and members of the college: This subject is a very important one in any money economy or credit economy. It is important to understand what can be done with such an economy.

We have learned a lot of things about money in the past 20 years. We have learned that we can do wonderful things with it. But, some people are giving it too much credit! That is a poor pun but good economics. As a matter of fact, some people in Washington think they have discovered the "stone of wisdom" with respect to money or credit expansion. But, this morning we want to give credit where credit is due. There's that punning again! We want to get an idea of what it is all about.

As a nation, we don't want to be like the fellow who went to a convention some years ago. After a rather rocky evening, this fellow woke up in the hospital about 10 o'clock the next morning. He got one eye open and saw that he was pretty badly banged up, with a broken leg and three or four other things. His friend hovered over him. He looked up at his friend and said, "What happened?" "Well," he said, "when we came home, we went up to your room on the third floor of the hotel; you walked over to the window and said you were going to fly around the block and stepped out." He said, "Why didn't you stop me?" "Why didn't I? Well, I thought you could do it!"

Now, we want to understand just how big a block we can fly around--how far and how high. I can't give you the answers. We just don't know the answers to these things. There is no way you can put an engineer's measuring device on them. You just do the best you can and hope it will work.

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The Present Role of Money

What is the role of money in modern times? We have in America what we call, "managed money." That means that the experts try to manage it. Literally speaking, there is no such thing as managed money. To really manage money you have to manage people. You are only able to do that in a dictatorship. You certainly can't do it in a democracy, where you have elections every four years.

We call it a managed money, but it is somewhat of a courtesy title. We do the best we can about managing it, but our best has many, many shortcomings and many, many limitations.

Before we go into that, let us look for a moment at the functions of money, because money isn't what it used to be. There is no question about that--no more than you and I are what we used to be! I don't know whether that is bad or whether it is good. It may be bad for us but good for the country. But, in any event, what are these traditional functions of money?

Well, the first thing the economists list is that money is the medium of exchange. Now, that is simply not true unless you have a very broad and elastic idea of the term "money." You and I know that a lot of goods exchange hands because you tell someone to "charge my account." Goods change hands by means of charge accounts.

Goods also change hands because we go to the bank and say: "I don't have any money and I need some, so lend me some." We get a loan, that is, book credit at the bank. In a broad sense, of course, that is money. But it is money only under the definition that anything that does money's work is money. If money is what money does, that, of course, is money. But in the sense that the economists use it, in the traditional sense, it is a difficult kind of money, as they had in mind currency and coins. So money in the sense of being the medium of exchange is a narrow definition of the term "money" and in this respect money doesn't amount to very much.

As you know if we want to get something that is at all expensive, we do not use folding money. On the contrary we charge or we check. It is as simple as that. For pin money purchases, yes, we use money. If we buy gasoline, we may use money; but even there we often use credit cards. If we buy an automobile, we certainly would use credit; most people do. So, for this traditional function of being the medium of exchange, we must bring in credit also.

As for the next function, money in the sense of being a store of value--the law has changed all that. The only value currency has is that someone else will take it as money. It has no intrinsic value. One piece of our money is just as good as another piece, whatever that

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may mean, because the President and the Treasury have the responsibility of keeping all our different kinds of money at a parity. So, you no longer have to bite it; you no longer have to compare it, analyze it, or weigh it, as you did a long while back. Nowadays you take it for better or for worse. So far as the store of value, function is concerned, that was changed by law in 1933. Intrinsically, today, currency is merely a piece of paper. Extrinsically, in the sense that people will give you value for it, it is "A"-number one, don't pass any up!

The next function is as a standard of deferred payment. In other words, you can make contracts that run on into the future. That is something you men don't have to worry too much about in Military purchasing. You have to have the goods in a hurry; preferably, "right now"!

It was customary before 1933 to determine the amounts due on long-term obligations by some reference to gold. All of that is illegal now. Under the law the dollar must be used as the unit, whatever its value may be at the time of the payment. In short, money is no longer a standard of deferred payment except insofar as a dollar is a dollar, as Gertrude Stein put it.

Then, what is money in the narrow sense of the term? It is our common denominator of value. It is as a standard of value that men are largely interested in money. How much can we get with how much? How many units does it take to get a plane, a battleship, or a tank? It is the price-level angle, the yardstick angle, that will primarily interest you. It is anything that affects that yardstick, anything that affects that purchasing power, that is of tremendous importance to you gentlemen who are spending my money and your own money. Don't forget that last part--your own money! As I said when I talked to the Industrial College last year, "Don't worry too much about the economy surviving. Worry about your surviving, because every contract you sign a little bit of your hide rides with it." Just keep that in mind.

Obviously, we are talking now about inflation and the things which make it possible. That brings us up to credit expansion. Summarizing, it is as a standard of value that money in the narrower sense renders its real service to us. And it is because of the effect on that standard of value, of credit expansion, that we are devoting our high-priced time to it here this morning.

Credit, the Modern Money

Credit is said to be the lifeblood of industry. Credit may well be the most important weapon we have. Most industrialists and all bankers would maintain that one of the greatest advantages America has over other countries is its credit system, its modern credit system, which permits it to marshal its resources and give aid where aid is needed, which enables it to shift production from one line to another without

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the long, slow, steady accumulation of cash, or even gold itself, that states used to have to do when they wanted to wage war.

Let us see what that meant in World War II. As you gentlemen well know, World War II cost us a lot of money. In fact between 1 July 1941 and 1 July 1945, this Government spent 317 billion dollars. Of that 317 billion, only the sum of 127 billion was raised by taxes. More of it should have been raised by taxes. For example, the Canadians did far better. We could have carried more taxes, especially at lower income levels. But only the amount of 127 billion dollars was taxes; the sum of 190 billion was through borrowing.

Of that 190 billion dollars, roughly 100 billion came from real savers, what we call ultimate investors--people who did not spend some of their "folding money," but handed it to the Government for bonds, or put it into an investing institution which turned that dollar of purchasing power over to the Government. That 100 billion dollars is not what we are interested in. It is the 90-odd billion dollars of bonds that was put into commercial banks that we want to take a good look at. It is through this 90 billion that the commercial banks greatly aided in financing the war by credit expansion.

So you can see we have a pretty sizable item there that came through credit expansion. In other words your interest in this is that credit expansion can be made to help fight a war. But, before we take off on that, let us take a look at these dollar-for-dollar institutions.

The outline said that I would mention some important components in the monetary system. That is just what I am going to do. I am going to mention them. Then, we will go on to the main performance.

The most important of these savings institutions is not what you think. It is the life insurance companies. They are the ones with the real "dough," because, as you know, they have sold life insurance to people who have paid in money. The life insurance companies today constitute an accumulation of more than 70 billion dollars of savings, and, the premiums flow into them in a growing stream every day.

Your next most important savings pool is also going to surprise you. I can't prove it; but it is, in my opinion, trust funds in the personal trust departments of banks. It would be my guess that the trust funds being handled by the trust departments of banks would be above 50 billion dollars. I can safely make that statement, that guess, because nobody can prove I am wrong!

Now, another source of real, nice purchasing power, which has the advantage of being noninflationary, is your savings banks. Savings banks' assets today are running around 23 billion dollars.

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Then you have the pension funds. The pension fund idea has become very popular largely because of its tax-saving features. At the moment private pension funds are accumulating about 2.5 billion dollars a year, which is being salted away against the future. In addition to that the sum of approximately 3.5 billion dollars a year is going into Uncle Sam's pension funds--you know, old age security, unemployment insurance, and so on. So, today 6 billion dollars are coming out of the income stream and are being put aside, either to be invested through government investment accounts or through these pension funds of private industry.

Obviously, 6 billion dollars a year can accumulate to a sizable figure, especially with the pension fund idea growing the way it is. As you know, official support is being given to upping the pensions to where they will be in line with today's prices. As a result, pension fund payments are increasing at a rapid rate.

As for the next dollar-for-dollar source, we have in the commercial banks an element that from the standpoint of banking theory, at least, should never have been there, namely, time deposits. We have 40 billion dollars of such time deposits in the commercial banks. They are a pool of savings similar to those in the savings banks and the life insurance companies. Likewise, the savings and loan institutions constitute another pool of savings of some 20 billion dollars.

Please note that we are talking about the total resources of these various savings institutions. They did not, in fact, cannot, put anything like the totals I have mentioned into government securities.

Commercial Bank Credit Expansion

Now that we have surveyed the institutions which have no credit expansion, let us turn to the credit expansion end of the commercial banks. This involved, in World War II, the carrying of 91 billion dollars' worth of government bonds at the peak. In addition, the Federal Reserve banks carried another 24 billion at the peak of the financing of World War II. The figures I am giving you are as of 31 December 1945.

How was it that the commercial banks could buy 91 billion dollars and the Federal 24 billion dollars' worth of bonds? How could they do it? Did they manufacture paper money in the back room? I even heard some Republicans say in the late 1930's that the Treasury waited at the back door of the bank to take out the money that "honest" men put in at the front door. That's not right--they've got a better system than that!

If I can just give you a little idea of this credit expansion, your morning will not be wasted. I warn you, though, that for a while

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you will be in a fog about it. But, if you will stick with me, I promise to bring you out of it. In essence, I want you to get the idea that we have here a marvelous instrument, not only of great potentiality but of great actuality. If you master that idea, my efforts will have been very much worth-while.

Gentlemen, where do commercial bank deposits come from? I think most of you, based on your experience with commercial banks, probably think these deposits are taken down to the banks. Well, some deposits are taken down to the banks, but most of them come out of the bank through credits to deposit accounts--credits which are offset on the other side of the ledger by an increase in loans and discounts, or in investments.

In a commercial bank we have two kinds of deposits--primary deposits and derivative deposits. Primary deposits come from outside the bank; derivative deposits, from inside the bank. It is derivative deposits that we are looking at here (on blackboard), those that are made right there on the barrelhead. Let us see how it is done. Let us see how banks can expand purchasing power. Let us see where such deposits come from.

You go to a bank and borrow a billion dollars. What do you do? You sign a note. The bank calls that a loan and discount and enters it on its books thus--"loans and discount, plus 1 billion."

Then what does the bank do? What is the other entry? You know banks have double-entry bookkeeping. They must debit and credit. If they don't somebody goes to jail, just exactly as in the services! So what is the other, and opposite, entry? It is "deposits plus 1 billion."

Gentlemen, if you can understand what I have put here on the board, we are halfway home. Of course, there are some prerequisites, such as the reserve requirement at the Federal Reserve bank, capital funds, and so on. Also, the bank has to have marble pillars out in front and all that sort of thing. It has to be a member of the "club," that is, it is the banking system which makes this credit expansion possible, or, more properly, the confidence of the public in that banking system.

To repeat, you go to a bank and borrow one billion dollars and to do that you have to sign a note. Then what does a bank do? What are the entries? On the asset side, "loans and discounts plus 1 billion"; on the liability side, "deposits plus 1 billion." Thus, deposits have been "created"; and, deposits are purchasing power!

Now, what has happened? Has anybody sacrificed? Did anybody dig any gold out of the Andes or out of Montana? No. Did anyone do without anything? No. Did anyone sweat, labor, toil? No, not at all. What happened was that the bank made two entries in its books!

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What you are looking at was a revolutionary thing in banking only 70 years ago. Originally it was thought that the way a bank got its credit in circulation was by handing out bank notes. A Boston bank would put its notes out through a bank in Ohio or wherever the frontier was and the western bank would put its notes out through the Boston bank. Then they would hope that the notes would never get home! (This delayed presentation and demand for payment at the issuing bank.)

The national bank system was started as a means of helping to finance the Civil War, as a means of creating a demand for government bonds as security for the notes issued by such banks. It didn't aid much; it got started too slowly. Before that the state banks put out note issues but under the new legislation the national banks were given a monopoly by means of a 10 percent tax on the notes of the state institutions. For a while the state banks practically folded up. Finally, they got on to the idea of deposit banking which, of course, avoids the issuance of notes by the lending bank. They developed deposit banking so successfully that, as you know, the national bank notes were eventually forced out of circulation. In other words we shifted from what is called note-issue banking to deposit banking.

This was a great step forward, because by means of deposit banking a businessman, through the aid of his banker--and that goes for the Government too--can cut his cloth to fit. Businessmen don't have to wait for gold to be dug out of the ground for metallic currency. They don't have to wait until the notes are engraved over at the Bureau of Engraving here in Washington. Deposit banking permits increased purchasing power to be put on the books of the banks instanter, subject, of course, to the limitations of reserves, capital, and banking prudence. Unfortunately, nowadays, deposit banking has too many "friends". Why, some of the boys over on the other side of the street here in Washington, as I said before, think that we have discovered the "Stone of Wisdom" and that we can do anything through bank credit expansion. That is not so. There are limits. Those limits have to do with legal requirements and public confidence. There is little that can be done about these limits. The consequences of exceeding them are so terrible that we must do everything possible to gage the limits in order to avoid going too far. Unfortunately, there is no way we can determine the precise limits until it is too late. And, as you know, Humpty Dumpty can't be put back on the wall!

To come back, let us look at deposit banking here. Where did that deposit come from? Was it merely because someone went to a bank and said, "I want a billion dollars' worth of purchasing power" and they made it for him on the barrelhead? Oh, there is more to it than that. The bank had to analyze the man's statement. It had to find that he had productivity--that he was able to produce something to liquidate that billion. They don't just hand a billion to anyone who asks for it.

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Don't get the idea that deposits are created out of whole cloth. Don't get the idea they are created for anybody and everybody. There is a system to it. The banks have a system and that is what you gentlemen want to learn about--the system.

Let us go one step further. Suppose the Government wants a billion dollars. Well, first, it taps the savings banks, it taps the life insurance companies, and the other savings sources, including individuals. It puts out long-term bonds paying 2.5 percent and "E" bonds paying 2.9 percent, and maybe even up the latter a little! But there are not enough available savings, so it turns to commercial banking to utilize this credit expansion system.

By authorization of the Treasury, the banks have an account on their books reading, "tax and loan account." (They put the right word first!) It used to be "war loan account."

The Government, through its fiscal agents, the Federal Reserve banks--remember not as the central banks for the commercial banks, but as fiscal agents for the Government--sends formal letters to the commercial banks, inviting the member bank to subscribe to a forthcoming bond issue on such-and-such date. And this letter has one little clause in it that makes the bank very happy. It says: "You may credit your tax and loan account."

Banks can buy bonds for cash; but they don't unless they have to do so. Why pay cash when they can get them on credit? Let us put this on an accounting entry basis. It is an investment--I will use the term "governments." So, it is governments, plus 1 billion on one side; tax and loan account, plus 1 billion on the other side.

As you can see the Government has been given a billion dollars of purchasing power. Some of you are going to get lost on this next detour, but I have to mention it for the sake of completeness.

For auditing reasons--and political reasons too, I might say--the Government doesn't draw checks on commercial banks. Such checks are drawn on the Treasury and are payable at the Federal Reserve banks out of the account which the Treasury maintains with them as fiscal agents for the Government. They transfer the money out of these "tax and loan" accounts by means of a transfer order, to the Treasury account at the Federal Reserve banks, as it is needed.

The mechanics of this transfer are very simple. Each of these banks has a reserve account at the Federal, so the Federal Reserve banks simply debits the reserve account of the member bank and credit the Treasury account. The Treasury then draws checks to pay for materials, salaries, and things of that sort. Those checks are deposited for credit to deposit accounts at the Commercial banks and, in turn, are deposited

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by the member banks at the Federal Reserve banks. The Treasury account then goes down and the reserve account of the member bank goes up.

Because of this method of putting bonds in the banks, you have increased purchasing power one billion dollars. How long will it be there? As long as the bonds are on the other side. Remember what I said--double entry or somebody goes to jail.

How did we work up to this peak figure of 91 billion? This process I have described was done over and over again--in fact, with each bond drive during the war. Interestingly and paradoxically, the more you do it, the easier it is to do it. Look at the 31 December figure and I will show you why.

"Governments, 91 billion," on one side; "John Q. Public, 91 billion," on the other side. Now John Q. Public has 91 billion in his very own deposit accounts to buy government bonds that he wouldn't have had if the banks had not bought government securities and created those deposits. He has 91 billion of purchasing power there that he can use going to the dog tracks, or for the purchase of government bonds for cash.

If he bought government securities, there would be no credit expansion--merely a transfer of purchasing power. That would be John Q. Public turning over to the Government his purchasing power. The public can buy bonds by just drawing checks on these deposit accounts. There is nothing unusual about the bookkeeping. Dollars are just taken from one account and put into another.

Why is it easier with each successive bond issue? That is what often misleads military people. It gets easier and easier when you do it this way, until finally it gets as easy as falling off a log. Why?

But first, let me point out, you don't pay the banks very much for this 91 billion. As a matter of fact, they didn't do too much, did they? They just told their bookkeepers to make some entries! Was that all? Oh, no. They gave access to a system which has such public confidence that its book entries serve as money. Do you know what the banks got for that? For a large part of the 91 billion they got only 37.5 hundredths of 1 percent per year during all of World War II.

You see, this is credit expansion; this isn't savings. This isn't somebody doing without a ham sandwich. This isn't anybody doing without anything. No; there's no great sacrifice here. This is writing it up on the books, and for that the banks don't get the same as for true savings. On the bonds that they bought with the time deposits of their customers, they got 2.5 percent or 2 percent, depending on the issues; but on the Treasury bills, short-term issues running for three months, they got only 37.5 hundredths of 1 percent per year during the war

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period. On the certificates of indebtedness, which ran for one year, they got only 87.5 hundredths of 1 percent. These low rates were for the service of credit expansion. The rates paid for Capital Creation by real saving were, of course, necessarily much higher.

Returning to why this gets easier and easier with each succeeding issue, it is because the public has 91 billion dollars here which is just like mana from on high. There hasn't been one dollar of that put up by anybody. It was put there by the banks. It is as simple as that. Since we did it by increasing deposits, the American people have 91 billion dollars of deposits with which they can buy government bonds on a cash basis. These 91 billion dollars of deposits came into being because of the sale of securities to the banks and are thus an addition to the purchasing power of the public. So, as I say, it gets easier and easier; and the first thing you know it may become a habit! And, if it does, runaway inflation becomes inevitable.

As I said before, your interest in this is because of its effects on the value of money, on what you will have to pay for the vast house-keeping, the vast supplies, and the vast purchasing of material that you have to do. So let us take a quick look at that, because there is considerable misinformation about what determines the value of money.

Relation of the Gold Standard to Credit Expansion

You hear a lot of people mourn the day we left the 100 percent gold standard. Frankly, I don't quite see why. Don't misunderstand me--I believe in the gold standard. You have to believe in it just as you have to believe in home and mother. But that doesn't mean we are ever going to be able to go back to it; nor does it mean that it was perfect when we had it on a 100-percent basis. Let me make that clear. I am in a way a sort of devil's advocate here for a moment. I don't know anything that there is more bunk going around about than the gold standard. If we are going to understand the situation, we have to look it in the eye.

We have more actual gold now than we had in 1929, when we had the 100-percent gold standard. (I had nothing to do with this, so, I am not defending anything that I did. But I don't believe in kidding myself about it.) Today we have 12 percent in gold back of each dollar of our purchasing power (currency outside banks, plus demand deposits). Whereas we had only 7 percent in 1929, when no one worried about the gold standard.

Also there is a lot of bunk about how wonderful the gold standard was. It is a sort of fetish. I call your attention to the fact that we had in 1929 the greatest boom that we ever had up until August 1950; and, we were on the 100-percent gold standard in 1929. In 1932 we had the

greatest depression we ever had in our history; and, we were on the 100-percent gold standard!

The idea that prices are determined by the amount of gold in the dollar is simply not true. As a matter of fact, in my opinion, gold doesn't determine the value of our dollar. Most of the professors would dispute me on that and they are entitled to their views. But, I feel that, quite to the contrary, our dollar determines the value of gold!

I am going to give you a quick illustration. Suppose you had been a "wise" boy and just when we were coming out of World War II, you said to yourself: "I know what all this is going to do to the value of the dollar. They are not going to quit spending, because they are going to take care of the bureaucrats and their relatives! Therefore I am going to buy gold as a hedge against the drop in value of the dollar. Gold is the supremely desirable thing." Suppose you then had done exactly that.

Well, let us just take a quick look. On 1 January 1946, if you had bought gold in the free market at Tangier--to get it at its true value you would have had to go to a free market and Tangier was nearest to a free market--you would have had to pay 63 dollars an ounce. That was the quotation on 1 January 1946. Suppose you decided to get out on 26 December 1951--roughly six years afterward. What do you think you would have gotten for that gold? Under the notion that the dollar was going to shrivel and that you could protect yourself against inflation, you had bought that gold; you would have gotten only 39 dollars an ounce six years later.

During that same period the dollar dropped 34 percent. How much did your gold drop? It dropped 38 percent. In other words our dollar held its value better than gold! That doesn't mean that we like what happened to our dollar since the end of World War II. But just because you lose on one thing doesn't mean that you couldn't lose more on something else!

Let us calculate the beating taken by those who hedged with gold; those fellows who didn't want to ride with Uncle Whiskers--see the beating they took. They got back 39 dollars, which had dropped 34 percent in value, or, a drop of \$13.26, leaving only \$25.74 in terms of 1946 dollars.

Is that all? No; oh, no. They had to pay those boys over in Tangier to do these things for them. They lost compound interest on their money for six years. That is the loss they took because they lost confidence in the dollar. If that isn't a beating, I never saw one! Well, gentlemen, we want to get back on the track and take a look at what really determines the value of our money.

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I am not trying to flatter you at all, but you military men play more of a part in the value of the dollar than gold does. If we didn't have the military strength to protect our economy, what good would our dollar be? Stability, law and order, and public confidence are things that give value to our money. Its main value, of course, comes from our ability to produce. But you men at the Industrial College know more about America's fantastic production capacity than any other group, so it will not be necessary for me to dwell on it. Sufficient for me to say that our dollar will have value to the extent that we can produce goods to back it.

Gentlemen, that is my nickel's worth. Do you have any questions?

QUESTION: When you had that 91 billion dollars on each side, you said that as long as it stayed on one side it would stay on the other. What are the mechanics of reducing that if you ever desired to reduce it?

MR. RODGERS: It actually has been reduced to 61 billion. We did it this way: We overborrowed on the last war loan. We got about 13 billion dollars that we didn't need and that was repaid; so that was automatic. In other words we turned the excess amount in on this account on one side of the balance sheet and reduced it straight across the board.

Later, some of these bonds were shifted from the banks to ultimate investors by selling securities to the public and redeeming the securities held by commercial banks.

You may ask, why not just increase taxes and pay off these bonds? That this can only be done very slowly becomes obvious when you follow through on the entries. As you well know, you pay your taxes by writing a check. The "money" is transferred from your account to the Government's account. Let us forget about it going to the Federal and then coming back, even though that is the way it goes. Let us just say it is transferred from your account to the Government's account. These bonds are then charged against the Government's account. So the amount of the bonds goes off the balance sheet and an identical amount goes out of the deposit. This reduces deposits, the "means of payment," and is thus deflationary.

This reduction of the "means of payment" makes it very, very difficult to pay off a bank-held debt. Suppose we decided, like Andrew Mellon did after World War I, to start paying off the debt. Taxes would have to go up. They would take a lot of meat and maybe some of the bone! (They are already taking our hide!) Such an increase would certainly be deflationary. Then suppose the Government decided to pay off 10 billion of this 61 billion dollars on the books of the banks.

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When this 10 billion goes off the bank's balance sheet, 10 billion comes off the means of payment, that is, demand deposits go down 10 billion dollars. That is not just 10 billion dollars taken out of the economy. That is 10 billion multiplied by around 30 times each year (the current rate of turnover). That means you have taken 300 billion dollars per year out of the economy at one crack. No political party would want to have a share in that!

Let us go through that again. What happened when the banks purchased those securities was this, in effect: The Government in Washington spend more money than it took in. It had a deficit; for that deficit it issued a piece of paper called a bond. That bond is bought by a bank, and the fact that the bank buys that bond means that there is an increase in bank deposits, that is, in purchasing power. In short, the deficit in Washington became purchasing power when you put it on the books of the bank. That is having your cake and eating it, too; but, you pay twice on the way down.

In short, the deflationary effects of a substantial increase in taxes and a consequential reduction of demand deposits would be so great that no political party would hazard it. This means the debt held by the banks will have to be paid off slowly, if at all!

QUESTION: You mentioned earlier that there was a limit to the credit expansion before there was this big "boom". Would you care to enlarge on the point at which the crash would come?

MR. RODGERS: There is, unfortunately, no answer until afterward. It is like blowing up a rubber balloon. You don't know when it will burst until it is too late. Your question is a perfectly proper one but I can't answer it. No one can answer it, because we don't know until afterward.

You might very well have put the question like this: "We went from 50 billion to 250 billion dollars during World War II, which was up four times. We got away with it. We only lost a little of our hide. Now, why can't we go from 250 to 500 billion? That is only up one time. Why can't we go to 500 billion dollars and buy all the planes, all the supercarriers, and so on, that we need?"

Well, I will only say to you, we can do that in wartime and get away with it. In peacetime, I don't know how far we can go. I do know we can't go as far as we can in wartime. As for the ability of our banking system to expand, I'll give you the mechanics--I will give you a technical answer.

Our Federal Reserve banks must have 25 percent in gold certificates back of their deposit and note liabilities. Today, Federal Reserve notes total 24.8 billion dollars and deposits are 22 billion dollars.

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This gives a total liability of 46.8 billion dollars. Twenty-five percent of this equals 11.7 billion dollars in gold certificates required.

The Federal Reserve banks have 22.1 billion dollars of gold certificates. The Treasury has, in real gold, 1.2 billion dollars. This gives available gold of 23.3 billion dollars. Subtracting the required 11.7 billion, we have left 11.6 billion of "free" gold--this "free" gold is available for credit expansion.

This sum of 11.6 billion dollars of "free" gold will support 4 X reserve balances, or 46.4 billion dollars more reserve balances. These reserve balances will support 5 X deposits, or 232 billion dollars more in deposits.

The Federal Reserve banks now have 23 billion dollars in governments. They could buy 46 billion dollars more without changing the law. The commercial banks now have 61 billion dollars of government securities. They could buy 232 billion dollars more without changing the law--right here and now! So, we aren't down to our last legal dollar by any means. There's a great deal more credit expansion where the other came from!

Of course, this would have an effect on prices. It certainly would be a big shot in the arm, but mechanically it can be done.

Let me tell you something else. We cut our required gold reserve from 40 percent down to 25 a few years ago and I'll bet none of you can tell me when it happened. I didn't realize it had happened until afterward and I am in the business! So, in an emergency, we might even cut our required gold reserve from 25 to 12.5 percent and get away with it. If we did, we would still have more gold against the purchasing power of our money than most other countries. Such a reduction would permit credit expansion, so far as the mechanics are concerned, of about 600 billion dollars more. It really makes you dizzy to contemplate it.

COLONEL BARNES: Professor Rodgers, on behalf of all of us I thank you for taking the mystery out of this complicated theory, as you always do. We certainly appreciate your coming down.

(19 Nov 1952--250)s/fhl

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