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Sound Money and Sound Banking

A Review of *A Proper Monetary and Banking System for the United States**

There has long been need for a definitive statement of what constitutes a sound monetary and banking system. That need has been met for the intelligent layman in this authoritative, compact, and readable book, which is the work of nine well-known monetary economists. Their contributions have been skillfully edited into a unified whole by Professors Bell and Spahr, who also are contributors. The book was prepared under the auspices of the Economists' National Committee on Monetary Policy.

The purpose of the study is to describe "the fundamental errors in principle and practice in our monetary and banking structure" and make "specific recommendations for improvement." (p. iii) This is accomplished by means of succinct analysis and prescription, with a minimum of background material. The book is an example of excellent collaboration in the treatment of a subject that is in some ways complex; its content makes it a work of enduring value.

Developments of the past three decades afford ample evidence that the monetary and banking system of the United States is imperfect and therefore has lent itself to abuse. As the editors point out in their Preface:

"Of most fundamental importance are the departure by our Federal government from the integrity of a redeemable currency; the use by our central government of the Federal Reserve System and commercial banks to finance its activities by devices favorable to itself, especially by conversion of government debt into note and deposit currency; the pronounced depreciation of the purchasing power of the United States dollar; and the persistent agitation for another devaluation of our dollar." (p. iii)

At the outset, the elements of a sound monetary system are considered. The functions and requisites of a sound monetary standard are discussed; kinds of coin, currency, and bank deposits that serve as a medium of exchange are described; and what constitutes the right amount of each is explained. The authors, in recommending the gold coin standard as the best monetary standard for the United States, present a model bill that specifies in detail the legislative provisions necessary "To provide the United States with a gold standard and redeemable currency, and to correct other defects in the monetary system of the United States." (p. 17) Obviously, much careful thought went into the drafting of this bill.

In the chapter on "A Proper Central Banking System," six of the authors have collaborated to describe, analyze, and make recommendations as to the purpose and structure of the System, the credit liquidity problem that is involved, appropriate methods of credit control, and the relationship of central bank policy to the balance of international payments. Clear and carefully worded exposition makes the rather technical subject matter of this chapter readily comprehensible.

Among other aspects of the money-credit system considered in this study is that of the relationship of central banking to government. Although the experiences of central banks in other countries are reviewed, particular attention is given to the relationship of the Federal Reserve System to the U. S. Treasury. The major problems involved in this relationship are analyzed. The need for close administrative cooperation between the System and the Treasury, and "the need for a clear definition by Congress of the policy objectives of the Federal Reserve System" (p. 156), are emphasized. Both the Federal Reserve and the Treasury, however, "should preserve their freedom of decision—even at the cost of a temporary stalemate." (p. 155) The independence of the System is seen to be of primary importance:

"The Federal Reserve System should be placed beyond political and special-interest influences. If this principle is not carefully observed, the results can be unfortunate. The System was designed and established, and properly so, for the benefit of all the people of the United States, rather than for any particular political party or special-interest group. It is, therefore, desirable that the Federal Reserve banks not be owned by the government, since political influences flowing from such ownership permit and invite their domination by the Administration in office and interfere with their appropriate independence." (p. 168)

The correct relationship of the Federal Reserve System to other financial institutions is carefully considered, and recommendations are made. Because commercial banks can increase and decrease the amount of their demand deposits (which are simply checking-account purchasing media), their relationship to the Federal Reserve banks should be a close one in which Federal Reserve authorities exert control over the commercial banks' credit expansion activities.

The relationship of the Federal Reserve banks to domestic financial institutions outside the commercial banking system should be such that the effect of Federal Re-

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serve monetary control is indirect and generalized. Those institutions include savings banks; savings-and-loan associations; credit unions; insurance companies; private pension funds; Government insurance and pension funds; land banks; investment, mortgage, and finance companies; security brokers and dealers, Government lending institutions, trustees, etc.

Such institutions are not, and should not be, a part of the Federal Reserve System; and Federal Reserve policy should not attempt to favor or discriminate against the lending operations of any of them. Underlying this and other recommendations that are made is the principle that except for generalized control by the Federal Reserve over the money market, the markets for both short- and long-term funds should allocate those funds according to the free play of demand and supply.

As for the relationship of the Federal Reserve System to foreign central banks and international financial institutions, closer cooperation and freedom of all the officials from political influence would be desirable. The International Monetary Fund and the International Bank for Reconstruction and Development at present are far from being free from outside influence:

"The Fund and the IBRD were conceived from the outset not as a 'central banks' bank' as was the BIS [Bank for International Settlements], but as independent international institutions free from the influence of either governments or central banks. The goal has not been achieved. While the central banks, including the Federal Reserve System, have little or no direct influence on the policies of the Fund and the IBRD, both institutions are apparently subject to strong political pressures from the United States Treasury and State Departments." (p. 196)

The constitutional and other legal qualities of United States coin and currency are ably discussed in a chapter on "Legal Considerations." In it also are considered the question of gold-clause contracts and the question whether to integrate monetary and fiscal management under the authority of the President.

It is to be hoped that the recommendations for a sound monetary and banking system that are made in this practical compendium will come to the attention of every individual in Government and private life who can be influential in bringing about the adoption of sound fiscal and monetary policies and the enactment of appropriate legislation that will support and implement those policies.

Discount Rate Reduced

A reduction in the Federal Reserve discount rate from 4 to 3½ percent was announced June 2. The significance of the change in Federal Reserve Board policy thus evidenced perhaps can be judged if adequate weight is given to the following:

1. There has been no marked increase in the funds available for new investment, nor has there been a marked decrease in the demand of borrowers for funds. Such easing of money market rates as has occurred in recent weeks reflects the willingness of the Federal Reserve Board to supply additional reserves to the commercial banks by purchasing securities in the open market.

2. Potential foreign demand claims on U. S. gold still are accumulating at a dangerous rate, and the risk of a "run" on the dollar will be increased by widening the gap between interest rates in the United States and those in the financial centers of other leading industrial nations.

We conclude that the artificial easing of money rates fostered by the Board in recent weeks probably indicates concern about present business trends, concern so great and presumably so well founded that in an attempt to halt or reverse a serious contraction of business the Board is willing to incur the grave risk of encouraging speculation and of jeopardizing the standing of the dollar abroad.

What the Indicators Say

Note: The indicators reported on below are seasonally adjusted.

Among the leading indicators, manufacturers' new orders for durable goods decreased from March to April.

Among the lagging indicators, manufacturers' inventories increased in April.

The leading indicators continue to signal a business recession.

* * * * *

The Iron Age composite price of No. 1 heavy melting steel scrap, not one of the indicators, was $32.50 on May 31, unchanged from that on May 24.

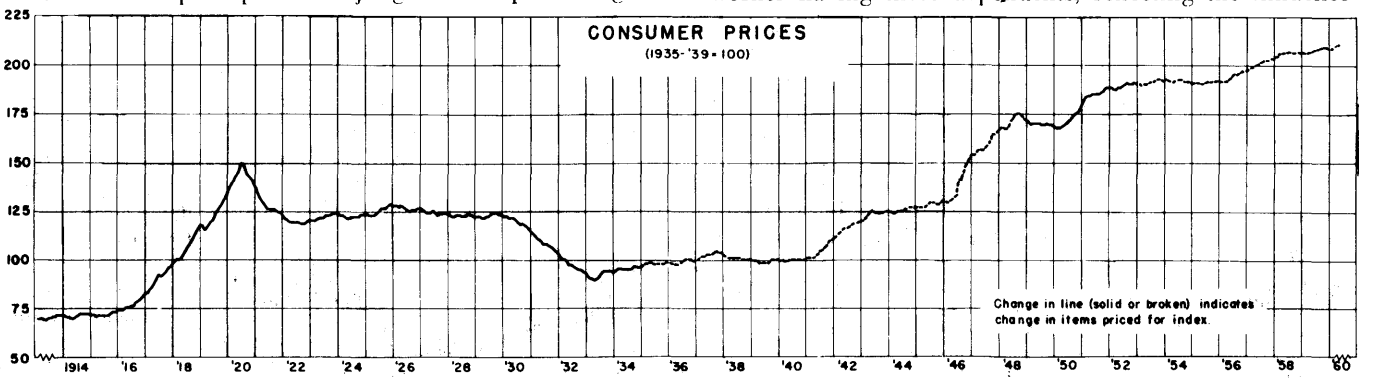
PRICES

Consumer Prices

The Bureau of Labor Statistics index of prices of goods and services bought by moderate-income families, known as the Cost of Living Index, increased more for the month ended April 15 than for any month since last June, reaching another record level nearly 2 percent higher than that for April last year.

Food prices, continuing their seasonal upward trend, increased 1½ percent during the month, compared with an increase of four-tenths of 1 percent for the entire index. The greater part of the increase was attributable to increases in prices of fresh fruits and vegetables, meats, and eggs. There were small increases in all other components except transportation, which decreased slightly as used-car prices declined significantly.

The average weekly "take-home" pay for a factory worker having three dependents, reflecting the influence



of a shorter average workweek, decreased 85 cents from March to April or to $80.20, compared with $80.68 a year earlier.

Arnold Chase, Chief of the Bureau's Price Division, said that he expected the overall index to increase gradually through the summer.

The increase in food prices, which had been anticipated, was due mainly to decreased supplies of meat animals and potatoes, together with seasonal price increases for fruit. Unseasonable weather in March contributed to the amount of the increase in the index, but the effects of this influence were diminishing in May as wholesale prices of these items began declining. Commercial meat production in the first quarter of 1960 was 9 percent more than that of the corresponding quarter last year, but 3 percent less than that of the fourth quarter of that year. Since last fall, the flock of laying hens has been less than that of a year earlier, and egg production in April was 5 percent less than that in April 1959. The Department of Agriculture reports, however, that increased hatchery activity indicates greater supplies of broilers beginning about mid-July.

Except for food prices, the increase in the cost of living this year cannot be attributed to rising commodity prices. Comparative stability in average prices paid by consumers for nonfood items this year has resulted principally from price cutting on some durable goods, sales of which have proved to be more or less disappointing. Although demand for automobiles and certain other consumer goods improved in April and May, large inventories have been a restraining influence on prices.

Further increases in the consumer price index seem more probable than decreases for a few months at least, but such increases probably will be small.

Commodities at Wholesale

Index	*1959 June 1*	*1960 May 25*	*1960 June 1*
Spot-market, 22 commodities	270	265	264
Commodity futures	315	307	307

Note: The indexes are respectively those of the United States Bureau of Labor Statistics and Dow Jones. Both indexes are converted so that their August 1939 daily averages equal 100.

BUSINESS

Business Failures

Liabilities of business failures in April were $69,200,000, slightly less than those in March and about 4 percent less than those in April 1959. Our 3-month moving average of liabilities for March was $66,800,000, about 8 percent more than that for February and slightly more than that for March 1959.‡ At this level, the moving average was higher than that for any postwar March except that of 1958.

‡This article is based on data reported by Dun & Bradstreet. Reported liabilities exclude long-term debt publicly held. Our 3-month moving average is centered at the second month.

BUSINESS FAILURES: NUMBER AND LIABILITIES
BY TYPE OF BUSINESS
April 1959 and 1960

Business	*Number April 1959*	*Number April 1960*	*Percent Change*	*Liabilities* April 1959*	*Liabilities* April 1960*	*Percent Change*
Mining & mfg.	202	215	6	16.5	18.5	12
Wholesale trade	132	140	6	14.0	11.4	−18
Retail trade	671	674	0	22.8	18.6	−19
Construction	166	220	33	8.6	13.6	58
Com. service	121	121	0	10.0	7.1	−29
All businesses	1,292	1,370	6	71.9	69.2	− 4

* In millions of dollars.

There were 1,370 failures in April, 3 percent more than the number in March and 6 percent more than those in April 1959. In April as compared with March, retail trade failures increased 11 percent, those in commercial service remained almost unchanged, and those in the other major categories, mining and manufacturing, wholesale trade, and construction decreased by 2, 4, and 9 percent respectively.

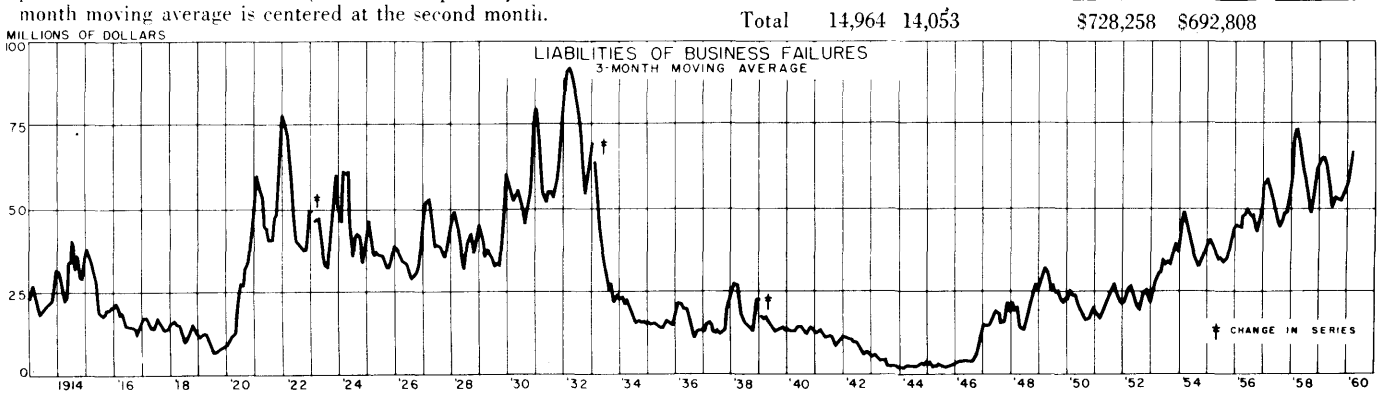
The number of failures in the 4 weeks ended May 26 was 1,243, or 13 percent more than the number in the corresponding period last year.

Liabilities per failure averaged $50,500 in April, compared with $52,600 in March and with $55,700 in April 1959.

Failure liabilities in the first 4 months of 1960 were about 6 percent more than those in the corresponding period last year. The relative increase appeared to have been attributable chiefly to losses in the construction industry, in which failure liabilities for the period increased 58 percent. There were also small increases in wholesale trade and in mining and maufacturing, while failure liabilities in retail trade and commercial

BUSINESS FAILURES: NUMBER AND LIABILITIES
By Months, 1958-1960

Month	*Number 1958*	*Number 1959*	*Number 1960*	*(000 omitted) Liabilities 1958*	*Liabilities 1959*	*Liabilities 1960*
January	1,279	1,273	1,181	$ 64,442	$ 73,564	$ 53,671
February	1,238	1,161	1,214	65,295	58,592	60,945
March	1,495	1,263	1,335	71,555	65,051	70,193
April	1,458	1,292	1,370	83,977	71,907	69,192
May	1,341	1,135		56,246	50,917	
June	1,260	1,244		61,445	49,197	
July	1,253	1,071		65,375	51,197	
August	1,127	1,135		50,765	54,501	
September	1,039	1,144		48,103	54,736	
October	1,271	1,125		47,268	50,376	
November	1,121	1,130		56,718	53,214	
December	1,082	1,080		57,069	59,556	
Total	14,964	14,053		$728,258	$692,808	



services decreased sharply by 34 and 24 percent respectively.

As percentages of all monthly failure liabilities, those among the various divisions of industry and trade changed as follows from March to April: retail trade up from 20 to 27; wholesale trade up from 14 to 17; mining and manufacturing down slightly at 27; commercial services down from 11 to 10; and construction down from 28 to 20.

Dun's Failure Index, seasonally adjusted and expressed as an annual rate per 10,000 active enterprises, increased from 51.1 in March to 54.9 in April, compared with 52.0 in April 1959.

The fifth consecutive increase in the 3-month moving average of failure liabilities into the highest reaches since 1932 suggests that the current business recession may be accentuated.

SUPPLY

Industrial Production

Production of steel, automobiles, lumber, and electric power (1) in the 1- and 4-week periods ended on the indicated dates in the current year and (2) in the corresponding periods of earlier years was as follows:

	1929	*1932*	*1957*	*1958*	*1959*	*1960*
Steel						
Ingots—million tons						
1 week: June 4	1.31	0.32	2.25	1.69	2.68	1.77*p*
4 weeks: June 4	5.33	1.43	8.96	6.20	10.68	7.79*p*
Automobiles						
Vehicles—thousands*						
1 week: May 28	136	47	159	92	154	180*p*
4 weeks: May 28	553	181	637	424	666	738*p*
Lumber						
New York Times Index						
1 week: May 21	133	42	111	104	115	108
4 weeks: May 21	130	41	110	101	111	109
Electric Power						
Kilowatt-hours—billions						
1 week: May 28	1.7	1.4	11.6	11.2	12.8	13.6
4 weeks: May 28	6.8	5.7	45.7	45.1	51.0	53.5

p Preliminary.
* Cars and trucks in the United States and Canada.

DEMAND

Department-Store Sales

We estimate that the seasonally adjusted sales of the department stores reporting to the Federal Reserve banks were almost 10 percent less in May than those in April, and about 5 percent less than those in May 1959. Exceptionally large sales in April account partially for the May lull, but the May index also dipped perceptibly below the February-March level.†

†The reference basis of our 4 department-store series has been shifted from 1935-39=100 to 1947-49=100; also, our indexes of department-store prices and physical volume of sales have been completely revised in accordance with recently available source data. The index of potential department-store sales will be revised later.

Our index of department-store prices remained substantially unchanged from March to April when it was about 1 percent higher than the index for April 1959. Apparel prices advanced very slightly in April, while housefurnishings prices remained unchanged from the March level.

Our index of the physical volume of goods sold through department stores decreased nearly 10 percent from April to May, and was 6 percent smaller than the index for May 1959.

The potential physical volume of department-store sales, as measured by the production of goods sold in department stores, continued to decrease through April from its last peak in December, but was still 4 percent more than the production of such commodities a year earlier.

Reports on sales by departments, covering the first 3 months of the year, indicate that the largest sales increases were in homefurnishings, piece goods, and household textiles, while sales of men's and women's apparel decreased from sales during the first 3 months of 1959 (presumably attributable largely to the later Easter this year).

Surprisingly large sales volume in April, attributable partly to deferred sales because of unfavorable weather in February and March, and partly to the April date of Easter, appears to have been followed by a May slump somewhat greater than seasonal.

We see no reason to expect marked gains in sales for department stores during the next several months.

Latest Weekly Data

Sales of department stores reporting to the Federal Reserve banks compare with those of corresponding periods a year earlier as follows:

Period	*Percent Change*
Week ended May 28	+14
Four weeks ended May 28	+ 2
Year to date	+ 3

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INDUSTRIAL PRODUCTION
FEDERAL RESERVE BOARD INDEXES
(Seasonally Adjusted: 1947-49=100)

Industry	*1959* *Apr.*	*1960* *Mar.*	*1960* *Apr. p*
INDUSTRIAL PRODUCTION—Total	162	165	165
Manufactures—Total	161	164*r*	164
Durable	*171*	*175r*	*173*
Nondurable	*155*	*157*	*159*
Mining	129	125*r*	128
Utilities	262	282*r*	278

p Preliminary. *r* Revised.