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COMMITTEE:
BANKING AND CURRENCY

Congress of the United States
House of Representatives
Washington, D. C.

June 13, 1960

Mr. Per Jacobsson
International Monetary Fund
19th and H Sts.
Washington, D. C.

Dear Mr. Jacobsson:

I appreciate very much your excellent remarks to the Reserve City Bankers at Phoenix. I finally had an opportunity on the plane the other day to read your remarks in full. Your analogy of self-adjusting mechanism is, I think, an interesting and useful one.

When you come at page 7 to deal with the effect of credit expansion, I would not ask the question the way you do -- the question in my view is not whether credit expansion can add to savings, but whether it can add to real investment and real income rather than merely reallocate resources by the route of inflation. If the increase in credit expansion cannot put idle resources to work but merely competes for existing scarce resources, the effect will be inflationary; but certainly the experience from 1939 to 1944 was that a significant portion of the credit expansion put to work idle resources.

A growing nation needs a growing money supply. Inasmuch as the volume of gold and silver is not increasing in amount equal to our needs, it is essential that there be some credit expansion through the banking system in order to increase the money supply. I find that the total debt in the United States between 1955 and 1959 increased about $200 billion, while the federal debt merely increased $20 billion. I still think it is important to talk about the total credit expansion and not merely the national debt. Indeed, it may be necessary to explain surplus financing as a necessary governmental policy, as a means to compensate for private deficit financing, and this can only be done in the perspective of the total money and credit. This also relates in part to your comment, on page 11, about the Democrats' desire to expand the money supply. The creation of the Federal Reserve provided a far better answer than William Jennings Bryan's answer of free silver. But Bryan's demands were not unrelated to the need for an expanding money base. His solutions may not have been the best solutions, but they did fit the institutions of that day. We are fortunate that he made the case he did, because it made the creation of the Federal Reserve System easier to accomplish.

At page 10 your discussion of the 4¼% limit on long-term government bonds falls aside from the basic issue involved in the debate last summer. I don't know that anyone objected to temporarily paying a higher rate for short-term credit.

But we did object to locking the taxpayer into a heavy obligation for twenty years or more at 5%. I think the evidence of the past weeks clearly supports the position we took. Not only is it now possible to refinance short-term debt at low interest rates, but it is now possible to sell long-term issues within the $4\frac{1}{4}$% ceiling. We cannot lose sight of our obligation to the taxpayer who pays the bill for the mounting interest charges that these policies have created.

Finally, I still believe that a good banking system uses more than one regulatory factor -- interest is but one measure of control; the terms on which credit is extended also include the amount of down payment, or borrower's equity at risk, the amortization period, and the character or capacity of the borrower to repay. Were the Federal Reserve and other money managers to show an equivalent zeal for varying the other factors, our nation would be in a stronger position. For example, you can increase the rate of saving with more certainty by shortening the amortization period than you can by raising the interest rate. Indeed, raising the interest rate has in recent years caused a reduction in the amount of savings and a lengthening of the amortization period. The failure to relate these two factors to the volume of savings represents a tragic hiatus in the public discussion of the entire issue.

Notwithstanding the foregoing remarks, I did appreciate what you had to say, and I have enjoyed the opportunity to discuss these matters. I hope we shall have the opportunity to do so again -- if not before the campaign, then after it.

May I also commend you for an excellent report to the Economic and Social Council. The accomplishment of the past fifteen years is a tribute to your own work and the work of your organization that deserves only the highest praise.

With every good wish, I am

Cordially yours,

Byron L Johnson

BYRON L. JOHNSON, M.C.

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