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**CONFLICTING OFFICIAL VIEWS ON  
MONETARY POLICY: APRIL 1956**

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**HEARING**

BEFORE THE

**SUBCOMMITTEE ON ECONOMIC STABILIZATION**

OF THE

**JOINT COMMITTEE ON THE ECONOMIC REPORT**

**CONGRESS OF THE UNITED STATES**

**EIGHTY-FOURTH CONGRESS**

**SECOND SESSION**

PURSUANT TO

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(79th Congress)

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# CONFLICTING OFFICIAL VIEWS ON MONETARY POLICY: APRIL 1956

TUESDAY, JUNE 12, 1956

CONGRESS OF THE UNITED STATES,  
SUBCOMMITTEE ON ECONOMIC STABILIZATION,  
JOINT COMMITTEE ON THE ECONOMIC REPORT,  
*Washington, D. C.*

The subcommittee met, at 10 a. m., in room P-38, United States Capitol Building, Washington, D. C.

Present: Representative Wright Patman, chairman, presiding.

Also present: Grover W. Ensley, executive director; William H. Moore, staff economist, and John W. Lehman, clerk.

The CHAIRMAN. The subcommittee will be in order.

The Joint Economic Committee and its Subcommittee on Economic Stabilization have a continuing responsibility to watch carefully the workings of monetary policy, since it is one of our chief instruments for advancing the objectives of stabilization and growth, as called for by the Employment Act of 1946.

Moreover, as I have said in releasing the correspondence which is the subject matter of this morning's hearing, the workings of monetary policy, through its effect upon interest rates and the availability of credit, intimately affect the lives and fortunes of every business, every homeowner, every farmer, and every citizen.

As is generally known, the Reserve System authorities on April 13 again took steps to raise the rediscount rate. Within a few days thereafter, stories began to appear in the press, with indications that the step had been taken contrary to the judgment and wishes of various Cabinet members, specifically Secretaries Humphrey, Mitchell, and Weeks, and Dr. Arthur Burns, Chairman of the Council of Economic Advisers.

For the purpose of getting the record clear as to precisely what had taken place, I wrote to these officials, along with Chairman Martin, of the Board of Governors. For some reasons which I hope will be clearer after this morning's hearing, the replies we received from Chairman Martin, of the Board of Governors, and from the Secretary of the Treasury fell short of being wholly responsive to the few simple, direct questions which we had asked respecting this particular incident.

Had these replies been more responsive, there would have been little need for this morning's hearing. The occasion for this hearing is consequently the desire of the subcommittee to obtain orally the record which the correspondence failed to achieve.

As I have previously indicated, it is our hope that the hearing this morning can be confined as far as possible to the several specific ques-

tions propounded in my letter of May 10. The intention is that this brief hearing at this time can avoid, so far as possible, going into the merits and economic consequences of the action taken in raising the discount rate and otherwise pursuing a tight money policy over the past year or more.

I think it is only fair to say that these substantive aspects and the pros and cons of the tight money policy, including this April 13 action, are subjects which are clearly within the investigative powers of the Congress, since the Reserve System itself is an instrument to which Congress has seen fit to delegate a portion of the powers explicitly assigned to Congress under the Constitution. The authorities of the Reserve System must accept the responsibility for their action under this delegation and, I must say, I have no reason to feel that they want or try to shirk that responsibility.

That responsibility, however, cannot and ought not to be shared with others in the executive branch. Nor ought the responsibility of an agent be allowed to become diffused by the action of a principal too constantly looking over the agent's shoulder. This is not to suggest that in due course an accounting for stewardship is not to be expected and insisted upon from an agent such as the Reserve Board and Open Market Committee are. The time and place for that accounting will come later after we have more evidence as to the wisdom and foresight demonstrated by the System in continuing the tight money policy by its April 13 action.

Since the proceedings this morning are directed primarily at providing a clear public record as to the consultations, views, and differences of opinion which have been the subject of so much recent press comment, I would like to include at this point the memorandum which was sent to members of the Joint Economic Committee on May 23, transmitting the correspondence in question.

Without objection, that will be included.

(The memorandum and letters referred to follow :)

[For release morning of May 23, 1956]

CONGRESS OF THE UNITED STATES

JOINT COMMITTEE ON THE ECONOMIC REPORT

MEMORANDUM

To : Members of the Joint Committee on the Economic Report.

From : Representative Wright Patman, chairman, Subcommittee on Economic Stabilization.

Subject : Correspondence respecting recent monetary developments.

The workings of monetary policy, through its effect upon interest rates and the availability of credit, intimately affect the lives and fortunes of every business, every homeowner, every farmer, every citizen.

It is not surprising, therefore, that many people are disturbed by widespread press stories and whisperings of conflicting opinions at responsible and official levels concerning the wisdom of the recent action of the Federal Reserve System in raising the rediscount rate.

On May 10, I accordingly advised members of the Subcommittee on Economic Stabilization that I was writing the Chairman of the Federal Reserve Board and various members of the executive department, for the sole purpose of getting the record clear precisely as to what lies behind these press stories. The inquiry was not intended to question the judgment of the action itself, the internal procedures of the System, nor the propriety of outside consultation, but merely to learn something of the conditions under which the action was taken. The questions were specific and sought nothing more than simple, factual replies.

I am disappointed, therefore, and I may say, vexed at the unresponsiveness of the replies which have been received from the very agencies which should be most interested in providing a clear public record. The general professions of mutual respect and best wishes for each other contained in the letters from the Secretary of the Treasury and the Chairman of the Board of Governors are only too obviously intended to avoid answering the 3 or 4 simple, easy-to-answer questions concerning the specific incident which has aroused recent public concern. From the marked similarity in the two replies one might almost infer that the vaunted pattern of consultation applies to the problems of dealing with congressional mail, as well as to policy matters. The evasiveness of Secretary Humphrey's letter is all the more remarkable since, when questioned 2 days later before the Senate Finance Committee, he admitted: "If it had been my responsibility I would not have made this last move."

A reading of the questions and the replies is the best evidence of this avoidance. For that reason it seems appropriate that the full text of the exchange of correspondence be released to speak for itself.

Certainly the hope expressed in the letters to the agencies, namely, that by their replies the necessity for public hearings could be avoided, is given no encouragement or support by the unresponsive answers. A date for hearings will be set in due course.

CONGRESS OF THE UNITED STATES,  
 JOINT COMMITTEE ON THE ECONOMIC REPORT,  
 May 10, 1956.

HON. WILLIAM McC. MARTIN, Jr.,  
 Chairman, Board of Governors of the Federal Reserve System,  
 Washington, D. C.

DEAR MR. CHAIRMAN: You are no doubt aware of the press stories which have appeared in recent days indicating exceptions taken by various members of the Cabinet, specifically Secretaries Humphrey, Mitchell, and Weeks, together with Dr. Arthur F. Burns, Chairman of the Council of Economic Advisers, to the recent action of the Reserve System in raising the rediscount rate.

While it is perhaps too early to judge the merits of the conflicting viewpoints, and it is not my intention in this letter to pursue the arguments for and against the prevailing restrictive money policy, I am deeply concerned about the forces, governmental as well as other, to which the Board is subjected in the performance of its duties. The record which has given rise to these press comments should be made accurate and clear.

Preparatory to consideration of the matter by our Subcommittee on Economic Stabilization, as chairman I am writing to the several administration officials and to yourself. I would like to have your answers some time next week to the following questions:

1. Is it a fact, to your knowledge, that the decision of the Board of Governors went against the wishes of administration advisers? If so, whom?
2. What communications and representations from executive department officials or their subordinates did the Board have before it at the time of reaching its decision?
3. How and by whom were these representations made, to you as Chairman, to other members of the Board, or to the Board as a body?
4. Have you or the Board had any subsequent communication, through official or unofficial channels, from members of the Cabinet or their responsible subordinates criticizing the action which the Board has taken?

I hope that your answer, together with those from the several administration officials, will sufficiently illuminate the facts so that we can avoid the necessity for public hearings.

In asking you these questions, I want to assure you that we are not now seeking to probe into the judgment of the Board in the exercise of its responsibilities. Nor are we asking for information as to the Board vote or discussions which led to the decision. Since, however, the Board does act as an agent in carrying out the powers delegated to it by the Congress, I feel that it is not only proper but necessary that we should inquire as to the nature of the influence brought to bear upon it.

Sincerely yours,

WRIGHT PATMAN,  
 Chairman, Subcommittee on Economic Stabilization.

[Same letter to Secretary Sinclair Weeks, Department of Commerce, Secretary James P. Mitchell, Department of Labor, and Chairman Arthur F. Burns, Council of Economic Advisers]

CONGRESS OF THE UNITED STATES,  
JOINT COMMITTEE ON THE ECONOMIC REPORT,  
May 10, 1956.

HON. GEORGE M. HUMPHREY,  
*Secretary of the Treasury,*  
*Department of the Treasury, Washington, D. C.*

DEAR MR. SECRETARY: Beyond referring to questions at recent press conferences by the President, it is certainly not necessary here to call your attention to the number of press comments in recent days which have noted the existence of differences of opinion between certain administration officials, including yourself, and the Board of Governors of the Federal Reserve System in respect to the Board's action in raising the discount rate. I am sure you are also aware of the widespread public concern, both before and since the so-called accord of 1951, in the independent role of the Federal Reserve System as an agency carrying out the delegated powers of the Congress.

It is perhaps too early to judge at this time the merits of the conflicting viewpoints as to the prospects for further inflationary or deflationary pressures, and the appropriate monetary policy in the circumstances. The record which has given rise to this public discussion should, however, be made accurate and clear.

Preparatory to considering the matter by our Subcommittee on Economic Stabilization, as chairman I would like, therefore, to have your answer some time next week to the following questions:

1. Did you, and for what reasons, disagree with the action taken by the Board of Governors?
2. Did you or your associates, and by what channels—telephone conversations, memoranda, or meetings—communicate your views or make representation to System officials, either Chairman Martin, the Board, other members of the Board, or staff members?
3. Subsequent to the action taken by the Board, have you or your subordinates communicated your criticisms to representatives of the Board other than through the press stories purporting to state your views, either publicly or privately expressed?

I hope that the answers which we receive from you, the other officials, and the Board itself will sufficiently illuminate the facts so that we can avoid the necessity for public hearings.

As I have told Chairman Martin in writing to him, we are not now concerned with probing into the wisdom of the Board's decision but feel, however, that the Congress is entitled to and must of necessity know the forces brought to bear upon its agency in carrying out delegated powers constitutionally assigned to the Congress.

Sincerely yours,

WRIGHT PATMAN,  
*Chairman, Subcommittee on Economic Stabilization.*

BOARD OF GOVERNORS  
OF THE FEDERAL RESERVE SYSTEM,  
*Washington, May 16, 1956.*

HON. WRIGHT PATMAN,  
*Chairman, Subcommittee on Economic Stabilization,*  
*Joint Committee on the Economic Report, Washington, D. C.*

DEAR MR. PATMAN: This is to acknowledge your letter of May 10, with regard to the recent action of the Federal Reserve System in raising rediscount rates.

The directors of each of the 12 Federal Reserve banks who initiated this action, with the subsequent approval of the Board of Governors, voted for increased discount rates prior to publication of the press stories to which you refer. The decisions to increase discount rates were taken separately at each of the 12 Federal Reserve banks by their respective boards, consisting all told of 108 directors.

As you know, the Treasury and the Federal Reserve work as partners in discharging their responsibilities. To this end there must be and there is constant consultation and cooperative discussion between them with respect to economic and related problems with which both are concerned. Similarly the Federal Reserve, in keeping abreast of developments in the economy, nec-

essarily maintains contacts with branches of the Government other than the Treasury. Such consultations do not, however, mean any loss of independence by the Federal Reserve in discharging the responsibilities delegated to it by the Congress.

From time to time there are bound to be differences of judgment, of emphasis and timing. It would be astonishing in a democracy if this were not so and indeed it would be reason for grave concern if precautionary action had to wait for unanimity.

There has been no departure now or at any time during my chairmanship from the procedure of full and frank discussion between members of this Board and staff and officials of other interested Government agencies with a view to discharging public responsibilities in accordance with the best obtainable judgment and the independent exercise of that judgment.

Sincerely yours,

WM. McC. MARTIN, Jr.

THE SECRETARY OF THE TREASURY,  
Washington, May 15, 1956.

HON. WRIGHT PATMAN,  
*Chairman, Subcommittee on Economic Stabilization,  
Joint Committee on the Economic Report,  
Congress of the United States, Washington 25, D. C.*

DEAR MR. CHAIRMAN: I have your letter of May 10 and am glad to answer your questions.

As I have testified before your committee, the Treasury recognizes fully the independent responsibility of the Federal Reserve System for its decisions, and as long as I have been here we have never encroached on its domain.

However, as I have also testified before your committee, I believe it is in the best interest of the people of this country and Government operations as a whole that there should be the fullest consultation and cooperation between the Treasury and the Board. To promote this, Mr. Martin and other members of the Board and various members of the Treasury Department, including myself, make it a continuing practice to keep in the closest possible touch with each other to discuss fully current conditions and prospective trends in order that each of us may be posted as to the other's thinking and appraisal of the various influences affecting the economy both currently and prospectively.

It is, of course, only natural that we often have some differences of judgment arising from varying appraisals of the timing and effect of economic trends. We both are glad to have the benefit of the other's views, as well as the views of many other people in trying to help us reach our own independent judgments.

There is nothing in the events to which you refer that is at variance with our regular practice.

Yours very truly,

G. M. HUMPHREY,  
*Secretary of the Treasury.*

THE SECRETARY OF COMMERCE,  
Washington, May 15, 1956.

HON. WRIGHT PATMAN,  
*Chairman, Subcommittee on Economic Stabilization,  
House of Representatives, Washington, D. C.*

DEAR MR. CONGRESSMAN: I have yours of May 10 and following are my answers to your questions:

1. I did disagree with the action taken, but my disagreement was more in the realm of "timing" than otherwise.

2. Neither I nor any of my associates have had any communication with the Reserve Board—collectively or individually—on this subject.

3. I have not communicated any criticisms to representatives of the Board. In fact, I actually did not criticize the Board's action in my press conference to which you have made reference.

In this respect the press asked me the following question:

"Do you have any information on the recent increase in the discount rate's impact on housing particularly?"



My answer follows and I'm sure you'll agree that it was not voiced in a critical but in a factual vein.

"Of course, that is a field I don't move into very much. I leave that to the Treasury and the Reserve Board. Money is tight today and money is short, and that may prove to be a handicap as we move along here."

I think this answers your three questions.

Sincerely yours,

SINCLAIR WEEKS.

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DEPARTMENT OF LABOR,  
OFFICE OF THE SECRETARY,  
Washington, May 16, 1956.

HON. WRIGHT PATMAN,  
*Chairman, Subcommittee on Economic Stabilization, Joint Committee on the Economic Report, Congress of the United States, Washington, D. C.*

DEAR CONGRESSMAN PATMAN: This is in reply to your letter of May 10 in which you request my answers to the questions regarding the recent action of the Board of Governors of the Federal Reserve System in raising the rediscount rate.

I did not communicate my views or make representation to System officials, either Chairman Martin, the Board, other members of the Board, or staff members; and to my knowledge neither have any of my associates, either before or after the action taken by the Board.

Sincerely yours,

JAMES P. MITCHELL,  
*Secretary of Labor.*

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THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS,  
Washington, May 18, 1956.

HON. WRIGHT PATMAN,  
*House of Representatives, Washington, D. C.*

DEAR CONGRESSMAN PATMAN: I am writing in reply to your inquiry of May 10. In keeping with its duties prescribed by law, the Council of Economic Advisers keeps constantly in touch with the departments and agencies of the Federal Government that are principally concerned with economic matters. The Council's efforts in this direction have been described in its annual reports to the President, which have been published in recent years as appendixes to the Economic Report of the President.

I find it necessary and important to discuss the economic situation and governmental economic policies fairly frequently with Chairman Martin, among others.

You have inquired about the Federal Reserve Board's recent action with respect to discount rates. In view of somewhat conflicting tendencies, particularly the divergent movements that have occurred of late in retail trade and capital expenditures, I doubt the timeliness of this action. However, it must be recognized that some uncertainty inevitably attaches to judgments on a matter of this type.

The conversations that members of the Council have with officials of the Federal Reserve Board do not, of course, involve or raise any question concerning the independence of the Board. This is entirely clear as a matter of both law and policy.

Sincerely yours,

ARTHUR F. BURNS.

The CHAIRMAN. With this background, I should like to turn to my letter of May 10 to Secretary Humphrey of the Department of the Treasury, and ask him to respond now to the specific questions which I asked at that time. Mr. Humphrey, if you will identify yourself for the record, it would be appreciated, sir.

**STATEMENT OF HON. GEORGE M. HUMPHREY, SECRETARY OF THE  
TREASURY**

Secretary HUMPHREY. George M. Humphrey, Secretary of the Treasury.

The CHAIRMAN. Would you like to make any preliminary comment of your own, Mr. Humphrey?

Secretary HUMPHREY. No, Mr. Patman. I wrote you and I thought that I had answered your questions. If you did not feel they were responsive, I am glad to add to them in any way, and try to answer any questions you may have to suggest.

The CHAIRMAN. That is fine, sir. I would like to ask you, then, first, did you, and for what reasons, disagree with the action taken by the Board of Governors on raising this discount rate of April 13, 1956?

Secretary HUMPHREY. I thought that before it was done, that it was unnecessary to take that action. I thought that the situation was sufficiently in balance, and the trend was toward a sufficient balance without taking that action, and in our discussions, as we have discussions continuously, and we hear what the members of the Federal Reserve feel about things, and we tell them how we feel about things, we go over the situation frequently, very frequently, together, looking forward to trying to balance out how their opinions of things are, and ours are, and we are very frank in expressing our opinions to each other in order that each may have the benefit of the other's feelings in determining our respective responsibilities and determining what action we will each take for which we are responsible.

In those discussions, those conversations that we had, I had the feeling and expressed it that no further action was required just at that time.

The CHAIRMAN. You expressed your feeling in advance of the order being issued, I assume?

Secretary HUMPHREY. I did. We talked about it for a number of times, and over a rather extended period before action was taken, but it wasn't just with respect to this. We meet frequently and we talk about how things are going and get each other's views as to present conditions and what future trends are.

The CHAIRMAN. Now, there were, I believe, four other increases before this one.

Secretary HUMPHREY. Yes.

The CHAIRMAN. Over a period of what time, say?

Secretary HUMPHREY. Over a period of several months.

The CHAIRMAN. About 12 months, I believe, is that right?

Secretary HUMPHREY. About that.

The CHAIRMAN. Did you agree to those increases, the other four increases?

Secretary HUMPHREY. I didn't agree with them. I mean there is no such thing as agreeing from the point of view of influencing the action. I thought their action was wise when they took it.

The CHAIRMAN. You did not object to them?

Secretary HUMPHREY. I did not.

The CHAIRMAN. Well, this time, when you did not agree, it some way got in the press. How did it get to the press? Did you give

it out, Mr. Humphrey, that you were not in agreement with this particular action of the Board?

Secretary HUMPHREY. I have forgotten, Mr. Patman, how we did, what the first word about it was. Of course, it is always news if there is a disagreement on any subject, and I really have forgotten just how it did arise.

The CHAIRMAN. What caused me to wonder about that, is that so far as I know you did not advise the press at the time you favored the other four increases. On those occasions there was no publicity.

Secretary HUMPHREY. I don't know as anybody asked me. Strangely enough, it doesn't seem to be news if people are in agreement and it does seem to be news if they are not.

The CHAIRMAN. Well, I agree with you about that, Mr. Humphrey.

Did you or your associates, and by what channels—telephone conversations, memorandums, or meetings—communicate your views or make representation to System officials, either Chairman Martin, the Board, other members of the Board, or staff members?

I believe you have answered that. You did communicate your views?

Secretary HUMPHREY. I did.

The CHAIRMAN. To these different people.

Secretary HUMPHREY. On a number of occasions, and over a rather extended period.

The CHAIRMAN. Subsequent to the action taken by the Board, have you or your subordinates communicated your criticisms to representatives of the Board, other than through the press stories purporting to state your views, either publicly or privately expressed?

Secretary HUMPHREY. We have continued our discussions frequently, and just as we have always done ever since we have been here, and as we expect to continue as long as we are here. We have discussed these matters currently, and we keep doing it currently, and we expect to continue doing so.

The CHAIRMAN. You feel that you are communicating with them as to the extent necessary to get your views over?

Secretary HUMPHREY. Not to get our views over at all. We apprise them of what we think, and we will have the benefit of their thinking. We each are entitled to have the benefit of the other fellow's thoughts in this very important field.

The CHAIRMAN. I agree with you.

Secretary HUMPHREY. We not only have the benefit of each other's thoughts, but we seek and we welcome the benefit of any other person's thoughts, who is qualified and in whose judgment we have confidence.

The CHAIRMAN. This action raising the discount rate of course meant an increase in interest rates across-the-board, did it not?

Secretary HUMPHREY. Well, I don't know that it was this action or not. As a matter of fact, I rather think this action followed the pressure toward the increased rates rather than preceding it.

The CHAIRMAN. As Secretary of the Treasury, Mr. Humphrey, do you consider it your duty to keep the rate as low as possible on the national debt?

Secretary HUMPHREY. No, I don't think so. I don't think that it would be good for the country or good for the people in it if the rate on the national debt was depressed to an unduly low level.

The CHAIRMAN. What factors did you consider in agreeing to an increase in the discount rate, as you agreed in the four instances preceding the last one?

Secretary HUMPHREY. You keep saying "I agree."

The CHAIRMAN. Well, you did not object.

Secretary HUMPHREY. This is not a matter of a deal between us.

The CHAIRMAN. I know that.

Secretary HUMPHREY. It is a matter of my feeling as to whether it is wise or not.

The CHAIRMAN. I didn't intend to leave the impression that I suspected any "deal." In any case, it is not your responsibility.

Secretary HUMPHREY. Not my responsibility, and I don't agree to it. If they do it, and I think it is wise, or I think it may be unwise, I feel perfectly free to express my opinion either way.

The CHAIRMAN. Don't you think interest rates generally over the country have gone pretty high, Mr. Humphrey? Aren't you concerned just a little bit about the great increase in interest rates across the board?

Secretary HUMPHREY. I don't know, Mr. Patman. Interest rates, of course, fluctuate as they should. And I think properly so, with demand for money and, after all, you know, I think that to have interest rates too low and over a long period of time could be a very serious thing in this country.

We have to have, we have to try to provide in this country, have to try to have developed—the Government does not provide it, but we have to have—we hope that it will develop in this country that there will be opportunities for jobs for about a million more people a year and that is an increasing amount.

Now, in America today you cannot get a job and earn the kind of pay that Americans earn unless somebody has saved and invested a matter of somewhere from \$10,000 to \$20,000 to buy the things, to buy the tools, to buy the other things that are required to afford the facilities, the transportation, and all of the things, the power and all of the things that are required to make a job to permit an American to earn the kind of money that he now gets.

I think we went through a period in this country where the emphasis on saving was entirely wrong, where there wasn't sufficient emphasis on saving, and I think that it was time that that emphasis was changed, as it has been changed, and that there should be and there will have to be in the future a continuing emphasis on saving.

We have to obtain savings, to have savings, to buy the tools that make the jobs that give people work in America, and I am talking about not just factory employees, but everybody. We have to have capital investment in order to give them the opportunity, in order to have the facilities in the country available for them to have their jobs.

In order to have that saving, two things have to be pretty well assured:

First, that the savings, if made, will not be destroyed, will not be stolen by inflation. And second, that there will be some return on those savings which induce people to save for that return rather than to just spend their money currently, because it isn't worth anything to save it.

So that I think this country requires over a long period of time a renewed emphasis on the security of savings, and efforts to preclude inflation, to avoid inflation, and the theft of the savings in that way, and the incentive to save by having their savings worth something in interest that will be paid to them if they save it.

The CHAIRMAN. You have mentioned two things which I think are very important, namely, savings and inflation. The reason you did not oppose the four increases in the discount rate preceding this last one, was I assume because you thought there was some evidence of inflation that needed to be dealt with.

Secretary HUMPHREY. You have continually, Mr. Patman, in this country, and it is good that you do, you have continually changing conditions with varying pressures—inflationary pressures on the upside and deflationary pressures on the downside. The ideal situation has been, or is, when those pressures are fairly evenly balanced. That is when you make your most progress in this country, and that is when conditions are the best.

If inflationary pressures prevail to too great an extent, and you depress the value of your money and you destroy the value of savings, you set in motion a whole chain of events which are detrimental to the future of the country. If you let deflationary pressures prevail to too great an extent, you set in motion a whole chain of events that are unfortunate for the country.

So you want to go along as nearly as you can toward a balance of the two.

The CHAIRMAN. You are just as anxious to prevent deflation as you are to prevent inflation? You want an even balance and an even keel, if possible.

Secretary HUMPHREY. Absolutely.

The CHAIRMAN. You mentioned both savings and inflation in one of your statements. I think it is important that we explore that just a little bit, if you please.

If you want to encourage savings, don't you think a mighty fine way would be to allow more interest on time deposits? If you were to take off the limitations under existing laws and rules of the Board of Governors, and permit time deposits to receive as much, say, as four per cent on savings, don't you think that would have a tendency to retard inflation and also to encourage savings?

Secretary HUMPHREY. Of course, anything that pays for saving money, any incentive toward that is a good thing to have; but actually, what we want to do is to encourage people's savings in all ways, in all forms, and to just pick out one, as to whether a relatively minor action in one field is desirable or not, you have to balance them all out.

The CHAIRMAN. Mr. Secretary, you know more about this in a minute than I do in a week or a year but it really concerns me a great deal that you don't feel obligated to keep the interest rate down on the national debt.

Now, if you do not feel obligated as a representative of the people and of the United States Government to keep the interest rate down, who does represent the people in that capacity? Whose duty is it to keep interest cost on the Federal debt down?

Secretary HUMPHREY. I just got through telling you, Mr. Patman, that I don't think it is to the advantage of the people to have the interest on the debt too low.

I think it would be disastrous in this country if we could borrow money for an eighth of 1 percent. I just don't think we ought to have it.

The CHAIRMAN. You mean of course for short-term paper, like we used to.

Secretary HUMPHREY. Long-term paper at half of 1 percent. If that was your interest rate, just let's illustrate it by an absurdity. I think it would be just as absurd to get the interest rates too low as it would to have them too high. You would be in trouble either way.

The CHAIRMAN. Aren't you now considering factors which are primarily within the purview and the duties of the Congress and the Federal Reserve Board. I am not criticizing you for running your business like you want to, Mr. Humphrey, but it seems to me like you should keep your eye on the interest rate in the interest of the taxpayers.

Secretary HUMPHREY. I am very glad to have this chance to explain to you, Mr. Patman—

The CHAIRMAN. Let the Federal Reserve and Congress look after the general economic policies dealing with the whole country.

Secretary HUMPHREY. —why I think your views are wrong, and why I think they are unduly narrow.

It is my job also to raise the money to pay the bills of the country, and it is my job also to collect in our taxes, and if we don't have suitable times in the country, if we don't have good employment in this country, and reasonably good times in this country, we won't have any money with which to pay our bills.

Now, if I took your attitude and kept my eye solely on one item of trying to knock the interest rate down on the debt, I might get the interest rate down on the debt, but even if it was half of 1 percent, if we didn't get taxes in enough to pay, it wouldn't do us any good.

So it is a much broader field here to watch, to be watchful over, and my responsibilities cover a much wider field than your question indicates. You have to keep it all in mind, Mr. Patman. You have to keep it all in mind.

The CHAIRMAN. But the weighing of economic advantages and disadvantages, the effect upon the general welfare, the people, and the general economy are factors that the Federal Reserve Board is expressly charged with; don't you agree.

Secretary HUMPHREY. The Board has certain responsibility, and the Treasury has certain responsibilities. We both have them, and it is well that we both try to do the very best we can with respect to them, and it is particularly good that we cooperate in our thinking with respect to them.

The CHAIRMAN. All right. Now, don't you think your answer was rather unrealistic when you suggested that we shouldn't have a long-term interest rate of one-eighth of 1 percent? We never had that in this country.

Secretary HUMPHREY. I was trying to illustrate the absurdity of your position.

The CHAIRMAN. But that is using as an illustration a situation that has never existed in this country.

Secretary HUMPHREY. That is the way to illustrate when the position is taken—you can illustrate it better by carrying it to an absurdity than in any way I ever knew of.

The CHAIRMAN. We had one-eighth of 1 percent on very short-term securities, 30 or 60 days, but we have never had any long-term rate less than about 2 percent; have we?

Secretary HUMPHREY. I don't know.

The CHAIRMAN. I do not recall any long-term rates lower than 2 percent.

Secretary HUMPHREY. But when you say that I should be concerned to try to push it down—

The CHAIRMAN. To a reasonable level.

Secretary HUMPHREY. You didn't say that.

The CHAIRMAN. That is what I meant to imply. Naturally, I wouldn't think about a devastatingly low level, or anything like that.

Secretary HUMPHREY. Perhaps our difference then can be as to what is a reasonable level, and what is a reasonable level depends very largely upon times and conditions. What is reasonable today might not be reasonable tomorrow. So that you and I would move back and forth and if you stick to a reasonable level, and reasonable under the conditions existing, we wouldn't be far apart.

The CHAIRMAN. I have always had the feeling that since the rate on long-term Government bonds, is more or less the basic, wholesale rate of interest—the cost of money—that 2½ percent is a reasonable rate, and probably should not go beyond that.

Secretary HUMPHREY. I don't believe you can pin a figure that is continuously and always a reasonable rate for money any more than you can for the price of pork or beefsteak or eggs.

The CHAIRMAN. That is the reason I was shocked when you set the rate of 3 percent on a bond issue early in your administration. If you don't mind, how did you arrive at that 3 percent rate, Mr. Humphrey?

Whose counsel and advice did you seek, if you did seek the counsel and advice of other persons in arriving at that 3 percent rate.

Secretary HUMPHREY. You mean on our long-term issue?

The CHAIRMAN. On the long-term issue.

Secretary HUMPHREY. As I think I have explained to you before, Mr. Patman, we don't make interest rates. The market makes the interest rates. We have securities to sell, and we sell our securities. We sell our securities as nearly as we can at what the prevailing markets are.

The CHAIRMAN. Do you really believe, Mr. Humphrey, that we have a free money market in this country?

Secretary HUMPHREY. You try to sell something, and you will find out.

The CHAIRMAN. I wish you would answer my question. Do you believe that we have a free market?

Secretary HUMPHREY. Certainly we have a free market.

The CHAIRMAN. In Government bonds?

Secretary HUMPHREY. Certainly. Certainly we do. No question about it. We went for a long time under Democratic rule, when we didn't have.

The CHAIRMAN. Of course, I am not bringing any politics into this because I think this goes beyond politics. We are looking into the

future over a long period of time. But in arriving at this 3 percent rate, with whom did you confer?

Secretary HUMPHREY. Well, when that was—that was a year and a half ago, or something like that. I can't tell you exactly. We attempted to get all the information we can, as to market conditions currently. We have committees that we confer with. We have all sorts of meetings for learning what is going on in the financial markets, and we get the very best information that we can as to what the facts are, and as to what the trends are.

We seek information, as I said before, everywhere that we can get it, from sources in which we have confidence.

The CHAIRMAN. All right. Let me see if I can get more specific information from you. You confer with representatives of the American Banking Association?

Secretary HUMPHREY. Yes.

The CHAIRMAN. You confer with representatives of the Investment Bankers Association?

Secretary HUMPHREY. That's right.

The CHAIRMAN. You confer with representatives of the life-insurance companies?

Secretary HUMPHREY. Yes.

The CHAIRMAN. Do you confer with representatives of the Stock Exchange?

Secretary HUMPHREY. No.

The CHAIRMAN. Of speculative boards?

Secretary HUMPHREY. Oh, we know a number of people. I know a lot of people, and Burgess does—we all know a lot of people that—for example, the president of the exchange drops in the office every once in a while.

The CHAIRMAN. But those three groups are the ones that—

Secretary HUMPHREY. Oh no; we confer with a lot of people. We know a lot of business people. We confer with a lot of people, and we confer with everyone we know of in whom we have any confidence in their judgment with respect to money markets and money-market conditions.

The CHAIRMAN. Being more specific, Mr. Humphrey, don't you call these people in when you are trying to arrive at a rate, like the American Bankers Association, and the Investment Bankers, and the life-insurance company representative? You confer with them in your office?

Secretary HUMPHREY. That's right.

The CHAIRMAN. Here in Washington?

Secretary HUMPHREY. And a lot of others.

The CHAIRMAN. You have a formal meeting for that?

Secretary HUMPHREY. They come down here, and we present to them our situation; we present to them what it is that we propose to do, the amount of financing that is required at some time in the near future, and we get their opinion about conditions.

The CHAIRMAN. At this meeting, do you have any representatives of the Board of Governors of the Federal Reserve System?

Secretary HUMPHREY. No. These meetings are all separate. We meet with different groups and groups separately.

The CHAIRMAN. At different times.



Secretary HUMPHREY. At different times. But we also talk to the Board at the same time.

The CHAIRMAN. After you have this meeting with the groups I have indicated here, the three in particular, did you know that—

Secretary HUMPHREY. We meet with others right at the same time.

The CHAIRMAN. Do you know that the representatives of the three groups go out and confer with Mr. Martin of the Federal Reserve Board, and before they make their recommendations to you as to what you should—

Secretary HUMPHREY. I don't know who they talk to. I don't know who they talk to.

The CHAIRMAN. They come back and make their recommendations later?

Secretary HUMPHREY. Yes.

The CHAIRMAN. On setting this 3 percent rate, how many of those 3 groups agreed to the 3 percent rate?

Secretary HUMPHREY. Now, Mr. Patman, you have asked us to come here to talk about a matter between us and the Federal Reserve Board.

The CHAIRMAN. That's right.

Secretary HUMPHREY. Now you are talking about something a year and a half ago. Now, let's get back to what we are talking about.

The CHAIRMAN. I think the committee has a little something to do with that, Mr. Humphrey.

Secretary HUMPHREY. We will be perfectly glad to talk about the other if you will tell me you want to do it, but that isn't what we are here for now.

The CHAIRMAN. You are talking about interest and savings. This goes into it, relates to it.

Secretary HUMPHREY. That isn't what we are here for now. You asked us to come on this specific subject, and that is what we are here for.

The CHAIRMAN. I want to confine it more or less to that.

We expect to have another investigation later on. We hope to go into all of this.

Secretary HUMPHREY. All right.

The CHAIRMAN. Including the three and three-quarter—

Secretary HUMPHREY. I will be glad to refresh my recollection and tell you specifically who said what a year and a half ago, if you will tell me ahead of time you want to know it.

The CHAIRMAN. And the 3¾ percent, too?

Secretary HUMPHREY. Yes. If you will tell me specifically. I will get out the files and look them up and—

The CHAIRMAN. I don't know that I will ask you to name names.

Secretary HUMPHREY. You just did.

The CHAIRMAN. I am talking about the several groups: insurance, investment bankers, and—

Secretary HUMPHREY. Well, Mr. Patman, let me say this: I don't know ever—it may have occurred some time, but almost never have any of these groups been unanimous in their feelings. Almost always there is a difference of opinion among the groups themselves. They act—they are not acting as groups. They don't vote as groups. We get their general expressions of opinion of 20 men, and I, as a rule, ask every one of the 20, or every one of the 30, his individual opinion, and

almost invariably there is a difference of opinion in that 20 or 30 people on specific items that we are talking about, and we are glad to have that difference, and we are glad to have the feeling of the different people in order to measure them and to have them in mind when we reach our own decision as to what we will do. When we decide what we will do, it is our decision, and it isn't anybody else's.

The CHAIRMAN. Mr. Humphrey, there is some information in the press to the effect that if this discount rate works out all right, you won't say too much about it, and it will be all right. But if it is devastating to the country and slows up business and everything, you will be in a position to blame the Federal Reserve with it, and that it is a Democratic Federal Reserve Board, and Mr. Martin is a Democrat.

Secretary HUMPHREY. Mr. Patman, I never passed the buck in my life.

The CHAIRMAN. Beg pardon?

Secretary HUMPHREY. I never passed the buck in my life, and I am not going to start now.

The CHAIRMAN. You recommended the appointment of Mr. Martin?

Secretary HUMPHREY. I did.

The CHAIRMAN. His reappointment.

Secretary HUMPHREY. Yes, sir.

The CHAIRMAN. You announced it yourself, didn't you?

Secretary HUMPHREY. And I would recommend it again today. Mr. Martin is the best qualified man, in my opinion, in the United States for his job.

The CHAIRMAN. Did you have the authority from the President of the United States to make this designation?

Secretary HUMPHREY. Make what designation?

The CHAIRMAN. As Chairman of the Board of Governors of the Federal Reserve System?

Secretary HUMPHREY. I didn't designate him. The President of the United States did.

The CHAIRMAN. It is for a 4-year term as Chairman?

Secretary HUMPHREY. I don't remember what it is.

The CHAIRMAN. I believe you said down at the Press Club the other day that one of the first things you did when you were appointed Secretary of the Treasury was to ask Bill Martin if he would continue. He had tendered his resignation, but you asked him if he would continue as Chairman. According to a transcript of your remarks, you said "I did it for one reason. I did it because I thought then, and I think now that Bill Martin is the best qualified man in the job. He consented and took the job." I shall incorporate the full transcript of your remarks in this connection at the conclusion of your testimony this morning.

If this turns out in a way that is not in the interest of the country, you are not going to blame the Federal Reserve Board, and you are not going to blame Mr. Martin?

Secretary HUMPHREY. I have never blamed anybody for—

The CHAIRMAN. You are not going to blame the Democrats for having the Board composed mostly of Democrats?

Secretary HUMPHREY. If I found a way, I would be glad to. [Laughter.]

The CHAIRMAN. Are you alarmed just a little bit about the tightness of the money market now, Mr. Humphrey?

Secretary HUMPHREY. No, I am not.

The CHAIRMAN. You don't think that the layoffs in the automobile industry, and the failure of the automobile dealers to sell their cars has anything to do with the tight money market?

Secretary HUMPHREY. Well, I think their difficulties arise from a number of things, and I think perhaps credit had something to do with it.

On the other hand, I think that as you look at it now, conditions are proceeding in a very satisfactory way, and I believe that over a relatively short term some of these inventory difficulties will be behind us, and we can forget them.

The CHAIRMAN. Mr. Humphrey, I would like to have your opinion on this question: Interest rates have been raised more than 1 percent the last year, generally. I think you would agree to that?

Secretary HUMPHREY. Well, I guess that's right.

The CHAIRMAN. More than 1 percent. I think that is a very safe estimate. Well, a 1 percent interest rate across the board in a country whose aggregate debt, including public and private, is more than \$700 billion, would amount to about \$40 per capita each year increase, so during the last month we have had a \$40 per capita increase in the interest rates.

Now, in a family of five that is the equivalent of \$200 increase in interest rates.

Now, don't you think that by increasing these interest rates, and thereby diverting purchasing power, \$200 from a family of five, from buying automobiles and refrigerators and appliances and other needed comforts and conveniences of life, to the payment of interest, don't you think that has something to do with slowing up our economy?

Secretary HUMPHREY. Mr. Patman, you are just as wrong as you can be.

The CHAIRMAN. I hope I am.

Secretary HUMPHREY. Now, just let me show you how ridiculous that statement is.

The CHAIRMAN. I would like to be proven.

Secretary HUMPHREY. This debt, the great bulk of this debt is over a term. It doesn't all expire today, and a change in interest today doesn't change it all today.

The CHAIRMAN. Very true.

Secretary HUMPHREY. Bonds are out for 20 years and 30 years, and there are bonds out for 40 years, and bonds that are out for 10 years, and a change in the interest rate doesn't affect them a penny.

So you haven't had anything like what you say in the change of interest, anything like it. And it can't come that way, and it is very fortunate that it cannot, because you don't have these wide swings.

An interest rate change affects only the current borrowing at the moment. The borrowing next week is at a different rate from this week, and the week after that is at another rate, and all the debt which is outstanding in the meantime which is what you are talking about is not affected a penny because it is out at fixed rates, so you don't have anything like what you are indicating. Your premise is completely in error.

The CHAIRMAN. Let's bring it down a little closer. You will have to admit it will affect installment buying immediately, won't it?

Secretary HUMPHREY. I think that installment buying has slowed somewhat, and I think it is very good for the country that it has.

The CHAIRMAN. Now, you are going into something else.

Secretary HUMPHREY. You asked me if I thought it would do it, and I said it would, and I thought it was good.

The CHAIRMAN. It is slowing up installment buying?

Secretary HUMPHREY. I think that is good.

The CHAIRMAN. Of course, I don't think so, but you have as much right to your opinion as I have to mine.

Secretary HUMPHREY. That's right.

The CHAIRMAN. But on installment buying, that is something where the increase in interest rates is reflected quickly, isn't it, right now?

Secretary HUMPHREY. Yes.

The CHAIRMAN. Therefore, the poorest people in the country who represent a large part of the purchasing power, the increase in interest rates slows them down right quick.

Secretary HUMPHREY. Only as to new stuff they buy. It doesn't change the interest rate on what they bought last week. Certainly not. So you are not talking about that at all.

The CHAIRMAN. But the installment buying, you see, the terms there are not so long—12 months, 18 months.

Secretary HUMPHREY. That's right. The downpayment may be a little more, and therefore the new commitment isn't quite as readily made as this week, as it was last week.

And I think that is good. I think that it was good that some of these installment buying, that payments on it should catch up, and it has been catching up.

The CHAIRMAN. How do you determine whether or not installment buying, the aggregate amount, is too high?

Secretary HUMPHREY. That is a very difficult thing, and I don't think anybody can tell you whether it is too high, or whether it isn't too high. I think that you can get into periods that you can see where excesses are going on, and it is well to restrain excesses. It is good, Mr. Patman—one of the things that slows business down and puts people out of work in this country is the accumulation of inventory.

Now, inventory can accumulate in the hands of the public, just as well as it can accumulate in the hands of the intermediate manufacturer, or somebody else. It is total unpaid inventory, total inventory not in use.

Now, if inventory gets too great, then people stop and begin to use. They stop buying new and begin to use that inventory. They begin to use that inventory, the new manufacture slows down. That means people are out of work.

So that one of the things we don't like to see, and that isn't good for the country, is an accumulation of unused inventory. That is one of the things that credit helps to restrain. That is, inventory accumulates. If credit becomes a little tighter, it helps to restrain your accumulation of more inventory. If we just do these things, I think I told you a couple of years ago, and Senator Douglas, that if we can just restrain some of these excesses early, the earlier they are restrained, the less effect it has, the quicker they are corrected.

It is when you get to a great excess one way that you are forced into a great excess the other way.

If we can have, as we go along, a rolling readjustment, an adjustment here and there, and in the other place, one at a time as we go along, this country can continue at a high level and with lots of employment.

If we get into great excesses in any direction, there will be a day when there will be a lot of trouble. That is what we are seeking to avoid.

It is by restraints, when restraints are required, and by assistance, when assistance is required, that you try to level out and to keep a rolling readjustment going, rather than to get into a difficult position—you know, the higher you go the harder you fall. It is just that simple.

The CHAIRMAN. We should guard against falling down, too, as well as up; because deflation is just about as destructive as inflation.

Secretary HUMPHREY. Just exactly. The reason we don't want to get too far up is because we don't want to go too far down.

The CHAIRMAN. I remember a time in this country when automobiles were not selling, and people were saying it is overproduction when, looking back, it was underconsumption. People just didn't have the purchasing power.

Secretary HUMPHREY. I read in the paper the other day that Chevrolet automobiles were within 1 percent of the same number of cars sold up to June 1 this year as they were last year.

The CHAIRMAN. I am not keeping up with the exact amount.

Secretary HUMPHREY. That isn't very much of a fall-off.

The CHAIRMAN. In regard to this interest rate being reflected slowly, in the entire economy, I think you must admit, Mr. Humphrey, that it is reflected rather quickly among the masses of the people who are the low-income groups. They are the ones who buy on the installment plan all the time and charge accounts, and in addition to that where they have home mortgages they have to refinance them every now and then, and in refinancing they have to pay this increased interest charge. I think that you must admit that our economy is affected more seriously among those groups by an increase in interest rate than the other groups are, and by reason of that would have a tendency to slow up the economy quicker.

Secretary HUMPHREY. Well, increased interest, increased tightening of credit terms does tend to restrict activity. There isn't any question about it.

The CHAIRMAN. Do you know anything else that unbalances everybody's budget except increased interest rates?

Secretary HUMPHREY. Yes, a lot of things will unbalance them a whole lot faster than that. You lose your job—

The CHAIRMAN. You are talking about individuals?

Secretary HUMPHREY. Sure.

The CHAIRMAN. I am talking about throughout the Nation, do you know of anything else that will unbalance everybody's budget immediately except—

Secretary HUMPHREY. Interest wouldn't unbalance the budget immediately.

The CHAIRMAN. When they have to pay more interest—

Secretary HUMPHREY. They don't have to pay more interest unless they make a new—

The CHAIRMAN. They are spending less.

Secretary HUMPHREY. They don't pay more unless they make a new loan. It only affects the fellows that make new loans.

The CHAIRMAN. They are making new loans all the time, and increase in interest rates, that unbalances the Federal budget, the States, the counties, cities, political subdivisions.

Secretary HUMPHREY. Only when they borrow the new money.

The CHAIRMAN. Every corporation, every public utility, every partnership, every person, every family budget in the Nation is immediately unbalanced by increase in the interest rates.

Secretary HUMPHREY. That is where you are just as wrong as you can be, and if you leave out the word "immeditaely" and put in 20, 30, 40 years, I will agree with you.

The CHAIRMAN. But people look into the future.

Take, for instance, in the city where interest rate is going up, they know that means increased taxes. They begin to plan for it. They know that the telephone company is going to ask for an increase in rates because they are paying higher interest. The gas company and the electric utility, they know that all utilities are going to come in and ask for an increase in rates because they are having to pay higher interest.

Secretary HUMPHREY. Well, Mr. Patman, I think this is about the same line of talk you gave me 2½ or 3 years ago, at the time we put out those 3¼ percents, when you prophesied all these dire things, and we have had a two-tenths of 1 percent change in the cost of living, so it hasn't happened in the last couple of years.

The CHAIRMAN. Let's analyze that briefly, Mr. Humphrey. Where has the cost of living gone? The farmer hasn't received it. While industrial prices were going up, farm prices had to go down to keep the cost of living on an even keel.

Secretary HUMPHREY. Very small adjustment either way.

The CHAIRMAN. If farm prices had gone up in the same way that industrial prices went up, you couldn't say that you would be within that 2 percent.

Secretary HUMPHREY. I didn't say 2 percent. I said two-tenths of 1 percent.

The CHAIRMAN. You can't say 2 percent, or 5 percent, either. If farm prices had gone up in proportion to industrial prices, so, after all—

Secretary HUMPHREY. Now, wait a minute. Have you made those figures—

The CHAIRMAN. Wait just a minute. After all, this stable price level, if you want to put it that way, is at the expense of the farmer.

Secretary HUMPHREY. No.

The CHAIRMAN. Because as industrial prices went up, farm prices had to go down, or that cost level would have gone up, too.

Secretary HUMPHREY. No, no. If you made up the figures, Mr. Patman, you will find it would be a very small difference.

The CHAIRMAN. Concerning interest rates and looking into the future, people in our country in the Southwest are not voting bonds for public schools and roads and public improvements like they have been, because of this high interest rate. They are having to pay up to 3½ and 4 percent interest on securities. Now, that is a pretty high tax-

exempt interest rate. Doesn't that disturb you a little bit, Mr. Humphrey, that people have to pay  $3\frac{1}{2}$  percent on tax-exempt bonds?

Secretary HUMPHREY. No.

The CHAIRMAN. How much do you think they should pay?

Secretary HUMPHREY. I don't know. And what they should pay now may not have anything to do with what they should pay 6 months from now, or what they paid 6 months ago. It will vary. But I think this, Mr. Patman, that we are at the highest level of employment in this country that this country has ever seen. Never have there been as many people working in America for as high wages as they are today. We have never had anything like it before. We have a relatively full employment in America, a very high employment in America. We have shortages and have had over the past several months, shortages in a great many commodities. You are just on a balance, and it is hard to get a great many commodities.

Now, if when you are at that extremely high level, extremely high level both of manpower and materials, you still keep moving up, what happens is that you just bid against each other for the same things, and you don't make more things; you just raise the prices.

So that when you get up to a very high level, and you have got your head against the ceiling, it is well to just have it hesitate a little bit, and not keep pushing forward to a point where all you do is increase the price and not the commodities. And that is what is going on now, and I think it is very good and very wholesome.

The CHAIRMAN. But we have to expand every year to do what you said a while ago.

Secretary HUMPHREY. Sure.

The CHAIRMAN. To just take care of these million people.

Secretary HUMPHREY. We are expanding. We are expanding.

The CHAIRMAN. I guess about two-thirds of them each year are new people coming on the market and about one-third of them just displaced in some way or manner.

Secretary HUMPHREY. That's right, Mr. Patman, and real wages in terms of what money will buy, and real employment in terms of people employed are higher today than they have ever been in the history of this country.

The CHAIRMAN. What I can't understand is how we can keep on having this degree of prosperity in expansion if we keep on increasing the interest burden on the people unnecessarily and get more and more, taking more and more out of their pay envelope for increases, thereby making it impossible for them to buy more and more of the things that they actually need.

In other words, it is diverting purchasing power, and I think there will be a limit to it, and I think our whole economy will suffer from it. I hope it does not.

Secretary HUMPHREY. That is exactly what you told me 3 years ago, when you were talking about the  $3\frac{1}{4}$  percent, and for those 3 years you have been wrong all the while.

The CHAIRMAN. I don't know whether I have been or not. Talking about inflation, the farmers are still suffering; the small-business man is suffering. The small-business man, I think, is in worse shape than he has been in for a long time in this country, and I think it is one thing that is due to the fact there is no credit available for him.

Now, for the big man you have got the specialists, those who operate in other countries; we have the World Bank, where we put up our part of the money, about a third; with the Export-Import Bank—it has billions of lending power, and we put up all the money there. We have the International Finance Corporation that you so ably represented to us to be such a thing before the Banking and Currency Committee.

Those three agencies can take care of the big concerns. But we have no way of helping the little man, and the little man is suffering more now than he has ever suffered.

He has had no inflation. There is no inflation among the farmers, no inflation among the small-business men, no inflation among the home builders.

Secretary HUMPHREY. There isn't any inflation anywhere I know of, and I hope we don't get it.

The CHAIRMAN. That is the matter I am talking about: Why then all these interest rate increases?

Secretary HUMPHREY. They are helping to restrain inflation.

The CHAIRMAN. To restrain inflation?

Secretary HUMPHREY. They are helping to restrain it; yes, sir.

The CHAIRMAN. Don't you think we should keep in mind the needs to restrain deflation, too?

Secretary HUMPHREY. I do; very definitely.

The CHAIRMAN. Well, Mr. Humphrey, you have been very kind to come up and answer these questions today. I wish you had answered them more fully in your letter at first. But, of course, that is your prerogative, and you have a right to do anything you want to about it.

I would like to reserve the right, as I have before, if I have overlooked some question I would like to ask you, I would like the privilege of sending it down to you and ask you to answer it for this record before the record closes, if you please.

Secretary HUMPHREY. Mr. Patman, I will be glad to try to answer any questions you want at any time.

The CHAIRMAN. You have always been very cooperative, and I thank you.

Secretary HUMPHREY. I thank you very much.

(The excerpts previously referred to follow.)

EXCERPT FROM THE TRANSCRIPT OF REMARKS BY TREASURY SECRETARY HUMPHREY  
AT PRESS CLUB LUNCHEON, MAY 24, 1956

\* \* \* Knowing the Press Club's habit of thinking up the most embarrassing questions they can to present, I thought maybe I would feel that I would ask myself some questions first, taking my own questions that I would ask and perhaps by the time I got through answering them you would either be so tired listening, or it would be so late the chairman would adjourn the meeting and it would be all over.

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This is my last question: Is there a controversy between the Federal Reserve System and the Treasury?

You must admit that I have tried to ask questions that are at least subjects of discussion.

The Federal Reserve System as a whole spreads out all over the United States. It is made up of boards of our best citizens, a majority of whom are businessmen in the various communities, and these communities cover the entire United States.

When you are talking about the action of the Federal Reserve System, you



are talking about a widespread system of information, of opinion, of examination of what is going on, and of knowledge of conditions in this country.

The Federal Reserve System, under our laws, is an independent system and is responsible for certain areas of action. At some previous times in our history the question of its independence has come into discussion. There have been times when perhaps it has been subservient to other judgment.

Before we came here there was such a situation. It was resolved before we came here in the reestablishment of the independence of the Federal Reserve System in its field. Mark you, in its field.

When I assumed the responsibility of my office, I realized the close association that would have to exist between the Federal Reserve System and the Treasury, because our fields are so interlocked. Bill Martin was then the Chairman of the Federal Reserve Board. One of the very first things that I did was to ask Bill Martin if he would continue. He had tendered a resignation. I asked him if he would continue as the Chairman. I did it for one reason. I did it because I thought then, and I think now, that Bill Martin is the best qualified man in the United States for his job. [Applause.]

He consented and took the job. We arranged at that time that we would have the closest cooperation between the Federal Reserve Board and the Treasury, each recognizing the other's field of operation and the other's independence in his particular field.

We set up a lot of mechanics, such as meetings back and forth, weekly meetings, biweekly or triweekly meetings. We have gone along in a very close association, each presenting to the other his views, hearing his views, giving consideration to the other's views, and finally deciding what he was going to do in the field of which he was responsible and going ahead with his job. We have had that close association, as I think you must in any situation where you are trying to balance.

The most difficult situation is where you are trying to balance the effect of pressures, both inflationary and deflationary pressures, not only as to what the effects of those pressures are today but what the effect of those pressures is going to be 3 months, 6 months, or even some longer period hence.

You are in a field of tremendous difficulty. You are in a field where nobody can really be very sure that he is right. Worse than that, you never can know afterwards who is right because this is a moving business. When you take action one way you never will know, and nobody else will ever know, what would have happened if you had taken the action the other way. There is no way to ever check up.

All during this period we had continual discussions, continual questions back and forth amongst our staffs, as to what action should be taken to resist both inflationary and deflationary pressures.

By and large we have been fairly lucky in having a pretty close balance during most of the period between these pressures. That is the finest position that the people of the United States can be in. And it is the most difficult position for the people who are trying to balance the pressures in any way that they can.

I will just cite for a moment what the pressures are.

We have for a period of a good many months had the highest employment in the history of this country, the highest earnings in the history of the country, the greatest volume of business in the history of the country. We have been going along at this extremely high level a large part of this period, and pretty well balanced with very little change, either deflationary or inflationary, during this period. Very, very little change.

When you are in a period of very high employment, very high business activity, if you try to move up to any great extent from that extremely high level, you soon reach the place where there are not enough more materials, and there are not enough more people, to make many more goods. If the pressure is pushed too high under those circumstances, you get a scramble for materials and a scramble for people and you raise costs to the general public, the cost that the public has to pay, without giving the public anything more or better for it.

That is an inflationary pressure that should and must, be avoided, if it can be, because you are not getting better goods and you are not getting more goods. You are simply paying more for them because you already are at about as high as you can go.

If during such a period there are pressures and scrambles to increase inventories, or to build inventories, or to gamble with goods against price rises, or against material shortages, you very soon get yourselves into a position where

you have more than your normal requirements need. Under those circumstances as inventories accumulate they, in and of themselves, soon become a burden and have to be liquidated. As you liquidate the inventory you curtail your purchase of new products. Then you begin to have deflationary pressures and you begin to lose employment and begin to get in trouble on the down side.

The Federal Reserve System, with its combined judgment of all of these people, has been leaning, as they say, against the wind during this high period, to prevent inflationary pressures. We have had discussions as to when they should move, or how they should move. We very frankly always stated our opinions to them, and they to us. We talked about it at length. Included in those discussions are the President's economic advisers who worked with us continually, Arthur Burns and his people, and we all expressed ourselves, and a great deal of the time there is a difference of opinion in shades of timing and in shades of what the pressures will be.

We work this out to a point where the Federal Reserve System exercises its final judgment in its field and the Treasury exercises its final judgment in its field.

This last time when the discussion was up as to whether we would make this additional move, we had to balance not only the conditions that obtained at the time, but the question of what those conditions are going to be sometime hence. Very frankly I differed with Bill [Martin], and our people differed with his people, as to the force of the pressures some time hence. Not as to the conditions of today, but as to the force of pressures some time hence.

It seemed to us that we could already see some natural conditions that were coming. We could see some excessive inventory in the automobile business. We could see some excessive inventory here and there. We could see a steel wage negotiation coming up. We could see some accumulation in that field. We felt that the natural conditions would exert some downward pressures that would offset these pressures upward, and that there was no further action required at that time, that it was better to go without it.

My general feeling about our economy is that the best interests of America are served when the great majority of people in America have confidence in the situation, when they believe that things are sound and strong, that their jobs are reasonably secure and that good times, which we are in, are going to continue. Not necessarily peak times. I think we must distinguish that.

I think we are often apt to exaggerate when in some particular place there is some relatively small readjustment, and think that is bad times, or that when somebody is not breaking records all the time, that that is bad times. It is not.

When you have very high levels, you have to expect small adjustments in the economy, and you thank the Lord that they are small and come here there and the other place. When they are coming here and there and the other place, it means they are not all going to come at once. When they do not all come at once they correct themselves relatively soon and with relatively little damage.

When you have a high degree of confidence that that is the situation, you can feel that you have pretty sound ground under your feet.

The reason I put so much stress on confidence is this: The majority of people in America have more money to spend than just what they have to spend every day to live on—for clothes and food and shelter. They can spend a little more, or a little less, depending on how they feel, depending on how secure they feel—depending on their confidence.

They can buy a washing machine or not buy. They can trade automobiles, or go along with the one they have. They can buy a house or they can still pay rent. With confidence you have the people going along on an even keel and buying not just the things they need, but other things they want, the things that are available for them to have, to keep increasing their scale of living and to keep a strong economy and widespread activity.

If people begin to lose that confidence and they begin to curtail their activities, why you can very soon find yourself in a position where, when that fellow decides not to buy that washing machine, it is only a little while before either there is another washing machine in the inventory, and later there is a man out of a job.

The most important thing in America is a job. Don't ever forget it. If you do not have the jobs, you do not have any America. The problem for all of us is to see, in every way that we can, that we do have jobs in America. It is jobs in America that makes everything that we have. It makes all the goods we have. It makes all the material things. I am not talking spiritually. I am talking materially. Jobs make all the material things that we have. Jobs are the most important thing in this country.

Confidence in our financial situation and our financial management, in our prudence, in our financial integrity, is essential to the maintenance of jobs and lots of jobs. Therefore, I think that what we want to do is so conduct ourselves in every way so we do not shake that confidence, so that the people feel that we are working in the best interests of leaning against both inflation and deflation, but letting the judgment of 160 million people determine what they will buy, when they will buy it, and what they will pay for it and have the confidence to go ahead and do it.

**STATEMENT OF CHAIRMAN WILLIAM McCHESNEY MARTIN, JR.,  
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

The CHAIRMAN. Mr. Martin, we are delighted to have you here. Will you identify yourself for the record, please, sir?

Mr. MARTIN. Mr. William M. Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System.

The CHAIRMAN. Would you like to make a statement of your own, preceding the questions to be asked?

Mr. MARTIN. I would like to, Mr. Patman. I would also like to answer the 3 or 4 questions in the letter.

The CHAIRMAN. I wish you would do that first.

Mr. MARTIN. I would like to explain first that I regret very much that you feel that our answers were unresponsive in the first instance. There was no intention to be unresponsive. It was entirely a matter of endeavoring to describe the modus operandi of an informal working arrangement, which is nonstatutory, for consultation and continuous conversations and cooperation with the Treasury Department and other interested agencies.

It was in that light that we made the original answers, and you state in your statement that you suggest there is similarity between Secretary Humphrey's answers and my answers.

The CHAIRMAN. Yes.

Mr. MARTIN. I would like to say that I consulted with Secretary Humphrey about this answer, because I thought it was important to know whether he had a different concept about the Federal Reserve System than I had.

The CHAIRMAN. Preceding your reply.

Mr. MARTIN. Preceding my reply. If he had a different concept of the independence of the Federal Reserve System than I had, it didn't seem to me to make any difference particularly whether I answered these specific questions or not. So I would like you to know that I had that consultation. We did not exchange drafts in that sense, but I went over this matter with him to be sure that there was no conflict whatever.

Now, there has been no feuding between the Treasury and the Federal Reserve System, and we are continuing to work on a weekly, daily basis, and the nature of these conversations that we have are those where we get the benefit of being able to converse weekly, daily, over the telephone, and at any time that we feel like it, about any aspect of monetary and credit policy, and about other operations of the financial end of the Government.

Now, it is in that light and in the fact that we have certain statutory responsibilities given us in the Federal Reserve Act, that the Congress has given us the Federal Reserve Act, which, as I frequently say, is our trust indenture, whereby we act in a trustee capacity for the

Congress and the people of the United States, and the Congress can change the Federal Reserve Act.

The CHAIRMAN. May I interrupt you there just to remind you of a statement that went out from Washington last week by a famous weekly publication? I will just read it to you, and see if you agree with it, on that particular point.

Is there politics in it?—

speaking about the discount rate—

Is it due to administrative pressures for easy feeling before election? Federal Reserve men emphatically say "No." They say they are independent of any party or any Government administration.

Would you consider that a correct statement?

Mr. MARTIN. I would say that the Federal Reserve System, as set up and as presently administered, is as close to a nonpolitical agency as it is possible to have in this world. A definition of "politics" could become very difficult at times but we are trying to do what is right in a completely nonpolitical sense.

The CHAIRMAN. I know, but you have not answered the question.

Mr. MARTIN. I would say that the gentleman who wrote that is wrong. That is his judgment.

The CHAIRMAN. But you are not independent of any Government administration. You are independent of any political party. I would agree with you on that, but you are not independent of any Government administration. Of course, I assume Government administration would mean either one of the branches of the Government, like the executive or the legislative. You are not independent of the legislative branch of the Government, because you are an agent of Congress.

Mr. MARTIN. We are an agent of the Congress.

Vice Chairman PATMAN. Agent of the Congress.

Mr. MARTIN. I would like to stress that in my prepared statement that the Federal Reserve Act, as we read it—

The CHAIRMAN. Before we get away from it, if you please, Mr. Martin, pardon the interruption. In consulting all these different people and in arriving at your conclusions, and making these far-reaching decisions, do you confer with anybody in connection with the Congress that is connected with the Congress?

Mr. MARTIN. From time to time I have conferred with the chairmen of the Banking and Currency Committees, in the Senate and the House. I do not, as a regular practice.

The CHAIRMAN. Do you do that in regard to raising discount rates and similar things?

Mr. MARTIN. No; I have not done that.

The CHAIRMAN. It occurs to me that you are in a position—I am not trying to subordinate you or anything like that—but you yourself have said at one time that you are in the position of a servant. The relationship as between the Congress and the Federal Reserve Board, is more like that of a master and servant, and having that relationship, or a similar one, wouldn't you feel that you should confer with the Congress now and then about things which involve so much?

Mr. MARTIN. I am open to suggestions. I have had great question about it, because ours is a delegated authority. We are fully responsible, and accept responsibility. If something goes wrong, we expect

to take the blame. We stand before the body politic. It could be that you would want to have a watchdog committee, or to have a representative of the Congress attend all of our meetings, but in that event it seems to me that since this is a continuous process that changes from day to day, and week to week, that that representative ought to be a full-time representative, and ought to share in the responsibility for the decision, as well as serve on a consultative basis. The responsibility for the decision in this instance, or in other instances, in terms of the Federal Reserve Act, lies with the Federal Reserve Board, and we stand at the bar of public opinion and congressional behest on that at any time.

The CHAIRMAN. May I comment briefly on that suggestion of yours, namely, that whoever you confer with should assume some of the responsibility, if it is a representative of the Congress? You do not expect the people with whom you confer outside of Congress to share your responsibility, do you? You do not expect the Federal Advisory Committee of the Federal Reserve System, for instance, to share in your responsibility. You don't expect any of these 108 directors of the 12 Federal Reserve banks to share any of the Board's responsibility. You take the responsibility yourself, do you not?

Mr. MARTIN. Oh, no; I expect the directors of the Federal Reserve banks, in accord with the Federal Reserve Act, to act to accept their share of the responsibility. As to the Federal Advisory Council, that is a statutory body—

The CHAIRMAN. That's right.

Mr. MARTIN. And where it is written into the statute that we should confer with anybody, why, of course, we are going to do it. I am talking about statutory responsibility now.

The CHAIRMAN. Of course, you know why the Federal Advisory Council was written in there. You know that President Wilson was determined that bankers should not be on a policy-making board and finally they agreed on having the bankers represented through that Council. After Mr. Wilson died and we were in the depths of the depression, the bankers who wanted representation on important money management boards got it during the depression and they still have it. That is right, isn't it?

Mr. MARTIN. The Federal Advisory Council is a part of the statute.

The CHAIRMAN. They have got not only the Federal Advisory Council, but they have got banker representation, too, on the Open Market Committee.

Mr. MARTIN. Not banker representation on the Open Market Committee unless—this is a favorite discussion between you and me—your reference is to the fact that the original recommendation comes from the board of directors of a given bank that includes certain directors who are bankers.

The CHAIRMAN. I once asked you to find out how many of the class B directors own interests in banks. Didn't your questionnaire disclose that a majority of them were bankers?

Mr. MARTIN. I don't think a majority.

The CHAIRMAN. That is the impression I got from the information from your Board.

Mr. MARTIN. I think I could resubmit for the record that statement. I would be very glad to do it, but there were a few that do have interest in banks, though there are very few.

The CHAIRMAN. The information I got was majority.

Mr. MARTIN. I will put that statement in the record of this hearing, if that is desired.

(The statement referred to is as follows:)

Information with respect to the ownership of bank stock by class B directors of Federal Reserve banks was furnished at the request of Mr. Patman for the record at the hearings before the Committee on Banking and Currency of the House of Representatives on H. R. 9285—Direct Purchases of United States Obligations by Federal Reserve Banks—on February 27 and 29, 1956. The following is taken from page 25 of those hearings:

"The law does not prohibit class B directors of Federal Reserve Banks from being stockholders of banks. In order to respond to the request of Mr. Patman and Mr. Multer, therefore, it was necessary to ask each Federal Reserve bank to obtain a statement from each of its class B directors of the amount of bank stock now owned and whether there had been any change in ownership during the past 3 years or since their election as directors, whichever is the shorter period.

"Under the law, there are 36 class B directors of Federal Reserve banks (3 for each of the 12 banks). At the time of this inquiry there was 1 vacancy, and it was not possible to obtain the information from 2 of such directors who were on extended trips and could not be reached.<sup>1</sup>

The remaining 33 class B directors own stock of banks as follows:

"Sixteen own no bank stock and have owned no bank stock since their election as directors.

"Eleven own less than one-half of 1 percent of the stock of any 1 bank.

"Three own less than 2 percent of the stock of any 1 bank.

"One owns 2½ percent of the stock of 1 bank (130 of 6,000 shares).

"One owns 13 percent of the stock of 1 bank (3,900 of 30,000 shares).

"One owns 15½ percent of the stock of 1 bank (312 of 2,000 shares).

"Four of the directors had increased their holdings of bank stock within their term of office for the past 3 years. The increased holdings of three resulted from stock dividends or the exercise of rights in connection with an increase in capital. Only one represented an increase in proportionate ownership. None of the 17 owning bank stock has decreased his holdings since his election as director."

The CHAIRMAN. They are elected by bankers. Out of the board of directors in New York—and it is the same in each Federal Reserve district—6 of the 9 directors are elected by the banks. Now, whoever they select, of course, I consider that banker representation has selected them. You think that because some of them are not bankers that—

Mr. MARTIN. I think because they are insulated—and I am glad to have an opportunity to put this statement in the record, because I think if there is anything not in consonance with the Federal Reserve Act, nobody wants to know it quicker than we do.

The CHAIRMAN. All right, sir. Pardon the interruption, Mr. Martin. You may proceed.

Mr. MARTIN. Would you like me to read this statement?

The CHAIRMAN. If you prefer.

Mr. MARTIN. Then I will answer these questions very briefly at the end.

Your letter of June 4, advising me of the time for this public hearing, and the subcommittee's statement of June 7 for the press, state

<sup>1</sup> Since that time the vacancy has been filled and the information from the two directors referred to has been obtained as follows:

One director owns eighty-two hundredths of 1 percent of the stock of one bank.

One owns 1½ percent of the stock of one bank (300 of 20,000 shares, which has been reduced from 350 shares within the past 3 years).

One owns 3¼ percent of the stock of one bank (200 of 6,000 shares) and 10 percent (100 of 1,000 shares) of another bank. There has been no change in his holdings during the past 3 years.

that you are interested at this time in procedural matters surrounding the recent increases of the discount rate at Federal Reserve banks, and that you wish to leave for a later date questions as to the merits and wisdom of the action itself.

Your decision not to go immediately into the merits or demerits of this particular action seems to me a wise one. As you know, the Federal Reserve Act specifies a procedure for reporting annually to the Congress, whose agent we are, on the policy actions of the Reserve Board, and of the Federal Open Market Committee.

A wider understanding of these procedures is very desirable. Accordingly, this statement will set forth an elementary outline of organization and procedure and will include a statement relative to the 108 directors of the 12 Federal Reserve banks, who, under the Federal Reserve Act, have initial responsibility for determining discount rates at their respective institutions.

I list the name and the directors at the back of the statement.

The CHAIRMAN. You list those that were class 3 directors that owned the stock in banks?

Mr. MARTIN. No, but I will supplement this statement with other material to meet the request which has just come up.

Discussion and full disclosure of monetary policy and action are, of course, essential. The effects of a given step in the development of monetary policy, however, are difficult, if not impossible, to gage in the short run.

Monetary policy is a fluid, not a static, process. Each separate action is usually a supplemental or complementary step in development of an overall pattern of policy.

Policies are shaped from day to day by a connected series of separate actions, with constant adaptations to the ever-changing factors and forces in the vast economic fabric of the country.

Therefore, it would be illogical and misleading to lift out of context a given step in the process. Debate close to the time of action does not afford a broad enough perspective, particularly when judgments as to timing or as to the economic outlook differ.

Under circumstances of diverse trends, hesitancy and delay in taking monetary action might result if those responsible for action were expected to explain publicly and defend any given step of a continuing or changing pattern, before the economic indicators were so unmistakably clear as to support a unanimity of judgment.

The annual reports to Congress required by law are sufficiently removed from the time the various actions are taken to afford a broader perspective as to their wisdom or lack of it. Thus, a better, calmer appraisal is probable than is apt to be the case if judgments are made around the time action is taken.

The CHAIRMAN. May I ask you a question on that one?

Mr. MARTIN. Certainly, sir.

The CHAIRMAN. I know that your reports are invariably delayed. Instead of making a report right at the end of December, you usually make the report about—when?

Mr. MARTIN. We have been usually doing it around March or early April, because—

The CHAIRMAN. We don't usually get them, or at least I haven't been getting them early. I had this in mind, about the first of June or first of July.

Mr. MARTIN. We have done better than that, and I am making every effort administratively to get them up earlier. I hope next year to get it in in early March.

The CHAIRMAN. Since you mentioned that here, it was wise to have the decision, the announcement of the decision delayed, I thought maybe it was deliberately done.

Mr. MARTIN. No, sir; absolutely not.

A wider understanding of these procedural processes which you are studying today should lead to a better public understanding of policy action, what they aim to accomplish, and what they can and cannot do. There is, of course, no magic in Federal Reserve, monetary, or other governmental measures that will assure perpetual and evenly distributed economic health. Maladjustments, imbalances, excesses in some sectors and shortages in others are inevitable; but partial readjustment should not be postponed, at the risk of increasing the general ailments.

Monetary policy is a standard, though limited, remedy for some ills.

The discount rate particularly can be greatly overrated as a cause or cure. Open market operations, discount rate changes, and reserve requirement changes are the closely interrelated parts of Federal Reserve monetary mechanism. Confusion often arises because we are apt to talk about the three parts of this mechanism as if we were offered a choice among three separate means of easing or tightening credit.

All three must operate together—in a continuing pattern, the supply of reserves always being basic. Open market operations and reserve requirements affect that base. Discount rates do not affect the volume of that base, but only the cost of reserves. It is therefore misleading to think of the three components as if they were alternatives to be used independently of each other. They must be used together.

The use of one component rather than another at a particular moment is explained by the fact that, by its nature, each has a different impact. Reserve requirements are the bluntest of the three, having the heaviest impact because they directly affect all member banks in varying degree and release or absorb very large sums. Changes in reserve requirements are best suited to broad basic adjustments, and the impact of such changes is often modified by subsequent Federal open market operations.

Open market operations are best suited to day-to-day adjustments, for they can be used to release or impound small or large sums of reserves in accordance with current conditions. In this way, what have aptly been called "high-powered dollars" are added to or taken out of the reserves of the banking system.

It is most important to note here that contrary to a widespread misunderstanding, the Federal Reserve System does not use the reserves deposited with it by the member banks to buy Government securities.

The CHAIRMAN. On that point, Mr. Martin, you remember that a representative of the American Bankers Association insisted one time in answering my question before the Banking and Currency Committee of the House that these deposits were used to buy Government securities. Every year I questioned them, and the American



Bankers Association representatives adhered to their former insistence. Finally, last year they wrote me a letter and stated I was right and they were wrong. I have never published that letter, but I think I should. I am glad you brought it out.

Mr. MARTIN. I think that was very helpful, your bringing out that error.

For this purpose the Reserve System creates money, and additional reserves are thus put at the disposal of member banks on which loans and investments can be pyramided at a ratio of about 6 to 1. That is why the money created to make such purchases is spoken of as "high-powered dollars."

Discount rate changes, in respect to frequency of use, are less frequent than open market sales and purchases, but more frequent than reserve requirement changes. For example, the rates of discount were revised downward twice in 1954, during a comparatively short and mild business downturn, and have been revised upward 5 times over the last 12 or 13 months as the economy rose toward its production capacity, and demand for credit strained the limits of supply.

The initiative as to discount rates rests with the directors at each of the 12 banks. They meet regularly, different Reserve banks having different days, in some instances, for directors' meetings; but each bank acts every 14 days, either to reestablish or change its existing discount rate. The action taken, whether to continue the same or to change the rates, is immediately reported to the Board of Governors, and acted upon at a regular or special Board meeting.

Since System procedure is based on organization, it seems relevant and appropriate to outline briefly the way in which the Reserve System is organized. It is essentially a regional system, made up of 12 Reserve banks with 24 branches, and having a total of 260 directors. The Board of Governors has responsibility for coordinating policy of the 12 banks, and in some instances supervises operations as well.

The Federal Reserve Act spells out, in detail, how the directors of the banks and branches are to be chosen. At the head offices, there are 9 directors, 6 elected by member banks. You are correct in that.

Three—class A, in the law—are chosen from local member banks, so grouped as to provide representation for the larger, medium-sized, and smaller banks in each district. And the bulk of the member banks are, in fact, small businesses, engaged in serving small businesses in their communities. Three—class B—are required to "be actively engaged in their district in commerce, agriculture, or some other industrial pursuit." The first 3 may be considered as lenders, the second 3 may be looked upon as representatives of borrowers. The remaining three—class C—are chosen by the Board of Governors with a view to providing a still broader representation, and they cannot be bankers. Of the class C directors, the Board of Governors designates one as the chairman and another as the deputy chairman for each Reserve bank.

The CHAIRMAN. May I interrupt you there? You state here that class C directors cannot be bankers, but I believe the law requires them to be men of tested banking experience.

Mr. MARTIN. That's correct, as to the chairmen.

The CHAIRMAN. They must have been bankers recently?

Mr. MARTIN. Oh, no.

The CHAIRMAN. They must be of tested banking experience.

Mr. MARTIN. It is banking in the broad sense.

The CHAIRMAN. I am not making any point, except to say that the whole board is topheavy with bankers.

Mr. MARTIN. Well, we have for example, Mr. James R. Killian, Jr., who is the president of the Massachusetts Institute of Technology, one of those selected as a class C director. He has been very faithful, and a fine director.

The CHAIRMAN. I am not saying anything against any of them.

Mr. MARTIN. I know that. I just wanted to point that out.

In this blending of public and private participation, the act vests the regional banks with as large a degree of autonomy as is feasible in an organized system. While each president and first vice president of a Reserve bank is initially selected by the local directors for a term of 5 years, the selections are subject to approval by the Board of Governors, a procedure that, in my judgment, gives these officers a very desirable freedom from domination by the Governors, the directors, or by others.

The CHAIRMAN. May I ask you about the Open Market Committee on this particular action, Mr. Martin? The Open Market Committee manager is selected by the 9 directors of the New York Bank, 6 of whom were selected by the banks in that Federal Reserve District. Is that correct?

Mr. MARTIN. New York Federal Reserve Bank?

The CHAIRMAN. That is the only one, of course, that has a manager.

Mr. MARTIN. That's right.

The CHAIRMAN. The Board of Governors approved him?

Mr. MARTIN. That's right.

The CHAIRMAN. That person who has that very important place handling the operation, open market operations, is not directly responsible to you, is he? When I say "you," I mean of course the Board of Governors. He is responsible to the New York Federal Reserve Bank?

Mr. MARTIN. He is responsible to the bank, but the bank is acting as an agent of the Open Market Committee.

Now, on this point, in our ad hoc subcommittee report, which we have discussed frequently, it has been my feeling that the selection of the manager should be by the Open Market Committee, and then the directors of the New York bank should approve the selection rather than having it in reverse. That is the wiser approach, in my judgment.

The CHAIRMAN. Wouldn't you go further, Mr. Martin, and say that the bankers should be off the Open Market Committee, and that the Open Market Committee should be composed of the Board of Governors here in Washington and the whole open market operation moved to Washington?

Mr. MARTIN. No; I wouldn't go that far.

The CHAIRMAN. You wouldn't go that far? All right.

Mr. MARTIN. Similarly, the functions of the System are distributed. Thus reserve requirements are the sole responsibility of the Federal Reserve Board. Open market operations are the responsibility of the Federal Open Market Committee, a statutory body consisting of the 7 members of the Reserve Board and the 5 Reserve bank presidents. And the law specifies that all the presidents shall serve on the Committee at intervals. Discount rates are a joint responsibility of the Reserve Board and the Reserve bank directors.

The CHAIRMAN. May I interrupt you there, and you say the law specifically says that these are at intervals? Isn't there an exception, a very important one, that the president of the Federal Reserve Bank of New York is always a member?

Mr. MARTIN. That's correct.

The CHAIRMAN. This is incorrect to that extent.

Mr. MARTIN. Well, not so far as my comment here is concerned with the fact that all the presidents serve on the Committee at some time.

The CHAIRMAN. At intervals, but indicating that they skip, 1 year on, 2 years off, which of course is true.

Mr. MARTIN. Not true in the case of New York.

The CHAIRMAN. In New York they are permanent members.

Mr. MARTIN. They are permanent members under the law.

These provisions have been carefully thought out in the legislative process and have worked reasonably well in practice. I do not mean to say that the System is perfect—it is not—but I am confident that the Congress would not wish to make important changes in it without thorough study and deliberation.

Although the discount rate is fixed periodically by each bank subject to the Board of Governors' approval, in the actual granting of discount accommodation to individual member banks, the Federal Reserve bank directors act on their own initiative and responsibility, free from intervention or pressures by the Board of Governors or by other Reserve banks. These directors are always in close touch with conditions in their districts, and the discount operations, including the rates, take account of local economic needs and trends. At the same time, through the constant stream of intercommunication among governors, directors, presidents, and their staffs, all who have responsibilities in the System, are in touch with and advised of the economic picture nationally and the needs of the overall economy.

The CHAIRMAN. May I interrupt you there, too, Mr. Martin?

Although these directors have all this power and the responsibility of fixing these rates, you can veto any rate you want to, can't you?

Mr. MARTIN. The law gives us that authority.

The CHAIRMAN. Gives you that power. In other words, they can talk about it and decide on it, but if you want to change it, you can do it.

Mr. MARTIN. The final authority rests with us.

The CHAIRMAN. In the Board right here in Washington.

Mr. MARTIN. In the Board right here.

The CHAIRMAN. That's right.

Mr. MARTIN. Through the medium of frequent meetings of the Federal Open Market Committee—meetings are held every 3 weeks or oftener as circumstances require—there is an interchange of economic information and operational experience that keeps Board members and the Reserve bank presidents and directors informed on the course of the economy, both regional and national.

I would like to point out here that the airplane has been a very great help to us.

The CHAIRMAN. What has?

Mr. MARTIN. The airplane has been a very great help to us, in that the president of the San Francisco Reserve Bank hasn't missed a meeting in months—since February, I think, although I didn't check this exactly. That wouldn't have been possible 10 years ago, or at least

it would have been very difficult, so swift transportation has been helpful to the operation of this Committee.

As discount policy is closely interwoven with open market policy, it is among the important subjects discussed at the frequent meetings of the Federal Open Market Committee, and the presidents of the Reserve banks generally express their individual views as to whether they feel they should recommend to their boards of directors changes in discount rates. A consensus may emerge from the round table discussion, but—and this is important to bear in mind—there is no effort on the part of any member of the committee to dictate to any individual Reserve bank, its president or directors what those rates should be.

The CHAIRMAN. On that point, I think it is germane to ask you about this last increase in the discount rate which was passed on, I believe, by 10 or 11 of the banks, the same day.

Mr. MARTIN. That Board approval was given 11 banks on the same day. The reason for that was that we held up to give—but let me give you the sequence: The first bank to come in with a recommendation was the Atlanta Reserve Bank. The second bank to come in was the Philadelphia bank. We knew that the following Thursday—April 12, the day, as it happened, that the discount action was announced—there would be some meetings of quite a number of banks. On Wednesday, April 11, preceding the Thursday date—as I pointed out, these banks have different meeting dates, and no effort was made to pressure anybody to go along and do anything—and the San Francisco bank came in.

The CHAIRMAN. You don't mean to say you were not conferring with them at different times?

Mr. MARTIN. On this discount rate change?

The CHAIRMAN. Yes, sir.

Mr. MARTIN. We conferred in the Open Market meeting, which preceded it, but we did not confer with them individually as they went along.

The CHAIRMAN. In the Open Market Committee preceding the actions of the different boards you had discussed it, and you had agreed it might be a good thing?

Mr. MARTIN. No; we didn't come to any agreement. We had a full discussion of it in which it was indicated that several of the banks might go up.

The CHAIRMAN. It was not wholly unexpected?

Mr. MARTIN. Not wholly unexpected, but I was by no means certain. I did know that two banks were coming in with different rates, that they would come in at rates different from the others.

The CHAIRMAN. Were they justified, or authorized in reaching that conclusion, that it would meet with the approval of the Board, if they did raise these rates?

Mr. MARTIN. They knew that it would be considered by the Board promptly, and having participated in the Open Market Committee meeting, they had reason to believe that there was gradually crystallizing in the System a view that a higher rate might be desirable.

That there should be differences—as evidenced at the moment by different rates in two of the districts—reflects not only different judgments, but also the absence of dictation or undue influence. This, I believe, is the way in which this function was expected to be performed, based primarily on the judgments of directors familiar with local

conditions, and with coordination effected through the Board of Governors.

Finally, let me point out that discount rates are the interest rates paid by member banks, when they borrow from their district Federal Reserve bank. It should be emphasized that such borrowing is intended to meet only temporary needs of member banks for reserve funds, and not long-term needs geared to the normal growth of the economy, or to the annually recurring seasonal requirements of commerce, industry and agriculture in the 12 districts. Reserves necessary for such general and repetitive purposes are predetermined as closely as possible by the Federal Open Market Committee and ordinarily supplied by Federal open market operations or occasionally by the Board of Governors through changes in reserve requirements.

In arriving at policy decisions, great care is taken to obtain and evaluate all relevant views, including, of course, the views of officials of the Government who have responsibilities in the economic field. These consultations frequently develop differences of view. That is to be expected. Our final decision, however, under the law, must be our own and represent, as closely as human relations can, our judgment on the direction of action that will contribute most to the public welfare.

Following is a list of the Federal Reserve bank directors and their business affiliations:

DISTRICT 1—BOSTON

Class A:

Lloyd D. Brace, president, the First National Bank of Boston, Boston, Mass.  
 Harold I. Chandler, president, the Keene National Bank, Keene, N. H.  
 Oliver B. Ellsworth, president and trust officer, Riverside Trust Co., Hartford, Conn.

Class B:

Milton P. Higgins, president, Norton Co., Worcester, Mass.  
 Frederick S. Blackall, Jr., president and treasurer, the Taft-Peirce Manufacturing Co., Woonsocket, R. I.  
 Harry E. Umphrey, president, Aroostook Potato Growers, Inc., Presque Isle, Maine.

Class C:

James R. Killian, Jr., president, Massachusetts Institute of Technology, Cambridge, Mass.  
 Robert C. Sprague, chairman and treasurer, Sprague Electric Co., North Adams, Mass.  
 Harvey P. Hood, president, H. P. Hood & Sons, Inc., Boston, Mass.

DISTRICT 2—NEW YORK

Class A:

John R. Evans, president, the First National Bank of Poughkeepsie, Poughkeepsie, N. Y.  
 Ferd I. Collins, president and trust officer, Bound Brook Trust Co., Bound Brook, N. J.  
 Howard C. Sheperd, chairman of the board, the First National City Bank of New York, New York, N. Y.

Class B:

Lansing P. Shield, president, the Grand Union Co., East Paterson, N. J.  
 John E. Bierwirth, president, National Distillers Products Corp., New York, N. Y.  
 Clarence Francis, director, General Foods Corp., New York, N. Y.

Class C:

Jay E. Crane, vice president, Standard Oil Co. (New Jersey), New York, N. Y.  
 Forrest F. Hill, vice president, the Ford Foundation, New York, N. Y.  
 Franz Schneider, consultant to Newmont Mining Corp., New York, N. Y.

DISTRICT 3—PHILADELPHIA

Class A :

- Wm. Fulton Kurtz, chairman of the executive committee, the First Pennsylvania Banking & Trust Co., Philadelphia, Pa.
- W. Elbridge Brown, president and trust officer, Clearfield Trust Co., Clearfield, Pa.
- Lindley S. Hurff, president and trust officer, the First National Bank of Milton, Milton, Pa.

Class B :

- Warren C. Newton, president, O. A. Newton & Son Co., Bridgeville, Del.
- Bayard L. England, president, Atlantic City Electric Co., Atlantic City, N. J.
- Charles E. Oakes, president, Pennsylvania Power & Light Co., Allentown, Pa.

Class C :

- Lester V. Chandler, professor of economics, Princeton University, Princeton, N. J.
- William J. Meinel, chairman of the board, Heintz Manufacturing Co., Philadelphia, Pa.
- Henderson Supplee, Jr., president, the Atlantic Refining Co., Philadelphia, Pa.

DISTRICT 4—CLEVELAND

Class A :

- J. Brenner Root, president, the Harter Bank & Trust Co., Canton, Ohio.
- Edison Hobstetter, president and chairman of the board, the Pomeroy National Bank, Pomeroy, Ohio.
- King E. Fauver, director, the Savings Deposit Bank & Trust Co., Elyria, Ohio.

Class B :

- Alexander E. Walker, chairman of the board, the National Supply Co., Pittsburgh, Pa.
- Joseph B. Hall, president, the Kroger Co., Cincinnati, Ohio.
- Charles Z. Hardwick, executive vice president, the Ohio Oil Co., Findlay, Ohio.

Class C :

- John C. Virden, chairman of the board, John C. Virden Co., Cleveland, Ohio.
- Frank J. Welch, dean and director, College of Agriculture and Home Economics, University of Kentucky, Lexington, Ky.
- Arthur B. Van Buskirk, vice president and governor, T. Mellon & Sons, Pittsburgh, Pa.

DISTRICT 5—RICHMOND

Class A :

- J. K. Palmer, executive vice president and cashier, Greenbrier Valley Bank, Lewisburg, W. Va.
- Daniel W. Bell, president and chairman of the board, American Security & Trust Co., Washington, D. C.
- Joseph E. Healy, president, the Citizens National Bank of Hampton, Hampton, Va.

Class B :

- W. A. L. Sibley, vice president and treasurer, Monarch Mills, Union, S. C.
- Robert O. Huffman, president, Drexel Furniture Co., Drexel, N. C.
- L. Vinton Hershey, president, Hagerstown Shoe Co., Hagerstown, Md.

Class C :

- Alonzo G. Decker, Jr., executive vice president, the Black & Decker Manufacturing Co., Towson, Md.
- D. W. Colvard, dean of agriculture, North Carolina State College of Agriculture and Engineering, Raleigh, N. C.
- John B. Woodward, Jr., chairman of the board, Newport News Shipbuilding & Dry Dock Co., Newport News, Va.

DISTRICT 6—ATLANTA

Class A :

- Roland L. Adams, president, Bank of York, York, Ala.
- W. C. Bowman, chairman of the board, the First National Bank of Montgomery, Montgomery, Ala.

William C. Carter, chairman and president, Gulf National Bank, Gulfport, Miss.

Class B:

A. B. Freeman, chairman of the board, Louisiana Coca-Cola Bottling Co., Ltd., New Orleans, La.

Pollard Turman, president, J. M. Tull Metal & Supply Co., Inc., Atlanta, Ga.

Donald Comer, chairman of the board, Avondale Mills, Birmingham, Ala.

Class C:

Harlee Branch, Jr., president, Georgia Power Co., Atlanta, Ga.

Henry G. Chalkey, Jr., president, the Sweet Lake Land & Oil Co., Lake Charles, La.

Walter M. Mitchell, vice president, the Draper Corp., Atlanta, Ga.

DISTRICT 7—CHICAGO

Class A:

Vivian W. Johnson, president, First National Bank, Cedar Falls, Iowa.

Walter J. Cummings, chairman, Continental Illinois National Bank & Trust Company of Chicago, Chicago, Ill.

Nugent R. Oberwortmann, president, the North Shore National Bank of Chicago, Chicago, Ill.

Class B:

William A. Hanley, director, Eli Lilly & Co., Indianapolis, Ind.

Walter E. Hawkinson, vice president in charge of finance, and secretary, Allis-Chalmers Manufacturing Co., Milwaukee, Wis.

William J. Grede, president, Grede Foundries, Inc., Milwaukee, Wis.

Class C:

J. Stuart Russell, farm editor, the Des Moines Register and Tribune, Des Moines, Iowa.

Bert R. Prall, 558 Ridge Road, Winnetka, Ill.

Carl E. Allen, Jr., president, Campbell, Wyant & Cannon Foundry Co., Muskegon, Mich.

DISTRICT 8—ST. LOUIS

Class A:

William A. McDonnell, president, First National Bank in St. Louis, St. Louis, Mo.

Phil E. Chappell, president, Planters Bank & Trust Co., Hopkinsville, Ky.

J. E. Etherton, president, the Carbondale National Bank, Carbondale, Ill.

Class B:

Louis Ruthenburg, chairman of the board, Serval, Inc., Evansville, Ind.

Leo J. Wieck, vice president and treasurer, the May Department Stores Co., St. Louis, Mo.

S. J. Beauchamp, Jr., president, Terminal Warehouse Co., Little Rock, Ark.

Class C:

M. Moss Alexander, president, Missouri Portland Cement Co., St. Louis, Mo.

Joseph H. Moore, farmer, Charleston, Mo.

Caffey Robertson, president, Caffey Robertson Co., Memphis, Tenn.

DISTRICT 9—MINNEAPOLIS

Class A:

Harold N. Thomson, vice president, Farmers & Merchants Bank, Presho, S. Dak.

Harold C. Refling, cashier, First National Bank in Bottineau, Bottineau, N. Dak.

Joseph F. Ringland, president and chairman of the board, Northwestern National Bank of Minneapolis, Minneapolis, Minn.

Class B:

John E. Corette, president and general manager, Montana Power Co., Butte, Mont.

Ray C. Lange, president, Chippewa Canning Co., Inc., Chippewa Falls, Wis.

Thomas G. Harrison, president, Super Valu Stores, Inc., Hopkins, Minn.

Class C:

Leslie N. Perrin, director, General Mills, Inc., Minneapolis, Minn.

O. B. Jesness, head, department of agricultural economics, University of Minnesota Institute of Agriculture, St. Paul, Minn.

F. Albee Flodin, president and general manager, Lake Shore, Inc., Iron Mountain, Mich.

DISTRICT 10—KANSAS CITY

Class A:

- W. L. Bunten, president, Goodland State Bank, Goodland, Kans.
- Harold Kountze, chairman of the board, the Colorado National Bank of Denver, Denver, Colo.
- W. S. Kennedy, president and chairman of the board, the First National Bank of Junction City, Junction City, Kans.

Class B:

- K. S. Adams, chairman of the board, Phillips Petroleum Co., Bartlesville, Okla.
- Max A. Miller, livestock rancher, Omaha, Nebr.
- E. M. Dodds, chairman of the board, United States Cold Storage Corp., Kansas City, Mo.

Class C:

- Oliver S. Willham, president, Oklahoma Agricultural and Mechanical College, Stillwater, Okla.
- Joe W. Seacrest, president, State Journal Co., Lincoln, Nebr.
- Raymond W. Hall, vice president and director, Hallmark Cards, Inc., Kansas City, Mo.

DISTRICT 11—DALLAS

Class A:

- W. L. Peterson, president, the State National Bank of Denison, Denison, Tex.
- Sam D. Young, president, El Paso National Bank, El Paso, Tex.
- J. Edd McLaughlin, president, Security State Bank & Trust Company, Ralls, Tex.

Class B:

- John R. Alford, industrialist and farmer, Henderson, Tex.
- D. A. Hulcy, chairman of the board and president, Lone Star Gas Co., Dallas, Tex.
- J. B. Thomas, president and general manager and director, Texas Electric Service Co., Fort Worth, Tex.

Class C:

- Hal Bogle, rancher and feeder, Dexter, N. Mex.
- Robert J. Smith, chairman of the board and president, Pioneer Aeronautical Services, Inc., Dallas, Tex.
- Henry P. Drought, attorney at law, San Antonio, Tex.

DISTRICT 12—SAN FRANCISCO

Class A:

- M. Vilas Hubbard, president and chairman of the Board, Citizens Commercial Trust & Savings Bank of Pasadena, Pasadena, Calif.
- Carroll F. Byrd, president, the First National Bank of Willows, Willows, Calif.
- John A. Schoonover, president, the Idaho First National Bank, Boise, Idaho.

Class B:

- Alden G. Roach, president, Columbia-Geneva steel division, United States Steel Corp., San Francisco, Calif.
- Reese H. Taylor, president, Union Oil Company of California, Los Angeles, Calif.
- Walter S. Johnson, chairman of the board, American Forest Products Corp., San Francisco, Calif.

Class C:

- A. H. Brawner, chairman of the board, W. P. Fuller & Co., San Francisco, Calif.
- Philip I. Welk, president, Preston-Shaffer Milling Co., Walla Walla, Wash.
- Y. Frank Freeman, vice president, Paramount Pictures Corp., Hollywood, Calif.

Now, I would like to supplement, if I might, Mr. Patman, turning to your letter, a comment on why I made the answer I did to your first letter, which I am sorry was not clear to you.

I would like to point out that since I have been in the System, we have tried to operate in the most effective way possible consistent with the act.



Now, in 1935 the Comptroller of the Currency, and the Secretary of the Treasury, were removed by statute from the Board of Governors. They were on it up to that time, and they were voting members.

Now, since that time there has been no formal statutory provision outlining consultation or conversation. When we had President Truman and Secretary Snyder we had a working relationship where I conferred with Secretary Snyder every single day of the week. After Secretary Humphrey came in, with the administration of President Eisenhower, Secretary Humphrey and I have conferred every Monday. And on Wednesday, the lunches which were started at the time that you are familiar with—from our hearings, the time of the Treasury-Federal Reserve accord, those lunches have been continued. The only difference in this administration has been that where Assistant Secretary Bartelt was the ranking Treasury official at most of the lunches during the Truman-Snyder regime, Under Secretary Burgess has been ranking luncheon guest during the Eisenhower-Humphrey regime.

The CHAIRMAN. I think it is appropriate to ask you here, Mr. Martin: Do you feel like that Mr. Humphrey is the delegated person by the President of the United States for you to confer with?

Mr. MARTIN. No.

The CHAIRMAN. You don't refer to him or think of him then as one designated by the President. You don't confer with him by reason of any designation by the President?

Mr. MARTIN. The President has never mentioned any delegation of that sort to me, but I confer with Secretary Humphrey quite naturally because debt management and monetary policy are very closely inter-related. Senator Douglas, who I am sorry isn't here today, used to say, "Good fences make good neighbors." Now, we have tried to work out a relationship on monetary and credit policies and debt management. I have insisted that in addition to the Senator's comment, and you have heard me a number of times, that we need a revolving door to go through to make it effective. That is the type of relationship that we tried to work out.

These conversations that we have frequently over the telephone on a regular weekly basis, and sometimes on a daily basis, as I have indicated to you, have no agenda, no memorandum of what the conversations are at the time, and they are completely informal. I change my mind from time to time; the Secretary changes his mind from time to time.

I have discussed matters with Chairman Burns of the Council of Economic Advisers on exactly the same basis.

In other words, we have tried to get the maximum benefit of an informal working relationship, which is continuous.

The CHAIRMAN. I want to ask you a question, following up what I have just asked you.

Who asked you to serve, continue on as Chairman, Mr. Humphrey or President Eisenhower?

Mr. MARTIN. Well, let me put it this way: The reputed tender of resignation is not quite accurate. It was known to some people that I had received an offer that was attractive to me near the end of the previous regime, and that I had testified before your committee, the Patman committee, that since the change in the Banking Act of 1935.

which changed the Reserve Board Governor and Vice Governor to Chairman and Vice Chairman, designated by the President, that I was inclined to believe, if you will recall that testimony, that the designation of Chairman on a 4-year basis was intended to make it possible for an incoming President to designate or appoint his Chairman.

The CHAIRMAN. That's right.

Mr. MARTIN. As it has worked out, it hasn't happened that way because I was serving the unexpired portion of Mr. McCabe's term, and he was serving an unexpired portion of another term, so that the time aspect hasn't quite fitted in with that position.

When I had indicated privately to several people who knew of this that I was perfectly agreeable to act in accord with the position I had taken, if I were a persona non grata—now, I did not know at the time who the new Secretary of the Treasury would be. In the course of time, several advisers of the President-elect—later to be advisers of the President—informed me that they hoped I would not be precipitous in tendering a resignation.

I never tendered a resignation. Secretary Humphrey came in. He urged me, as he testified, to stay, and I told him I would stay, and subsequently I met with the President, President Eisenhower, and expressed to President Eisenhower the same position that I am expressing to you, and the President asked me to remain.

The CHAIRMAN. Now, do you consider that you have a 4-year term, commencing when?

Mr. MARTIN. Well, you see, my term changed. My term as a member of the Board of Governors expired on January 31, 1956.

My designation as Chairman of the Board expired April 1, 1955.

President Eisenhower sent for me in early March of 1955, and informed me that he would like to redesignate me as Chairman. I was very flattered and pleased, and said I would serve. He indicated to me that it was possible that my term would end January 31, 1956, and I said, Well, I wouldn't want you to be obligated to me, or me to be obligated to you, Mr. President.

Now, subsequently, I was reappointed, as you know.

The CHAIRMAN. At the same time, if you had not been reappointed, you could not have served on as Chairman, that is obvious.

Mr. MARTIN. I would have dropped out automatically.

The CHAIRMAN. So your term will expire 4 years from March 1955?

Mr. MARTIN. That's correct.

The CHAIRMAN. You did not resign, because it was not necessary for you to resign?

Mr. MARTIN. That's correct.

Well now, I just wanted to point out that there is no agenda or record kept of these conversations.

The CHAIRMAN. If you will go back now to answer the questions in my letter just briefly:

(1) Is it a fact, to your knowledge, that the decision of the Board of Governors "went against the wishes" of the administration advisers? If so, whom?

Mr. MARTIN. If you mean were there differences of opinion, the answer is "yes." As to the further inquiry. "If so, whom"—the conversations that I had over a period of some 3 weeks previous to the action were with Secretary Humphrey and with Chairman Burns of the Council of Economic Advisers and Under Secretary Burgess participated in a good many of them and on one occasion Dr. Hauge, of the White House staff, was present.

Now, "what communications and representations"—Question No. 2—

what communications and representations from executive department officials, or their subordinates, did the Board have before it at the time of reaching its decision?

The answer is, "None." I informed the Board, as is my practice, of the conversations which had been carried on and of the fact that Secretary Humphrey and Chairman Burns questioned the wisdom of the action, but there were no formal representations. That was conveyed to the Board. They knew that at the time they took their action.

"How and by whom were those representations made, to you as Chairman?"—I have already answered that in the preceding question.

(4) Have you or the Board had any subsequent communications, through official or unofficial channels, from members of the Cabinet or their responsible subordinates criticizing the action which the Board has taken?

The answer is, "None"; although we have, and I have, continued the same procedure, and the same considerations, with Secretary Humphrey and with Chairman Burns.

The CHAIRMAN. But you received no criticism?

Mr. MARTIN. None whatever.

The CHAIRMAN. The only criticism you have seen, then, was in the papers?

Mr. MARTIN. What was in the papers, that's right.

The CHAIRMAN. You mentioned "the accord" a while ago. I want you to comment on a statement that Mr. Burgess has recently made before a congressional committee in referring to the accord, that is, the agreement or accord, or whatever you want to call it which was entered into about March 4, 1951?

Mr. MARTIN. Right, sir.

The CHAIRMAN. All right. This is Mr. Burgess' testimony:

Now, the agreement had a lot of codicils and strings and things to it that made it far from perfect, but it was a great step forward. It did not go all the way. It did not completely free the market from Federal Reserve support. The Treasury, I think, continued to try to put out its securities at artificially low rates. When we came in, at the end of 1952 and the beginning of 1953, we recognized those principles. We felt we carried them to their logical conclusion in giving the Federal Reserve the freedom it needed to fulfill its lawful function of influencing the credit situation in the public interest.

Would you like to comment on that statement?

Mr. MARTIN. Well, I couldn't make any comment on it, except that is Under Secretary Burgess' judgment. Insofar as I am concerned, I have worked just as faithfully and conscientiously with the previous Treasury setup as I have with the current setup.

The CHAIRMAN. Yes, sir; but about changing the accord, he said it had a lot of codicils.

Mr. MARTIN. That is a technical document which expired at the end of 9 months. You see, in my understanding—I have worked on that, and I was in the Treasury at the time——

The CHAIRMAN. Just for the particular administration?

Mr. MARTIN. Not for that particular administration, but the terms of the accord, insofar as it applied to——

The CHAIRMAN. To an effective document.

Mr. MARTIN. To what we could do, and, I think I so testified on one occasion, ended up doing.

For example, in the accord—and this has come out in previous hearings—in the accord we had an agreement to maintain the discount rate, no matter what circumstances might occur until the end of the year. That is, from March 4, 1951 until January 1, 1952.

The CHAIRMAN. You mentioned a moment ago about the terms. Was it a written document?

Mr. MARTIN. Well, there were some aspects of it that were.

The CHAIRMAN. Have you filed everything before the committee that we had at one time that looked into that? Did you file everything that you had in connection with the accord that was in writing?

Mr. MARTIN. I did.

The CHAIRMAN. Everything that was in writing.

Mr. MARTIN. Everything that we had.

The CHAIRMAN. I don't recall anything in that that indicated it would expire in 9 months.

Mr. MARTIN. I am talking about this one aspect of it, because I am saying this was a specific provision that at the end of 1951 there was no obligation to maintain the discount rate beyond that time.

The CHAIRMAN. The rest of it did not expire?

Mr. MARTIN. The lunches have gone on just the same.

The CHAIRMAN. I am not talking about the lunches.

Was that one of the major things in the accord; the lunches?

Mr. MARTIN. You so stated on one occasion. [Laughter.]

The CHAIRMAN. I am asking you the question: Do you consider it one of the major functions?

Mr. MARTIN. I think it was a major thing, because I think it is important to have a regular date at which the staffs of the Treasury and the Federal Reserve Board, at the working level, get together, visit. You don't do it regularly. You have a tendency to go away on vacations, or something, and have a time lapse where you don't confer.

The CHAIRMAN. Well, Mr. Martin, have you finished your statement there now?

Mr. MARTIN. I think so, unless there is anything you would like to ask me on those four questions.

The CHAIRMAN. Your testimony has been quite revealing to me about why your letters were so similar, the fact that you gentlemen conferred together, and you didn't have any understanding and you couldn't call it unofficial understanding, but did not have any meeting of the minds. Since each one of you knew what the other one was going to say in reply to the letter, they naturally would be somewhat similar.

Mr. MARTIN. Which I thought was very important.

The CHAIRMAN. That explains why the letters were so much alike. That is the part I couldn't understand.

I didn't charge any conspiracy, or anything like that, but it did look like they had gotten together.

Mr. MARTIN. I want to put the facts out on the table.

The CHAIRMAN. You put it right out on the table. You have admitted it, and it is all right. I won't say you have broken down and confessed, because it is not one of those things. [Laughter.] But that does explain it.

Now then, about the discount rate increase. I can't understand, Mr. Martin, why you always use an increase in discount rates instead of a change in reserve requirements as a retarding influence on infla-

tion. The effect is to compel interest-rate increases all over the country, although the reasons may be largely psychological since the discount rate doesn't amount to much in a substantial way unless banks actually borrow.

Instead of an increase in reserve requirements which would not necessarily increase interest rates all across the board, why is it that you invariably use the discount rate? Having the two methods—you have others also—why do you choose the discount rate which automatically causes interest rate increases clear across the board, and unbalances everybody's budget in America?

The other vehicle or instrument is raising reserve requirements which would do, I think, the same thing, but not force an increase in interest rates. Why is it you always use the former, and never use the latter? At this point I would like to insert two tables based upon the Federal Reserve Bulletin, May 1956, which show the relative use of the two instruments since 1948 and especially since 1954.

(The tables are as follows:)

*Federal Reserve Bank of New York discount rate*<sup>1</sup>

[Percent per annum]

Date effective:	Rate	Date effective—Continued	Rate
1948—Jan. 12	1¼	1955—Apr. 15	1¼
Aug. 13	1½	Aug. 5	2
1950—Aug. 21	1¾	Sept. 9	2¼
1953—Jan. 16	2	Nov. 18	2½
1954—Feb. 5	1¾	1956—Apr. 13	2¾
Apr. 16	1½	In effect May 1, 1956	2¾

<sup>1</sup> Under secs. 13 and 13a, as described in table above.

*Member bank reserve requirements*

[Percent of deposits]

Effective date of change	Net demand deposits <sup>1</sup>			Time deposits	
	Central reserve city banks	Reserve city banks	Country banks	Central reserve and reserve city banks	Country banks
1948—Feb. 27	22				
June 11	24				
Sept. 16, 24 <sup>2</sup>	26	22	16	7½	7½
1949—May 1, 5 <sup>2</sup>	24	21	15	7	7
June 30, July 1 <sup>2</sup>		20	14	6	6
Aug. 1, 11 <sup>2</sup>	23½	19½	13	5	
Aug. 16, 18 <sup>2</sup>	23	19	12		5
Aug. 25	22½	18½			
Sept. 1	22	18			
1951—Jan. 11, 16 <sup>2</sup>	23	19	13	6	6
Jan. 25, Feb. 1 <sup>2</sup>	24	20	14		
1953—July 1, 9 <sup>2</sup>	22	19	13		
1954—June 16, 24 <sup>2</sup>	21			5	5
July 29, Aug. 1 <sup>2</sup>	20	18	12		
In effect May 1, 1956	20	18	12	5	5
Present statutory requirements:					
Minimum	13	10	7	3	3
Maximum	26	20	14	6	6

<sup>1</sup> Demand deposits subject to reserve requirements, which beginning Aug. 23, 1935, have been total demand deposits minus cash items in process of collection and demand balances due from domestic banks (also minus war loan and series E bond accounts during the period Apr. 13, 1943-June 30, 1947).

<sup>2</sup> 1st-of-month or midmonth dates are changes at country banks, and other dates (usually Thursdays) are at central reserve city or reserve city banks.

Mr. MARTIN. We don't always. This is a relatively short period we have been discussing.

The CHAIRMAN. Well, the last five times.

Mr. MARTIN. That is because we have been in an expanding and prosperous economy in this period. Our whole approach to this is, ultimately, to fight, as you and I are both doing, fight deflation.

It is our conviction that employment which is created out of borrowed money, which cannot be ultimately repaid with ease, is going to be temporary employment.

The CHAIRMAN. Mr. Martin, you say "borrowed money." Under our capitalistic system, you cannot have any prosperous economy unless people do borrow money. Our economy is based on debt: no debt, no money.

Mr. MARTIN. I want them to borrow money in accord with their position, the sensible relationship. We are talking about reserve requirements now.

The CHAIRMAN. You are talking about excess borrowing?

Mr. MARTIN. Now, reserves, and our gold stock, are at the heart of a sound banking system, and we want them to expand in a proper way. We used the reserve requirement method twice, and I was glad we could use it, when we were having a mild business decline. I am not at all certain that reserve requirements may not be too high in relation to permissible limits. That is something we will have to consider over a long period of time.

During the war they got up to pretty high levels, because we wanted to have adequate reserves from a national standpoint in a war emergency—that is, we wanted to be able to use our gold stock adequately. But when you see demand and supply in this market, which you don't think is as free as I do, but nevertheless—

The CHAIRMAN. You think it is free market?

Mr. MARTIN. I think it is a free market. I think one of the great blessings of our economy today is that neither the Federal Reserve nor the Treasury is strong enough to override the forces at the grass-roots that are there in this economy. Some of my good friends think I am a little bit hipped on this, but I think that is the strength of our economy.

Now, you can vitiate the forces of supply and demand, but you pay a price for it, and when the Treasury does its financing, neither the Federal Reserve nor the Treasury can afford to ignore the forces of the market unless they want to have unbridled inflation.

I want interest rates to be as low as we can have them without producing inflation, because I think that will contribute to capital formation. But when we artificially interfere with the forces of supply and demand to create low interest rates, then we are paying a price for it, which is too great, in my judgment.

The CHAIRMAN. That is the only way, I will agree, if you just have got to raise interest to fight inflation, I would agree with you, but I do not agree that you have got to raise interest rates to fight inflation. There are other ways to do it. You take, for instance, the suggestion I made to Mr. Humphrey that you could increase interest on savings and people, instead of spending their money, would deposit their money in savings banks. That is one way you could do it.

That would encourage savings and prevent inflation, too, but your Board has held it down. You have the power under existing law.

I of course don't think you should ever have been given that power, but you were; you have OPA powers to fix interest rates. You fixed them low, very low. Did you ever consider raising the interest rates on time deposits in the fight against inflation?

Mr. MARTIN. We have thought about that. I heard you raise that question before—but that is something that we have been considering from time to time.

The CHAIRMAN. How long have you been considering it?

Mr. MARTIN. Within the last year. We have constant discussions of this. The point I am trying to make is that interrelated parts of the monetary mechanism all have to be synthesized to be used effectively and it isn't possible to isolate any one of the monetary instruments at a given time. We don't start with a clean sheet of paper, in terms of what we are all working for, which is as high a level in employment as it is possible to have.

It is my conviction, that if you pursue an inflationary policy and let natural forces generate a boom and bust, then when the inevitable readjustment comes, you will have two people unemployed, whereas you would have only one person unemployed if you had followed a sounder policy. That is what we are both struggling so hard to achieve.

The CHAIRMAN. Yes, an even keel, of course, is preferable, but don't you see some reason for alarm in the present situation where there are so many people unemployed in the automobile industry, the farmers are suffering, and small-business fellows are suffering, homebuilders are suffering.

Mr. MARTIN. I don't want to see anybody unemployed any more than you do, but now let's take this question of availability of credit. There are more questions, of course. Business doesn't live on credit alone.

The CHAIRMAN. It lives on debt.

Mr. MARTIN. Not on debt alone.

The CHAIRMAN. Couldn't do business without debt.

Mr. MARTIN. It would be possible, but difficult. You would have to change the system. You would have to change the markets, and at some point the sources of supply and demand which determine through the market mechanism how those various needs will be met.

Now, so far as the little man is concerned, we have heard a lot of talk recently that a restrictive policy is making it a little more difficult for the little man and it doesn't weigh quite as heavily on the big man.

Now, I would merely like to point out here that in this question of bigness, a good big man is probably better than a good little man, but most good little men in business are trying to get larger. From having been a little man in a very small way, I think that the greatest blessing you can give the little man of this country is price stability. If prices get out of hand with him—and this means far more to him than the difficulty of getting credit—he is just cut to ribbons by it. Whereas the big entrepreneur, the big merchant, can handle a price advance in one way or another, the little fellow, if he has to struggle with price instability and it gets out of hand, is literally wrecked by it.

Administratively—if he has more difficulty in the early stages of a period such as we have been going through, getting credit accommodation, and I regret that as much as anyone—we can administratively help just with a little bank service the little customers; but you can't do anything about the price level that gets away from you.

Now, we saw sometime back an indication that prices might start booming and getting out of hand, with a boost from borrowed money. No objection whatever could be raised to plant equipment expansion being financed out of savings or retained earnings. But as to coming to the market and going to the banking system for a long-term credit under the guise that a few years from now maybe it will be cheaper—well if you really want to make a difficult situation ultimately, in terms of a bust, just let all of this wonderful plant and equipment expansion which we all want, go on being financed out of bank credit—particularly if it is short-term credit, when it should be long-term credit and when it is in excess of the savings.

The CHAIRMAN. You say about price stability. I agree with you that that is a big factor in business, but don't you think instability in interest rates enters into it, too?

Mr. MARTIN. I would like to see interest rates stabilized within bounds, but on the other hand, though business has been so good, the law of supply and demand has been the big factor with respect to rates and we have not been trying to fix interest rates—I think that the Secretary was quite correct in his answer this morning, making a judgment there, but the Federal Reserve probably followed interest rates in the discount rate action rather than leading them.

The CHAIRMAN. A booklet we get out here, Economic Indicators—I guess you see it around—I think it indicates that the people are paying now much more than \$4 billion a year in interest rates in excess of what they were paying, say, 3 years ago. Don't you think, Mr. Martin, that it is damaging to our economy to divert more and more from people more of their purchasing power, from their ability to buy goods and services to the payment of interest? Don't you consider that a factor that should be carefully considered?

Mr. MARTIN. Interest is one of the costs of doing business.

The CHAIRMAN. I know it is one of the costs.

Mr. MARTIN. As you have pointed out, I think flexibility in interest rates is an important ingredient of a strong vigorous economy.

Now, I think that by and large we want to have as much flexibility as we can have within reason, and that the greatest single blessing that we can give, particularly for the little people, the pensioners, and the people with small savings accounts, is to prevent inflation of their currency. I think that this money we have is something that ought to be really removed from politics, as it is in the Federal Reserve, with due respect to that writer you quoted earlier today; it ought to be removed from politics because this money belongs to Democrats and Republicans alike, and it is a very important thing, particularly for the little man, that he has a currency that he can depend upon.

The CHAIRMAN. Well, I think that the interest rates have gone too high. I think we should be concerned about them. I think they are affecting our economy. I think they are to blame for this drop in cars.

I don't think installment buying is too high. As long as people pay debts—and no one complains that people are not paying their debts today. I think installment payments are as good or better than they have ever been, aren't they, Mr. Martin?

Mr. MARTIN. I think they are very good.

The CHAIRMAN. That does not indicate that installment credit is too high if people pay their bills and their debts. It looks to me like that is getting along pretty good. Why should we jump on them and



say we should cut it down? Don't you think it is interfering with their ability to buy cars?

Mr. MARTIN. I question very much whether it had any influence. I would like to make a comment here, purely an aside, about an automobile dealer, who wouldn't mind my saying this. He called me not long ago and told me he wanted to congratulate us on raising the discount rates. He won't be identified. I thought at first he was kidding me. Then he said, "You know, we didn't have anybody to blame for our poor sales, until you raised the rate."

I said, "I am very glad to oblige you in that fact, but," I said, "I really would like your advice. I am seeking advice all the time. I am worried all the time." I am a professional worrier, as I have testified to your committee. That is what I am paid for. I try to get a good night's sleep so I can worry effectively. [Laughter.]

The CHAIRMAN. When was this time? Was that recently?

Mr. MARTIN. Within the last 3 weeks.

The CHAIRMAN. I think he might have had in mind the other four raises before the last one.

Mr. MARTIN. He didn't specify, but pursuing this, I said, "I would really like to know, because I am deeply interested in this."

He said, "I think when you make tight money, and when people talk about bad times, or the possibility of bad times coming, that that does have some influence on our sales."

"But," he said, "I would just like you to know that as far as our particular business is concerned, the customer we have lost is the cash customer and not the credit customer."

I just thought that was an interesting comment from a man who has been in the business for a good many years.

The CHAIRMAN. Do you expect interest rates to go higher, Mr. Martin?

Mr. MARTIN. I don't know, Mr. Patman.

The CHAIRMAN. You would not resist further increases then, if there should be a reason, in your opinion, for stopping inflation? You feel that raising the interest rate is the best way to do it?

Mr. MARTIN. I want to assure you that the Federal Reserve Board is going to do everything within its power to resist both inflation and deflation. We are going to lean against the wind just as hard as we can in both directions.

The CHAIRMAN. I hear talk of 7 percent interest, and 10 percent.

Mr. MARTIN. I have no idea about whether there is anything in that. I would not make any future predictions.

The CHAIRMAN. I heard one man say the other day that the concern in which he is a very large stockholder had put in orders for about \$60 million worth of modern, I will call it machinery, and they are seriously thinking about canceling that order and taking a loss of \$5 or \$6 million, or whatever is necessary, because this interest rate is going on up.

People won't have any money to buy things. You divert it to money lenders and take it away from the bloodstream of business and commerce. I guess that is rather a far-fetched conclusion that he drew, but he is a mighty sensible businessman. He is greatly concerned about the high interest rates. If they were to cancel that contract—it involves the employment of lots of people—that would mean that

these people couldn't pay the installments on cars and purchases and debts and rents and taxes, and thing like that.

It would become distressing and alarming.

Mr. MARTIN. I hope your friend will study the situation more carefully and come to a different conclusion.

The CHAIRMAN. But he has a lot to think about when in the last five times that you have dealt in inflation, you have dealt with it by raising interest rates every time. You didn't deal with it by reserve requirements, which you had the power to do.

Mr. MARTIN. Well, we have tried to use all of these instruments, and I wouldn't forecast what use we would make of any one of these instruments, because I couldn't say. After all, I am only one member of a group.

The CHAIRMAN. A rather powerful member, I would say, Mr. Martin.

Would you like to comment on the significance of Mr. Sproul's resignation, and the choice of this relatively obscure successor of his?

Mr. MARTIN. The choice of Mr. Sproul's successor was made by the directors of the Federal Reserve Bank of New York. It has never been my pleasure to work with a more dedicated and conscientious group.

They canvassed the field for a long time. They had a choice as to whether they would take a young man or an older man. They decided that the nature of this jobber and the problems were such that they would like to have a younger man, and they chose Mr. Alfred Hayes, who has a marvelous background. He was well known to two of the directors of the Federal Reserve Bank of New York. Two of them have worked with him, and he came down and met with the Board of Governors, and we were very much impressed with him, and we look forward to a very successful year.

The CHAIRMAN. In other words, you left it up to the directors of the Federal Reserve Bank of New York?

Mr. MARTIN. That's right.

The CHAIRMAN. Although you had veto power, you didn't feel like you should exercise the veto power? I am not saying you should in this case. I don't know. But I thought it was unusual.

Mr. MARTIN. We have used the veto power on a number of occasions.

The CHAIRMAN. More than once?

Mr. MARTIN. Yes.

The CHAIRMAN. Outside of Chicago?

Mr. MARTIN. Yes.

The CHAIRMAN. This person who has charge of the Open Market Committee, successor to Mr. Sproul, has lots of power, as you know. Now, that is an unregulated bond market that they are dealing with. Don't you think that the Government bond market should be regulated, Mr. Martin, or do you think you should turn those fellows loose with the Government's credit, unlimited as to billions of dollars, in an unregulated Government bond market?

Mr. MARTIN. I think that the Government bond market is by no means perfect, any more than the stock exchange or—

The CHAIRMAN. But the stock exchange is subject to regulation and some restrictions.

Mr. MARTIN. I think we need a lot of study about the Government bond market. I have never held it out as perfect. It is a negotiated market, as distinct from an auction market, and right at the present time New York clearance banks have agreed to make a study about the money aspect of it.

The CHAIRMAN. So you think the question should be studied as to whether they should be regulated?

Mr. MARTIN. I think that they have adequate supervision at the present time. As to whether you need a separate regulatory authority, I don't think you need anything; I think the Federal Reserve System is going to take care of it.

The CHAIRMAN. Would you like to comment further on anything we have brought up?

Mr. MARTIN. I don't think so.

The CHAIRMAN. If I, or any member of the committee, should want to ask you a question for this record, you would be willing to answer it for the record?

Mr. MARTIN. At your service.

The CHAIRMAN. Mr. Ensley.

Mr. ENSLEY. Mr. Martin, Business Week for the 5th of May carried an editorial on monetary policy, and I would like to read a couple of sentences, and get your reaction to it.

The editorial states:

The Federal Reserve is afraid of inflation. Yet, to some of its friends it appears to be acting as though it is afraid of growth. How is it possible to set a goal of a \$500 billion economy by 1965, as the President has done, if the money supply is to be frozen at a level inadequate to support a gross national product of less than \$400 billion?

That is the question raised by Business Week. You have testified on questions of this type in the past, but I wonder if you would again comment on this particular point?

Mr. MARTIN. I think we should provide the resources for growth. I don't agree with the judgment that is expressed in this editorial, and we are trying very hard to see that growth is there. It just happens—I had no idea, as you can testify, that you were going to make this comment—but it just happens I have here a table which I would be very glad to put in the record: "Changes in deposits and currency at all banks."

The CHAIRMAN. We would like to have that.

(The material referred to is as follows:)

*Changes in deposits and currency at all banks—selected dates*

Date	Demand deposits adjusted and currency outside banks <sup>1</sup>	Demand deposits adjusted, currency outside banks, and time deposits <sup>2</sup>	Date	Demand deposits adjusted and currency outside banks <sup>1</sup>	Demand deposits adjusted, currency outside banks, and time deposits <sup>2</sup>
	In billions of dollars: Increase or decrease (—)			In percent: Increase or decrease (—)	
1950.....	6.5	7.1	1950.....	5.9	4.2
1951.....	6.9	9.1	1951.....	5.8	5.1
1952.....	4.5	8.8	1952.....	3.6	4.7
1953.....	1.5	6.1	1953.....	1.2	3.1
1954.....	3.9	8.8	1954.....	3.0	4.4
1955.....	3.8	6.9	1955.....	2.8	3.3
Total, 1950-55.....	27.0	46.8	Total, 1950-55.....	24.3	27.6
Annual average.....	4.5	7.8	Annual average.....	4.1	4.6
1956—January.....	( <sup>3</sup> )	( <sup>3</sup> )	ANNUAL RATES OF GROWTH		
February.....	-0.6	-0.2	1956—January.....	( <sup>4</sup> )	( <sup>4</sup> )
March.....	0.4	0.9	February.....	-5.4	-1.1
April.....	1.3	1.3	March.....	3.6	5.1
May <sup>4</sup> .....	-1.4	-1.2	April.....	11.7	7.3
Total, January to May.....	-0.3	0.8	May <sup>4</sup> .....	-12.5	-6.7

<sup>1</sup> Demand deposits adjusted exclude interbank and U. S. Government deposits and items in process of collection. Currency excludes bank vault cash. Monthly data are adjusted for seasonal variation.  
<sup>2</sup> Time deposits include those at commercial and mutual savings banks and in the Postal Savings System.  
<sup>3</sup> Less than \$50 million.  
<sup>4</sup> Estimated.  
<sup>5</sup> Less than 0.05 percent.

*Changes in loans and investments at all commercial banks*

[In billions of dollars]

Item	Increase or decrease (—)			
	1955	1954	1953	1952
Loans, total.....	11.6	2.9	3.4	6.4
Business.....	6.4	-3	-7	2.0
All other.....	5.5	3.4	4.1	4.5
U. S. Government securities.....	-7.4	5.6	.1	1.8
Other securities.....	.4	1.6	.5	.8
Loans and investments, total.....	4.6	10.2	4.1	9.0
	January-March		April-May <sup>1</sup>	
	1956	1955	1956	1955
Loans, total.....	1.3	.8	1.1	1.6
Business.....	1.3	.5	.2	.6
All other.....	.1	.4	.8	1.0
U. S. Government securities.....	-3.1	-4.8	-1.0	.8
Other securities.....	-1	.7	-3	-3
Loans and investments, total.....	-1.8	-3.3	-3	2.1

<sup>1</sup> Data for May 1956 are estimated.

NOTE.—Data exclude interbank loans. Total loans are after and types of loans before, deductions for valuation reserves. Details may not add to totals because of rounding.

MR. MARTIN. In terms of averages, the annual average growth in demand deposits and currency from 1950 to 1955 shows here in percentage terms as 4.1 percent, which is a bit in excess of the 3 percent that we have talked about.

Now, when you study the money supply, and keep it in mind as a moving stream or flow, it seems to me it is the average over time, and not any given month, that is very important. I would be glad to put that table in the record.

The CHAIRMAN. You keep saying, "money supplied." You make the money supply?

MR. MARTIN. We have power to create money within the limits of the Federal Reserve Act, so long as our liabilities and—

The CHAIRMAN. You have unlimited power for all practical purposes, to manufacture it on the books of the bank.

MR. MARTIN. No; I do not—

The CHAIRMAN. In fact, banks are the biggest manufacturers in the Nation. I am not saying it is wrong. I think we have to have a fine commercial banking system; but the truth is they manufacture money, and you allow them to manufacture money. If they haven't got enough, you put it in the market through the Open Market Committee; you buy bonds.

Of course, through reserve requirements you can change it. Instead of being able to lend \$6 to every \$1 they have, you can enable them to lend \$10 for every \$1 they have, and if there is tightness of money you can supply that market with money to loosen it up. That is your purpose, is it not?

MR. MARTIN. The relationship of cost and availability of money to the stability of your currency is one of the important factors, also. You mentioned earlier several communities that might not want to borrow money at the present time because they might have to pay more than they thought they ought.

The CHAIRMAN. That's right.

MR. MARTIN. I think if you reduce that to nontechnical terms, I am not holding this out as a technically perfect thing—if you reduce it into nontechnical terms, then if the money is available under conditions of relatively full employment and prosperous conditions but people won't borrow the money because they want to get money cheaper, they're exercising a choice. The choice that people have, that businessmen have, is whether they would rather, for example, see this municipality have a sewer issue at  $2\frac{3}{4}$  percent instead of  $2\frac{7}{8}$  percent, or see money pumped out to provide an artificially low rate until it thereby depreciates their currency by a small amount.

It seems to me that that is a price that the majority of the people in this country wouldn't want to pay.

The CHAIRMAN. Don't you see a dangerous trend there, Mr. Martin, in tax-exempt securities being so high; I mean interestwise?

In other words, to a person in the 50 percent bracket  $3\frac{1}{2}$  percent is equal to nearly 7 percent, and in some instances up to 35 percent, depending upon the income.

MR. MARTIN. This is purely an aside. A lot of people don't like my views on this, but I personally don't like tax-exempt securities. I have so testified. To me, it is unfortunate to have them.

Mr. ENSLEY. Mr. Chairman, I ask consent to insert in the record the complete editorial of May 5, referred to above and a memorandum of the committee staff of April 18 with respect to the economic situation and outlook.

The CHAIRMAN. Mr. Martin, we want to thank you. You are always very cooperative, and we appreciate your testimony very much.

Before closing the record and for the sake of completeness, I think it is appropriate to include several other items which bear directly upon the subject of this morning's proceedings.

First of all is an article from Newsweek of April 23, 1956, entitled "Tighter Money: The Backstage Drama." So far as I know, this was one of the first public indications of conflicting official opinion over the wisdom of the April 13 action of the Reserve System in raising the discount rate.

Along with the editorial from Business Week of May 5, which has just been referred to, I think it appropriate also to include two other editorials which appeared in the same journal on May 26 and June 2 respectively.

A news article which appeared in the New York Times of April 26, 1956, reporting on a press conference with President Eisenhower and entitled "President Backs Federal Reserve," is quite significant.

An excerpt from the testimony of Secretary of the Treasury Humphrey at hearings before the Committee on Finance, United States Senate, May 17, entitled "Highway Revenue Act," pages 86-88, should also be included.

The Joint Committee staff memorandum entitled "The Economic Situation and Outlook," which Mr. Ensley has referred to and which came out about this time, should likewise be placed in the record.

(The documents referred to follow:)

[Newsweek, April 23, 1956]

#### TIGHTER MONEY: THE BACKSTAGE DRAMA

In one swift stroke last week, the Federal Reserve Board made money more expensive than it has been at any time since 1933.

The announcement was simple and unemotional: FRB hiked the discount rate, which determines bank-loan rates in general, by a fraction of a percent.

But the cold percentages obscured a behind-the-scenes conflict of dramatic proportions.

In essence, the issue was whether the move was nicely timed to head off a serious inflation or whether it might hobble the boom. Involved were men of the caliber of Federal Reserve Chairman William McC. Martin, Jr., on the one hand, and Treasury Secretary George M. Humphrey on the other.

In the following report, Hobart Rowen of Newsweek's Washington bureau and Associate Editor Clem Morgello tell what went on behind the closed doors, what the arguments were, and what the upshot may be.

For nearly 2 weeks, Federal Reserve officials huddled in conferences with Treasury people and other top administration aides, arguing whether it was time to tighten up on credit. Booming business across the country supplied the backdrop for these Washington sessions. With few exceptions (autos, textiles, farming, farm equipment), the economy was moving at top speed—so fast, in fact, that some feared it might blow a gasket.

*Arguments pro.*—The signs of boom—and threatening inflation—were not hard to find. First-quarter steel production broke all records as the industry poured out 31.9 million tons of ingots—and still customers clamored for more. Construction outlays rose 10 percent in March, to \$3 billion, equaling the record set last year. Capital spending hit a record annual rate of \$33.2 billion in the first three months and was due to go higher in the April-June period.

Money was needed to oil these furiously turning wheels. Businessmen and consumers, Federal, State, and local governments rushed to their banks or to Wall Street creating the tightest money market in almost 3 years. In February alone, commercial bank loans increased \$1.3 billion, or 5 percent.

Chairman Bill Martin and other FRB officials feared all this new money would do more to kick up prices than to boost production, since business was already at peak levels. And the price picture already looked dangerous.

Rail freight rates recently rose 6 percent. Some crude-oil producers were clamoring for a 60-cent-a-barrel hike. Steelmakers had long insisted they needed more for their product, and last week Pittsburgh Steel president Avery Adams put a price tag on that increase: \$12 to \$15 a ton. This estimate, Adams emphasized, didn't cover any wage hike that may soon be won by steelworkers. There was talk that their demands added up to a 40-cent-an-hour package, and it didn't take too much imagination for some to see that this might be the start of a vicious new wage-price spiral.

*Arguments con.*—But a number of top administration officials, including Treasury Secretary George Humphrey, believed that talk of inflation was being exaggerated. Key economic barometers weren't all pointing up, these advisers noted, and the economy had only been holding its own so far in 1956.

First-quarter figures, for instance, will show a gross national product of roughly \$398 billion (annual rate), only a fractional increase over the previous quarter's \$397.2 billion. After allowing for price increases, that means there was hardly any real gain at all.

White House insiders also contended that consumer buying was not creating a real inflationary push. True, said Humphrey et al., retail trade rose from \$15.3 billion in February to a record \$15.7 billion in March. But the gain did not seem great enough to them to force prices up.

As a matter of fact, Newsweek learned, the President's top economic adviser Arthur F. Burns believes the increases have been surprisingly small, considering the current worldwide boom. Burns thinks the economy could absorb the pressure even if prices edged up a bit.

Humphrey's views dovetailed with these, and he argued his point in conversations with the Federal Reserve's Martin. The Treasury boss—who well remembers the complaints that rolled in 3 years ago when money was tightened sharply—wanted to wait a few months to see if loans continued to expand rather than to act now and risk knocking the economy into a skid.

*Man of decision.*—But in the end it was Martin's decision to make, and he made it. The decision: Boost the discount rate from 2½ percent to 2¾ percent (and to 3 percent in 2 districts). By approving this increase—the fifth such boost in a year—Martin hoped to dry up some demand by making it more expensive for banks to borrow from the Federal Reserve, which in turn would make it more expensive for businessmen and consumers to borrow from their local banks. So strongly did Humphrey disagree that he drafted a public statement of his views. He killed it at the last minute to avoid an open controversy.

Meanwhile, the cost of borrowing money has already gone up. Major banks raised their prime rate—what they charge their best customers—from 3½ percent to 3¾ percent. Other rate hikes quickly followed. Possible effects: Less borrowing by business to build inventories; delay of expansion plans which are not essential this year; a slight tightening in consumer credit.

*Guideposts.*—In the coming weeks, Washington experts will keep especially close watch on the economic barometers. Among the things to watch will be consumer spending. If it goes up in the face of tighter credit, the FRB will be vindicated.

But if, for example, the FRB industrial-production index stays where it is (at 143 percent of the 1947-49 average) or falls off, worries about inflation will quickly die. In that case, the Federal Reserve may well decide to reverse last week's action.

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[Business Week, May 5, 1956]

#### THE POLITICS OF TIGHT MONEY

The prestige of the Federal Reserve System, which had fallen to a low estate during the first postwar years, has had a remarkable recovery. Under the chairmanship of William McC. Martin, the Federal Reserve Board has met skillfully and courageously the problems of a turbulent economy. At home and abroad, there is an almost alarming degree of confidence in its ability to steer our economy between the dangers of boom and bust.

The renaissance of the Fed reached a high point last week when President Eisenhower reaffirmed the complete independence of our central banking organization. He acknowledged that the policy of credit stringency now being pursued by the Federal Reserve was one that raised grave doubts on the part of his own advisers. Nevertheless, with his usual patience and breadth of view, the President defended the right of the Federal Reserve to pursue an independent course. No other President has ever spoken thus.

Yet at this moment of triumph, the Federal Reserve System, it seems to us, stands in considerable peril. No matter how secure their independence, Martin and his fellow members of the Federal Reserve System are up to their armpits in politics.

It is impossible to influence the basic trend of a nation's economy without at the same time influencing its politics. Economic intervention, if it is effective, is bound to be political action. And at this moment, the Federal Reserve is subjecting the country to the most drastic credit squeeze since early 1953.

It is not simply a matter of increasing interest rates, although the general level of interest charges has been raised to the highest point in 23 years. It is a question of the actual availability of money. Day after day, business enterprises are turned away as they seek to obtain credit to carry out their plans.

The Federal Reserve is afraid of inflation. Yet to some of its friends it appears to be acting as though it is afraid of growth. How is it possible to set a goal of a \$500 billion economy by 1965, as the President has done, if the money supply is to be frozen at a level inadequate to support a gross national product of less than \$400 billion?

#### WHEN THE SQUEEZE IS ON

Unless the Federal Reserve relaxes its stringent policy, and that promptly, we shall have to revise considerably these widely accepted goals of an expanding economy. American industry has planned this year to invest \$35 billion in new plant. The Federal Reserve's policy is designed to prevent any capital expansion program of this size.

If the Federal Reserve persists in this course, we may expect the current hesitation in business to develop into a downtrend. Such a downtrend in the normal course of events ought to be plainly evident in terms of falling sales and rising unemployment by September and October next.

Without in any way impugning the purity of the Federal Reserve Board, we may assume that this timing will cause no sadness in the Democratic National Committee.

The credit squeeze strikes most directly at smaller business. The giants, like General Motors and General Electric, will get the money for their capital expansion programs, but the smaller enterprises are already having to lay aside or cut their capital expansion plans. Thus the political charge that the Eisenhower administration favors big business will be strengthened if the Federal Reserve keeps the credit screw turned tight enough long enough.

#### WHEN THE SQUEEZE COMES OFF

Nor is that all. In 1953, when the Federal Reserve finally reversed its tight money policy, it slashed member bank reserve requirements and bought nearly \$1 billion of Government securities in the open market. It thus increased bank reserves by over \$2 billion. The inevitable consequence was that Government and other gilt-edged bonds, having been depressed unduly, rebounded sharply. Any financier of average intelligence was offered a guaranteed profit. All that was necessary was to sell enough Government bonds at the lower prices to wipe out the year's tax liability, switch the funds into comparable issues, and sit back for the free ride.

If the Federal Reserve has to make a similar abrupt reversal this year, the same thing will happen. It will take no very skillful demagog to point out that all this does no good to the farmer or to the worker—but it richly lines the coffers of the Wall Street banks, insurance companies, etc.

The Federal Reserve System ought to be above politics. It ought not to use its great powers for political purposes, and we are quite sure that no responsible official of the System would, under any circumstances, knowingly consent to such a course. Yet the System will not survive if it attempts to close its eyes to the political consequences of its actions. If the Federal Reserve System, by overdoing its policy of credit restraint, brings on a business recession this year,



we may be certain that a new administration of another party would not wait long to take away powers that can be used, however correct the motives, to accomplish such drastic political consequences.

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[Business Week, May 26, 1956]

#### SHARING RESPONSIBILITY

Misgivings about the current phase of the Federal Reserve's tight money policy have spread so widely that at this point the Fed seems to stand almost alone in its conviction that any relaxation of the squeeze on credit would invite inflation.

Almost every member of the administration with an interest in this area—from President Eisenhower on down—has voiced his concern, formally or informally, over the repressive effects of the last hike in the discount rate.

In all their statements about credit, administration officials have been scrupulously careful to respect the independence of the Federal Reserve. That is as it should be.

But in Government there is an important difference between an independent responsibility and an exclusive one. The Fed is not the only agency with the duty of guiding the United States economy and promoting its welfare. The Fed can preserve its cherished independence only as long as it realizes that it shares responsibility with other Government agencies and that its policies must harmonize with the policies of these agencies.

It is a good thing to be independent, but there is always a danger of carrying independence to the point of being just stubborn. Sometimes the line between the two is a little hard to define, but the line exists. It would be a tragedy for the country if the Fed let itself slide over that line without realizing it.

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[Business Week, June 2, 1956]

#### MONETARY CONTROLS: THE THEORY LAGS

The current dispute over the Federal Reserve System's credit policy has given rise to two separate proposals that merit serious attention.

One was made by Representative Wright Patman, of Texas, who is Congress' self-appointed watchdog on Federal Reserve matters. He has demanded that officials state their views in public hearings.

The other came from Allan Sproul, retiring president of New York's Federal Reserve Bank, who, in a valedictory address, proposed that the President appoint a commission to make a broad national inquiry into our financial institutions.

What these two proposals have in common is a desire to throw more light on the effect of monetary policy. Patman's plan is aimed at clarifying the present situation—the pros and cons of the Fed's most recent tightening moves. Sproul, on the other hand, seeks to study the entire history of our monetary system in order to improve its functioning.

We think both proposals should be acted on. Although we have not agreed with Patman's position on most matters of Fed policy, his plan to hold hearings could serve a constructive purpose in revealing how the Fed and the administration came to differ over policy.

Such an inquiry should not attempt to censure anyone but to define and clarify the areas of responsibility and independence held by the Fed.

A thorough examination of our financial system is long overdue. There was once a time when more was known about central banking than almost any other field of economic theory. In fact, the use of indirect monetary controls by a central bank was the first real attempt at Government intervention in free enterprise economics.

But over the past 2 decades, other economic weapons have been developed and have gained widespread acceptance. In the 1930's and 1940's, the central bank lost its pivotal role. Moreover, the function of monetary policy, and what it can or cannot do under changing conditions, was never examined. Today the study of monetary theory seriously lags behind other fields of economics.

Now that the Fed has regained its independence, this lack of knowledge is a great handicap. The Fed has done its best to reshape itself to meet new conditions, but it has been a piecemeal and pragmatic adjustment. As Allen Sproul himself said, "We cannot afford much longer \* \* \* to go ahead not really knowing what to expect of our central banking system, of our commercial banking system, of our savings banks and building and loan associations, of our insurance companies and pension trusts, and of all the other bits and pieces which we are using to try to keep our production facilities and our credit facilities in balance."

This is a remarkable admission from the dean of America's central bankers. Our reliance on monetary controls makes it imperative that we know more about their limits and their powers. Both Patman's and Sproul's proposals would help increase our understanding and our knowledge.

[New York Times, April 26, 1956]

PRESIDENT BACKS FEDERAL RESERVE—AFFIRMS ITS RIGHT TO ADJUST CREDIT INDEPENDENTLY OF THE EXECUTIVE BRANCH—DISPUTE ACKNOWLEDGED—"CERTAIN INDIVIDUALS" OPPOSED LOAN RATE RISE—BURNS, HUMPHREY MENTIONED

By Edwin L. Dale, Jr.

WASHINGTON, April 26.—President Eisenhower affirmed without qualification today the authority of the Federal Reserve Board to handle money and credit as an agency independent of the executive branch of the Government.

The affirmation came after his own top advisers, according to authoritative report, had opposed the latest increase by the Federal Reserve in the interest rate charged to member banks. The President indirectly conceded at his news conference today that his own people had had reservations about the move.

Two weeks ago this interest rate, called the discount rate, was raised from 2½ to 2¾ percent at 9 of the 12 Federal Reserve banks and to 3 percent at 2 others. The 12th went to 2¾ percent a week later. The raises were approved by the Reserve Board in an effort to curb what it felt were inflationary tendencies in the economy.

The President said he was confident the Federal Reserve would not let money get "too tight." But his central point was this:

"The Federal Reserve Board is set up as a separate agency of Government. It is not under the authority of the President, and I really personally believe it would be a mistake to make it definitely and directly responsible to the political head of state."

HISTORIC ISSUE RAISED

The history of conflict between central banks and elected governments is a long one, both here and abroad. Up until 1951, the Federal Reserve bowed to the wishes of the Treasury, and President Truman wanted it that way.

Thus today's statement, coming in an election year and at a time when there is a genuine fear in some quarters that the Federal Reserve may be going too far, may mark an important milestone in the history of monetary policy.

The President was asked to comment on the widespread reports that his Secretary of the Treasury, George M. Humphrey, and his chief economic adviser, Arthur F. Burns, had "serious reservations" about the increase in the discount rates. He made plain that he had kept fully informed on the subject and on the controversy.

The President said the Reserve Board "had the unanimous conclusions of their 11 district boards that this rediscount rate ought to be raised, and after studying the whole situation they decided to go ahead and do it." The 12th district was Chicago, which acted later.

General Eisenhower went on to say that the matter was "argued for a long time" and that "certain individuals had viewpoints on the opposite side of the fence."

CONFIDENCE EXPRESSED

The President said: "There are two things about money: one, it gets a little dearer in its cost to the borrower; the other is that it is just not there to borrow." But he said he had "this confidence" in the Federal Reserve Board—that "if money gets to what is normally referred to as tight, they will move in the other direction in some way or other as soon as they can."

The historic conflict over money has had two related aspects :

(1) The politically elected government is inclined to lean toward easier money, even at the risk of a little inflation, because that policy takes the least risk of recession and unemployment. Thus governments tend to have a "bias toward inflation."

(2) But if control over money and credit is removed from the politically elected executive, that does not remove from the executive the responsibility, as far as the public is concerned, for the state of the economy. If an independent central bank goes wrong, and tips a booming economy over into even a short recession by making money too scarce, the elected executive gets the blame.

In March 1951, the Federal Reserve asserted its independent authority, though the new policy was termed an "accord" with the Treasury. It has been operating independently ever since.

President Eisenhower pledged during his campaign to preserve that independence. Recent weeks have provided the first severe test of that pledge. To-day he reaffirmed it.

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EXCERPT OF TESTIMONY, SECRETARY HUMPHREY, COMMITTEE ON FINANCE, UNITED STATES SENATE, HEARINGS, MAY 17, 1956

Senator LONG. \* \* \*

I would like to ask this question, though :

Are you really in sympathy with this last increase in interest rate that the Federal Reserve Board has passed on?

Secretary HUMPHREY. That is a long story. I don't know whether you want to take the time to go into it in detail at this meeting or not. I would be glad to do it.

Senator LONG. I would like to hear your views on it. I wouldn't want you to testify all day here.

Secretary HUMPHREY. Let me put it just as simply as I can.

Under the law, the Federal Reserve Board is an independent agency. There is a great school of thought in the world, based on long experience, that central banks should be independent of current administrative processes, that it works better for the finances of the country over a long period of time.

Because of that, Senator Glass proposed in the original Federal Reserve Act that there be an independence in action of the Board, and it has obtained ever since, and it is still the law.

Now, I believe that a close cooperation, and an interchange of ideas and thoughts, as between the different departments of the Government, the different branches of the Government, is a very desirable thing, in order that, when a department is independent—and most of them are independent in certain fields—that before they take independent action they should have the benefit of consultation with the other departments of the Government and the varying views of the other people.

Fortunately, the present members of the Federal Reserve Board have that same feeling. The result is that, since we have been here, we had a period, as you will well recall, before we came, when the Federal Reserve Board and the Treasury were at outs, and there was such a battle that it finally got to the White House for decision, and it disturbed a lot of conditions.

We have attempted not to have that happen again, because it isn't good for the country.

So that, we have been very careful, and we both believe that we should consult with each other and have the benefit of each other's views in all the actions that either of us take that will affect the economy.

We visit right along, Martin comes over for lunch every Monday to the Treasury; I go to the Federal Reserve Board quite frequently, and one of us, either Randolph Burgess or I, go over there every week, and we meet several times between.

Now, in looking ahead, and in trying to gage what economic conditions are going to be, and what the demands of the economy for money and credit are going to be, and what the demands for people and employment are going to be, to keep jobs going, to keep plenty of jobs, as many jobs as we can have, and to keep things on an even keel as well as we can, and to keep prices from running away and getting into an inflationary period which robs the people of their money, we meet together and discuss all sorts of things that bear on those conditions in the future.

Now, Senator Kerr has just brought out how difficult it is for anybody to gage the future, and in these discussions that we have, we very often differ in our views as to the weight to be given to certain inflationary forces or certain deflationary forces or acts here, or acts later.

What we do—what we try to do is, we give them the very best estimates we can make of the effective weights and the time of the events in the future, the pressures that will be forthcoming in a few weeks, months, a year hence, inflationary pressures or deflationary pressures, so that we can have our views in their minds when they come to take their action. And they, in turn, give us the benefits of their views.

Senator Long. All I wanted to know was whether you agree with their decision or not, is what I really wanted to know.

Secretary HUMPHREY. I felt this last time, if it had been my responsibility, I would not have made this last move—all the others, but this last one might have been postponed, and natural conditions might have taken care of it. Whether I am right or wrong, I don't know.

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CONGRESS OF THE UNITED STATES,  
JOINT COMMITTEE ON THE ECONOMIC REPORT,  
*April 18, 1956.*

MEMORANDUM

To: Members of the Joint Committee on the Economic Report.  
From: Grover W. Ensley, executive director.  
Subject: The economic situation and outlook.

Attached is a summary of the economic situation and outlook prepared by the committee staff on the basis of information contained in Economic Indicators for April, released today, and other information received by the staff.

We have also ventured to suggest the implications of this outlook for Federal economic policy.

THE ECONOMIC SITUATION AND OUTLOOK

I. ANOTHER LOOK AT 1956

The first quarter has been marked by continued indications of economic strength. Other trends indicate instability.

*A. Total output and employment*

With output pressing against capacity in many industries and unemployment close to a minimum, changes in production and employment have been small in the first quarter:

(1) Gross national product, according to preliminary estimates, rose \$1.7 billion from the fourth quarter level to \$399 billion. Much of this increase represented higher prices

(2) The Index of Industrial Production averaged slightly under the fourth quarter.

(3) Changes in employment and unemployment since last October have represented mainly the usual seasonal movements.

*B. Business investment*

Business expenditures for new plant and equipment, according to the recent Commerce-SEC survey, are scheduled to reach about \$35 billion in 1956, some \$2 billion more than plans for this year reported in the MGeraw-Hill survey of last November, and 22 percent or \$6.2 billion more than in 1955. Considered together the annual and quarterly statistics imply a further, though slower rise in the second half. About half of the \$2 billion increase over earlier plans may be offset by less construction expenditures than previously expected, principally for housing.

*C. Sales, inventories, and new orders*

(1) Total business sales have fluctuated within a narrow range since late 1955.

(2) Business inventories reached \$83.5 billion in February, some 8.6 percent above the low of January 1955. With sales leveling out, ratios of inventories to sales have risen in recent months though, in some lines, are still below those prevailing in early 1953. Much of the rise in the value of inventories recently reflects price increases. Trade reports indicate rising steel inventories in anticipa-

tion of price increases or work stoppages. Some further rise in total business inventories seems probable although the automobile industry in March, according to press reports, brought its inventories down slightly by holding output below sales.

(3) New orders received by manufacturers have continued to exceed shipments, although the trend from December through February was somewhat lower (February about 5 percent below December), reducing the excess of new orders over shipments each month from about 7 percent to about 2 percent.

#### *D. Incomes and prices*

(1) Wages continue to rise. Average hourly earnings in manufacturing rose sharply in March, especially in the industries affected by the new minimum wage. The new high of \$1.95 per hour was 5.4 percent above a year ago. Therefore, in spite of a slight decline in the hours of work, average weekly earnings were 4.7 percent above a year ago. Provisions in existing contracts plus the trend of recent collective bargaining agreements point to further wage increases.

(2) Agricultural income in the first quarter was \$10.4 billion (seasonally adjusted annual rate), in line with the expected decline this year of \$1 billion or less from 1955 levels. However, action by the Department of Agriculture, under existing law, could add \$500 million to farm incomes this year.

(3) Prices continued to increase during early months of 1956 at about the rate prevailing since June 1955. Overall price indexes show less rise than many components since lower prices of crude foods and raw materials have been offsetting increases in finished goods and services. The recent 6 percent increase in railroad freight rates and steel price rises now in prospect are among the harbingers of continued price rises during the year.

#### *E. Consumption*

(1) Preliminary results of the annual Federal Reserve Board survey of consumer finances reaffirm consumer optimism.

(2) Personal consumption expenditures increased in the first quarter more than did disposable income, resulting in a reduction in the rate of savings from the fourth quarter. This trend seems to confirm earlier expectations that rising total consumer spending will be a strong factor this year in spite of lower auto sales.

#### *F. International situation*

Economic activity abroad continues strong, particularly in Europe and Canada. Both Great Britain and Canada are taking steps to curb excessive inflationary tendencies.

#### *G. Federal fiscal developments*

(1) Reports through mid-April indicate that the Federal budget will show an administrative surplus of about \$2 billion and a cash surplus of perhaps \$4 billion for this fiscal year ending June 30, 1956. These committee staff estimates represent increases in receipts of about \$3 billion over estimates in the January budget, which were reaffirmed in February by the Secretary of the Treasury. Expenditures may be about \$1 billion higher (due mainly to handling CCC payments inside the budget rather than by sale of notes to commercial banks).

(2) For the fiscal year 1957, the surplus will probably be larger than estimated in the January budget unless: (a) business conditions deteriorate, or (b) legislation increases expenditures significantly more than estimated.

#### *H. Monetary developments*

(1) Apart from meeting week-to-week seasonal needs, the Federal Reserve System during the past half year has supplied no added reserves to the banking system. Government security holdings of the Reserve banks are substantially the same as a year ago.

(2) Member banks have doubled their borrowing from the System in the past year. This increased borrowing to support added loans to customers has occurred in spite of successive increases in the discount rate from 1½ to 2¾ percent and to 3 percent in the San Francisco and Minneapolis districts. (The latest action was taken on April 12.)

(3) Since mid-1955, member bank borrowings have been greater than estimated excess reserves, with a resultant deficiency in the overall reserve position of member banks taken collectively of between \$300 and \$500 million.

(4) For the year ended March 30, 1956, weekly reporting banks reduced Government securities by about \$5 billion, while increasing commercial, industrial,

real estate, and other loans approximately \$8 billion. In spite of restraint, loans to business increased \$1.25 billion in March, or nearly 5 percent in one month.

(5) The trend in interest rates is illustrated by behavior of Treasury bond prices. This decline has meant an increase since mid-February of about  $\frac{1}{2}$  percent in the yield of Treasury securities with a maturity of  $2\frac{1}{2}$  years. The 3 percent's of 1955 have fallen to about  $97\frac{1}{2}$ .

## II. IMPLICATION FOR FEDERAL ECONOMIC POLICY

On balance, the changes in economic indicators in recent months reinforce the view that overall restrictive governmental policy continues to be warranted. As always, there are factors which may be pointed to on the deflationary side. These seem to be outweighed, however, by other considerations.

Some of the present inflationary forces do not appear to be sustainable, and if not now restrained, give prospect of creating maladjustments. The recent rises in industrial prices, stock market prices, inventory accumulation, and bank credit expansion are cases in point. The force of these upward pressures, coupled with foreseeable further increases in steel and other prices, freight rates, and wage rates tend to fan the inflationary forces into a speculative overexuberance which increases the risks of reversal if allowed to run undampened.

Given this preponderance of inflationary influences at the moment, what are the implications for public policy in the monetary and fiscal fields?

The committee's recommendation of March 1, 1956, against a Federal tax reduction continues at the present time to represent the best fiscal policy. A major guide to fiscal policy should be the state of the national economy, as the Subcommittee on Tax Policy has pointed out (S. Rept. No. 1310). Although long-run projections indicate the possibilities of tax reductions, the emergence at this time of a surplus, either anticipated or greater than originally anticipated, is not persuasive as to the wisdom of tax reduction in the face of a booming economy already pressing the limit of immediate resources and fanned by a variety of upward drafts. The fact is that the emerging Federal surplus of itself is but another indication of the strength of the booming forces present in the economy.

As pointed out above, the Federal Reserve System has been pursuing, and continues to pursue, a monetary policy consistent with this restrictive fiscal policy. A restrictive monetary policy necessarily involves some hazards. The principal of these is that too much or too long restraint can turn the economic situation toward caution or liquidation. Apart from judgments as to specific instruments to be used and their timing, it has been suggested that restriction may fall unequally upon small and large business, that it may unduly enhance bank profits, and that if long persisted in, it may have serious implications for the distribution of income. Continual alertness is necessary in carrying out monetary policy to insure that emphasis is shifted toward encouraging more liberality by lenders as soon as inflationary forces subside.

It is clear that the costs of a monetary policy sufficiently restrictive to maintain stability in the face of a tax cut now would be too great to risk. When inflationary forces slacken, a policy of progressive credit ease can be, and should be, initiated, with changes in fiscal policy reserved until more persistent depressing forces are apparent.

(Whereupon, at 12:15 p. m., the committee adjourned, subject to the call of the Chair.)

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