

92
MONETARY POLICY: 1955-56

HEARINGS
BEFORE THE
SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE
JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES
EIGHTY-FOURTH CONGRESS
SECOND SESSION
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MONETARY POLICY: 1955-56

MONDAY, DECEMBER 10, 1956

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

The subcommittee met, pursuant to call, at 10 a. m., in the Old Supreme Court Chamber, United States Capitol Building, Washington, D. C., Hon. Wright Patman (chairman) presiding.

Present: Representative Wright Patman (chairman), and Senator O'Mahoney.

Also present: Grover Ensley, executive director; William H. Moore, staff economist; and Reed L. Frischknecht, legislative assistant to Senator Watkins.

Chairman PATMAN. The subcommittee will please come to order.

Senator O'Mahoney will be here, I am sure, and while we are waiting for him I will read the statement that has been prepared; and, Mr. Bell, will you take a place here, please.

Mr. BELL. Yes, sir.

Chairman PATMAN. Mr. Bell is our first witness this morning.

It is very nice having you come down here to make it possible to give us the benefit of your views.

Senator Watkins' administrative assistant is here to cooperate with us, and we are glad to have him.

There would certainly be very few persons today who would disagree with the proposition that it is good sense, good business, and good government to strive in every reasonable way, within the framework of free enterprise system, to promote stability and high-level employment in our economy. The intention of the Federal Government to do its part toward those ends are stated in the policy declaration of the Employment Act of 1946.

While there are doubtless many ways in which government plans, functions, and policy affect the operation of the economy, it is generally agreed that monetary, credit, and fiscal policies are the principal means of directly promoting stability, high-level employment, and growth.

Having made such an undertaking, prudence dictates that Congress and the executive agencies of Government, with the help of experts in the field, give constant attention to the adequacy and the continual modernization of the stabilization tools.

Later this week, this subcommittee is going to hold hearings on the subject of automation and technological progress in industry. In that field we know that engineers, scientists, and technicians are giving constant attention and thought to the improvement and working of

various machines and processes. The same kind of checking and precautions are just as appropriate and called for in government and economics. We, too, must be continually sure that our instruments are regularly examined for rust and not allowed to be overtaken by obsolescence.

That is precisely the purpose of these current hearings—putting an important stabilization device under examination to see how it is working and if its working can be improved upon. Other subcommittees of the joint committee give similar study to other major policies affecting stabilization and growth, especially fiscal policy.

The Joint Economic Committee, charged as it is with the duty of making continuing studies of matters relating to the working of the economy, has, over the years, conducted a series of such hearings and examinations of progress and knowledge in the field of monetary and credit controls.

One great accomplishment under the authority of the Employment Act has been the extent to which general understanding and knowledge of monetary affairs by Members of Congress, the public, the press, and even experts themselves, have been materially aided by this series of periodic reviews. This hearing will undertake to bring the record on monetary policy up to date.

This hearing is only another in this series of regular studies which the Joint Economic Committee makes. It is important that that fact be stressed in view of the rumors we have recently been hearing from various sources that the independence of the Federal Reserve System as presently constituted is being currently threatened.

Whether there is any truth or not in such rumors, this hearing, at least, is not being held with any such notions in mind. It represents a good-faith search for information as to recent and current policy and its overall effects.

While it is obviously impossible to anticipate what the evidence presented at these hearings may show, no report or immediate recommendation are likely or expected. The record will, of course, be thoroughly considered in connection with the joint committee's annual report due March 1.

Hearings at this time are warranted by the need for public enlightenment and the danger that the tight money policy may wreck the economy.

As to the control and the kind of independence enjoyed by the Reserve System, it is well to keep in mind that the Constitution is quite specific in assigning to the Congress the control over money and the value thereof. In the modern world the money supply, of course, takes the form in large part of credit and credit instruments.

The Congress, as a matter of expediency, has delegated the administration of this power over the supply of money to the Board of Governors and the Federal Open Market Committee. The relationship is such that criticism of today's tight money policy should be directed at Congress as well as at its agent—the Federal Reserve System.

The determination of monetary policy is thus an important public function to be exercised in the public interest by public-minded servants. The United States is, I believe, the only country in which the central bank is not owned outright or controlled directly by the political government. We preserve the fiction that the central bank is a private concern by allowing commercial banks to make a sort of deposit

erroneously referred to as capital stock, which prompts the private banks to falsely claim that the central bank should be independent of government.

Our plan of organization has worked tolerably well, however, because we have checks and balances inherent in the structure of the System as provided by law, and we can always change the law.

We must always be alert, however, to the danger that considerations dictated by private interests may come to influence the decisions of the Reserve authorities. If, for example, the influence or the profit-making objectives of private banking were to crowd out the public interest in management of the System, we would perhaps have then to prefer some measure of political control as the only course guaranteeing the paramount public interest in the management of the Nation's monetary affairs.

The first question which the Federal Reserve authorities, the Congress, and the critics of recent System action must answer at a time like this is whether inflationary forces are currently strong and predominant in our economy.

If we conclude that inflationary forces are substantial enough to need restraint, we must then decide what can be done about them. What alternatives do we have?

(1) We can place reliance on fiscal policy, which would possibly mean increasing taxes; (2) we can rely more or less, as we have been, upon general credit controls with their admitted shortcomings; or (3) if we feel that general credit controls are unsatisfactory and fall unequally upon various parts of the credit structure, they can be supplemented by selective credit controls or other means of control. For example, should we directly control plant and equipment investments through some sort of capital rationing device?

The purpose of these hearings is to explore these questions, including the merits of possible alternatives to high interest and general credit restraints. In any case, we need to study the impact of these various alternatives upon large and small business and upon parts of the credit structure such as home mortgage financing, school construction, and consumer installment buying.

To the extent that we decide to rely upon general monetary control, we need to consider the various instruments used in making it effective. What control devices are there other than ever higher and higher interest rates? Are these rising interest rates effective in controlling inflation, or do they possibly contribute to it?

The important thing of which we must make sure is that such credit resources as are available are flowing to the right spots and that efforts, however justifiable, in the restraint of threatened inflation, do not lead over the hump into a period of deflation, which may be even more difficult to deal with.

Our methods of dealing with deflation once it gets started are much less adequate and certain than are our brakes upon inflation.

We must guard against the danger of making high interest rates and tight credit a permanent habit in the United States. We must recognize that monetary controls are essentially short-run tools and there are other and better long-run stabilization techniques.

Finally, I think the time is here when we must begin seriously to make a policy choice. And I would like to state that although I believe our productivity can in the long run give us both stable prices and full

employment, if I had to choose between a policy that might be mildly inflationary in the short run as against one that would plunge us into recession, unemployment, bankruptcies, and farm foreclosures, my choice would be unhesitatingly for the former.

I cannot understand how anybody could possibly support the alternative of recession. But there are men in high places who conscientiously think recession is the lesser of two evils.

I hope that we can bring this basic argument before the public gaze in the course of these hearings and this basic question of public policy can be resolved in the national interest.

To sum up, I fervently believe that the time is past due for a thorough reexamination of our country's monetary and credit policy. I hope that these 2 days of hearings by our subcommittee will be a helpful curtain raiser for that reexamination.

I know that efforts in that direction will be continued in the next session by the full committee.

Our schedule of hearings at this particular time will include on December 10 at 10 a. m. Elliott V. Bell, editor and publisher, Business Week magazine, New York, N. Y., and Arthur Levitt, State comptroller, State of New York, Albany, N. Y. At 2 p. m. Robert R. Young, chairman of the board, New York Central System, New York, N. Y. On December 11 at 10 a. m. William McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, accompanied by members of the Federal Open Market Committee; and at 2 p. m. Alfred Hayes, president of the Federal Reserve Bank of New York and Vice Chairman of the Federal Open Market Committee, accompanied by members of the Federal Open Market Committee, and Robert G. Rouse, manager of system open market account.

This morning we have as our witness, who accepted the invitation of the committee to be here, Mr. Elliott V. Bell, editor and publisher of Business Week magazine.

Mr. Bell, it was certainly nice of you to accept our invitation, and we are looking forward to your testimony, which we know will be constructive and helpful.

You may proceed in your own way, sir.

STATEMENT OF ELLIOTT V. BELL, EDITOR AND PUBLISHER OF BUSINESS WEEK

Mr. BELL. Thank you, Mr. Chairman.

I have prepared a statement, not very long, which I would like to read, if I may.

There exists today more widespread concern and questioning about the working of our money system than at any time since the banking crisis of 1933. There is need for a basic reexamination of our entire monetary and financial networks to determine whether the present institutions are adequate for present needs and whether the functioning of our money system could be improved.

Such an inquiry need not imply an indictment of our existing system, but it would almost certainly disclose defects that need legislative correction.

In the past, reform and improvement of our money system has generally been delayed until forced by critical events. Thus, the National Bank Act of 1863 followed the panic of 1857, which has been

brought on by a chaotic money system that allowed every kind of wildcat bank to issue paper money.

The Federal Reserve Act of 1913 was an aftermath of the panic of 1907, and the banking reforms of the early 1930's, including the establishment of the Federal Deposit Insurance Corporation, followed the banking holiday of 1933.

It is normal for conservative economists and financiers to oppose change; but if we run away from or try to shut our eyes to current problems, the chances are that those problems will some day be dealt with by more extreme people and in more radical terms.

I have in mind the sort of broad inquiry that has been suggested by Allan Sproul and others, conducted by a Presidential commission composed of outstanding citizens.

It is now more than 40 years since the last National Monetary Commission—the Aldrich Commission—made its report in 1912. In the interval, and especially in the past twenty-odd years, there have occurred revolutionary changes in the structure of our monetary system, and equally revolutionary changes in our economic objectives. I would like to summarize those changes.

I. The past 20 years have brought the development of federally chartered savings and loan associations which today constitute a third banking system, having their own central banks—the Federal home-loan banks.

It has brought the rise and growing importance of State-chartered savings and loan associations; the entry of life insurance companies into large-scale lending, paralleling and competing with the commercial banks; the growth of large finance companies providing consumer credit, and of pension funds—a comparatively new type of financial institution, enjoying tax exemption and free from any regulation, either Federal or State. These pension funds now engage in major financial operations and promise to become one of the most important sources of lendable funds in the future.

In addition, there has been an enormous growth of Federal instrumentalities such as the Federal Housing Administration, the Small Business Administration and the Veterans' Administration, which are engaged in lending or in guaranteeing or insuring loans. A report of the Hoover Commission lists 104 such instrumentalities, created between 1913 and 1955, and I understand about a score of them is actively engaged in lending or insuring loans in a way calculated to affect credit conditions and possibly to involve an intrusion upon the course of monetary policy.

Some of these Government credit intermediaries were established by Congress to carry out a social purpose—such as rural electrification—others are more akin to private financial institutions.

And so, the question arises whether there is need for all these agencies and whether their individual operations are always in harmony with broad national policies.

II. The period since the banking crisis of the 1930's has brought the development of an increased number of regulatory agencies. These now include: the Comptroller of the Currency, the 48 State bank supervisors, the Federal Reserve System, the Federal Deposit Insurance Corporation, the Home Loan Bank Board, and others. Their jurisdictions overlap and the coordination of policies followed is de-

pendent almost entirely upon the personalities of the individuals in charge at any one period of time.

It was said that the banking troubles of the 1930's were due partly to a "competition in laxity" among the various supervisory authorities in the booming twenties. There is nothing to prevent a recurrence of such competition in the present boom.

This multiplicity of regulatory and chartering authorities raises the question of the need for more uniform standards and requirements to govern the establishment of new financial institutions, including branches of existing institutions.

Every commercial bank in the country is a part of our monetary system, and its lending and investing activities affect the supply of money. Yet, the standards of competence, character, and public necessity governing the chartering and branching of such institutions vary enormously.

Lately a new complication has been introduced by the bank holding company legislation enacted this year, which would, according to Governor Harriman of New York and the banking superintendent of that State, George Mooney, provide a means of bypassing the State authority with respect to branch banking and the concentration of banking power.

III. There is need to reexamine the task now expected of monetary and fiscal policy in this country. When the Federal Reserve was established, its primary purpose was to provide an elastic currency geared to commercial paper. Today, we are committed to a national program which calls for Government action to promote high-level employment and to maintain economic stability.

In carrying out these objectives, monetary policy has a large role to play. Is the Federal Reserve System adequate to play its part: have its responsibilities in this connection ever been clearly defined so that either the members of the Federal Reserve Board or anyone else can know what its obligations actually are?

What should be the relation between the Federal Reserve and the various other governmental agencies which extend or guarantee credit or regulate financial institutions, and with the Treasury?

Is there need for new arrangements to provide for consultation and collaboration among these various agencies?

Mr. Chairman, I ventured recently to suggest the desirability of a National Economic Council which would function in respect to economic policies somewhat as the National Security Council functions with respect to defense policies.

In some quarters this suggestion has been misinterpreted as an assault upon the independence of the Federal Reserve System. I cannot see it that way. The suggested Council could be established by congressional action, as was the National Security Council, or it could be created by the simple act of the President in inviting the appropriate individuals to participate.

In either case, I cannot see why the essential independence of the Federal Reserve System should be endangered. That independence, as I see it, simply means that the Federal Reserve must not be compelled in peacetime to use its credit-making powers to facilitate the Treasury's financing needs as was done in two World Wars.

But apart from Treasury-Federal Reserve relationships, it would, it seems to me, be a matter of common sense to bring the Federal

Reserve more directly into the councils guiding the administration in its economic policies.

I do not have so low an opinion either of Governor Martin or of President Eisenhower as to think it would be impossible for the former to counsel with the latter without losing his independence.

If, however, it is felt that the Federal Reserve Board is so sensitive that contact with the President would corrupt it, then I suggest there might usefully be formed a National Economic Council without regular representation by the Federal Reserve Board. In this event, the Fed might be invited to send an observer with the express understanding that he could sit near an open door ready to fly to the sanctuary of Constitution Avenue if he felt the danger at any point of political contamination.

IV. For some years, there has been controversy concerning the relations between the Federal Reserve Board and the Federal Reserve banks. There have been differences of viewpoint as to the composition of the Federal Reserve Board, the term of office of Board members and the rate of compensation received by them.

During the first 20 years of the existence of the Federal Reserve System, the Board in Washington was relatively unimportant and relatively impotent. The Federal Reserve banks, especially the Federal Reserve Bank of New York, were dominant.

In the reforms following the banking holiday of 1933, this situation was abruptly reversed. Power was shifted to the Board in Washington and taken away from the regional banks. And yet the President of the Federal Reserve Bank of New York is paid about three times as much as the Chairman of the Board of Governors of the Federal Reserve System.

This is an anomalous situation. If the Board is to be dominant, the question is relevant whether the compensation paid to members of the Board should not be at least sufficient to make it possible to persuade a man who has distinguished himself as president of a regional bank to go on to Washington as a member of the Board. At present I understand this is practically impossible.

Study should also be given to the question of whether it is desirable to continue a 14-year term for members of the Board of Governors; whether the Chairman of the Board should serve at the pleasure of the President who appoints him; whether his term should be coterminous with that of the President; whether he should have more authority over other members of the Board than he now has; whether the entire Board setup should be altered and replaced by something more akin to European central bank organizations in which the system is headed by a governor or chairman assisted by various deputies.

I do not advocate any of these. I think they are questions that should be explored.

Now, there have been differences of opinion between the System and its member banks about the level of reserve requirements. There has been serious disagreement within the System over open market operations. There is confusion and inconsistency with respect to the System's responsibilities toward the Government securities market. All these questions and controversies need to be examined.

V. There is need to explore the role of selective credit controls as an instrument of national monetary policy. No one likes selective controls. Yet, they can be made to work.

An outstanding example of this is the selective control of security credit through margin requirements. There are times when selective controls might prove to be a lesser evil than overall quantitative credit restriction.

For example, when installment credit seems to be expanding too fast, it might be better to have a regulation tightening up the terms of installment credit rather than putting a stranglehold on the entire economy through an overall tight money policy.

I appreciate that there are dangers of bureaucratic interference with free enterprise in the use of selective controls, but I believe there will ultimately prove also to be great dangers in the attempt to stabilize our economy through the violent alternations of dear money and cheap money we have seen in recent years.

VI. There is need also to explore the possibility of compensatory fiscal policies, such for example as variable depreciation, as instruments contributing to economic stability. This might conceivably be a means of spreading out a capital expansion boom like the present, which it seems to me tight money thus far does not seem to have affected.

I understand this device is employed in the Netherlands, so there is means of learning how useful it has been in actual practice.

VII. Other questions that need study include the effects upon quantitative credit control of high taxes and of a large outstanding Government debt.

It has become apparent in recent months that rising interest rates present no serious obstacle to large and profitable corporations. Since interest paid is a tax-deductible expense, a prime rate of 4 percent costs the corporate borrower less than 2 percent. Even a rate of 8 or 9 percent would cost the large corporation, after taxes, less than municipalities are now paying for money to build schools.

On the other hand, the corporation that is in trouble, operating in the red, is directly penalized.

It has also been noted in the past year that the existence of a large Government debt, constituting a major part of the assets of the country's financial institutions, results in a pronounced lag in the effectiveness of a tight money policy.

Although the Federal Reserve has been following a stringent credit policy for well over a year, and has prevented virtually any expansion of the money supply, bank loans have expanded to record levels.

An explanation of this appears in the condition statement of weekly reporting member banks. In the 12 months ended last November 21, these banks showed an increase in their commercial and industrial loans of \$4,600 million, while their holdings of Government securities went down \$3,700 million and investments in other securities fell \$709 million.

In short, the banks simply shifted their assets from Government and other securities to loans. Meanwhile, deposits declined nearly half a billion dollars in the year.

I am told that in the first half of this year corporate business obtained over three and a half times as much in bank loans as was obtained in the first half of 1955.

And I know in the 18 months ended last June 30, bank loans rose \$17 billion—which was the largest 18-month increase on record.

And so it seems to me the tight money policy thus far has hurt home builders, small business, and municipalities that need to build

schools and other improvements. It has not, as far as I can see, touched the capital goods boom. It may actually have stimulated, rather than curbed, business borrowing because the prudent corporation executive, reading and hearing about tight money policies, has in many cases borrowed money he did not yet need—just to be on the safe side.

This, of course, is not to say that tight money will not be effective. It may grab hold very soon now because financial institutions have come about to the end of the road when it comes to selling "governments," especially at current prices and in present thin markets. Moreover, many banks are "loaned up" to the limit of what they consider prudent.

In concluding, Mr. Chairman, may I say a personal word. I am not posing here as an expert. I do not pretend to know the answers to these difficult questions. I think it would require at least 2 years' study by a monetary commission, aided by a first-rate staff, to begin to arrive at the answers. I do claim to be a qualified observer of the financial scene.

My record over nearly 30 years should prove, I think, that I am no enemy of the Federal Reserve Board or of any public officials who try honestly and according to their best judgment to serve us all.

So far from being opposed to monetary management, including the quantitative control of credit, I have, I think, a clear record of having encouraged the broader understanding of these matters.

As for the independence of the Fed—as far back as 1950 I pointed out that the Fed was under no compulsion, legal or otherwise, to peg Government bonds. I showed that in any contest between the Federal Reserve and the Treasury, the Treasury could not hope to win. I urged the Federal Reserve to take its courage in its hands and act independently.

The Board of Governors had a speech I made at that time reprinted and sent all over the country, and the following year they did assert their independence.

And so, in raising now some troublesome questions, I am not seeking to injure the Federal Reserve System. On the contrary, I believe that if we cannot soon persuade moderate men to face up to these questions, we will be too late and will find ourselves confronted with immoderate solutions.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Mr. Bell. You have certainly raised some good questions. Your statement is very fine.

I wonder, Senator O'Mahoney, would you like to ask Mr. Bell some questions now, or would you prefer that I interrogate him first?

Senator O'MAHONEY. It is quite immaterial to me.

Chairman PATMAN. I mean, I do not know what your schedule is. I know you are very busy.

Senator O'MAHONEY. I am here for the duration of the morning session, at any rate.

Chairman PATMAN. Thank you, sir.

Senator O'MAHONEY. Mr. Bell, I would like to start with calling attention to yourself as a witness and as a man of great experience in the field of finance—even though you do not call yourself an expert—I think you are overmodest in that. I read with interest Business

Week, which you edit. I read it almost every week except in political campaigns. [Laughter.]

The President of the United States is reported by the press to be advocating or preparing to advocate in his state of the Union message an expansion of the Marshall plan or, shall I say, a renewal of the Marshall plan on a great scale whereby the Congress will be asked to approve large loans to foreign countries, principally, of course, the Western bloc of free nations.

We already know, and this I approve completely, that he has recommended that the British request for remission of the interest due upon the British debt shall be forgiven.

That latter recommendation of the Government forgiving entirely the interest upon the debt is altogether contrary to the policy of the Secretary of the Treasury in boosting the debt—the interest upon the debt of private citizens, private corporations, and of the Government itself.

Do you find in these facts which I have just related, any basis for further comment?

Mr. BELL. Senator, the chairman referred, in his very excellent, if he will permit me to say so, opening statement, to the inherent checks and balances that we have in our system, not merely by reason of the institutions that we have, but by reason of the divergence of viewpoints of men. And I suppose that it is a sound thing in an administration not to have people who all think exactly alike, but to have people who have at least some variance of views and of the values they place upon matters.

I would certainly not want to pass any judgement upon the validity of the point of view of anybody in the administration. My own feeling, Senator, is that it—

Senator O'MAHONEY. I am not asking you to pass any judgement.

Mr. BELL. No.

Senator O'MAHONEY. I am just asking you to give your own opinions with respect to a central fact in this whole problem of interest upon debt. Can we logically follow a policy of no interest upon the debt owed the United States Government, while levying a constantly increasing interest upon the debt of the people of the United States through the policy of the Government?

The only purpose of our sitting here is to decide what is best for the policy of the United States. We have to be prepared in our reports to Congress, just as the Executive has to be, for the opening of the new session of Congress, and I would welcome your comment upon this apparent conflict of policy.

Mr. BELL. Well, sir, I do not quite see the conflict as sharply as you apparently see it. It seems to me clearly that we are faced with a very emergent situation in Europe. The Suez crisis, without entering into the question of the rights and wrongs of it, has created a serious economic crisis in Europe, and I think, sir, that we must be prepared for emergency measures such as this remission of this one installment of debt. Otherwise, I think the consequences might be serious, not merely for our allies but for ourselves.

Senator O'MAHONEY. Now let me ask you to turn to page 9 of your statement this morning. I began to read it only toward the conclusion of your statement.

Mr. BELL. Yes, sir.

Senator O'MAHONEY. Toward the end of the paragraph beginning, "My record over nearly 30 years" —

Senator O'MAHONEY (continuing). You say:

As for the independence of the Fed—as far back as 1950 I pointed out that the Fed was under no compulsion, legal or otherwise, to peg Government bonds.

In order to carry out the foreign fiscal policy as part of the foreign policy of the United States which the President has prescribed, it will be necessary for the Treasury to borrow money.

Mr. BELL. Yes, sir.

Senator O'MAHONEY. And it was so stated. The Treasury is wondering this morning what rate of interest it must be prepared to pay to the big banks in New York on the money that will be required because of the forgiveness of the interest on the British debt.

Mr. BELL. Yes, sir.

Senator O'MAHONEY. And because of the program which the administration apparently is about to follow, of expanding its policy of economic loans.

Mr. BELL. Yes.

Senator O'MAHONEY. In order that you may be under no misapprehension as to my own views about this, I advocated and supported the Marshall plan from the very beginning, and I see no objection to the continuation of the Marshall plan, even though some may prefer now to call it the Eisenhower plan or the Dulles plan, or some other plan.

It was a good plan, and it has done wonders for Western Europe. There is only one point on which I reserve judgment, and that is the policy which Secretary Dulles followed during the last administration, of refusing to allow his subordinates, or to testify himself, before the authorized committees of Congress with respect to how the money we loan was being spent abroad, and by whom.

I know very well, and I think everybody who has watched the development of the fiscal matters knows, that when the Government holds out the molasses pot and takes the cover off, the flies begin to gather.

So when the Secretary, Secretary Dulles, deliberately refused to allow witnesses to answer questions—questions by Congress, let me say—with respect to the manner of expenditure, I felt that was wrong. Congress ought to know about it.

But, with that reservation, I see no objection whatsoever to fighting communism by economic aids rather than by war, and I deeply believe that we are engaged in a cold war which, if we continue to follow the policy of the last 4 years, we may lose to Communist Russia.

And one of the indications before us now of the danger in which we are is the point of view which you have just expressed in your paper with respect to high interest rates.

I am sorry to have taken so much time in explaining my own point of view, but I did that merely to disabuse you of any fear that I was talking from partisan motives rather than from great concern for the monetary policy of the United States.

Mr. BELL. Yes, Senator.

Senator O'MAHONEY. Now, would you care to answer, to make any comment upon this apparent conflict?

Mr. BELL. The only comment I think that I could appropriately make, sir, is that this is another complication, a very serious one, which

makes it even more urgent. It seems to me that we should reexamine these policies and counsel together on them.

Senator O'MAHONEY. I apologize to you, Mr. Bell. I talked so long that you lost the question.

Mr. BELL. Perhaps I did.

Senator O'MAHONEY. The question was keyed to your statement on page 9.

Mr. BELL. On pegging Government bonds?

Senator O'MAHONEY. On pegging Government bonds.

Mr. BELL. Yes, sir.

Senator O'MAHONEY. Do you not think it would be a very sound policy for the Federal Reserve Board to come to the aid of the Government in selling these bonds which the Treasury Department will have to sell to carry out the program that President Eisenhower is now recommending?

Mr. BELL. Well, Senator, if you will permit me to put it in my own words, which may not be quite as concise as yours, I have always felt that the Federal Reserve and the Treasury were married, that they have to get along together and they have to help each other—

Senator O'MAHONEY. I agree with that.

Mr. BELL (continuing). That it is silly to think that one can go rampaging off entirely on its own. They cannot do that.

Now, that is not to say that the Fed must peg Government bonds or that it must be a handmaiden to the Treasury to cater to whatever desires or whims the Treasury may have. But it must, of course, share responsibility for the stability of the Government security market.

Senator O'MAHONEY. I knew you took that point of view because of your speech before the American Bankers' Association. I think you said that the Federal Reserve should not say to the Government, "Go fly your own kite." Those were your words, were they not?

Mr. BELL. That is correct.

Senator O'MAHONEY. And I think it is most important to take advantage of your appearance before this committee here to emphasize that point of view, with which I completely agree.

I judge, then, that I am justified in saying that in response to my questions now, you have reasserted your oft-repeated principle that the Federal Reserve Board owes an obligation to work as a partner with the Treasury Department to see that the Government bond market is not—

Mr. BELL. Sir, an equal partner in which neither side dominates or orders the other around; in which they work together.

Senator O'MAHONEY. I think I might be invading the chairman's field in this question.

When you say "an equal partner," do you believe that the Federal Reserve Board is superior to Congress?

Mr. BELL. Oh, no, sir.

Senator O'MAHONEY. It is not superior to the Treasury, but how about Congress?

Mr. BELL. I certainly do not; by no means.

Senator O'MAHONEY. Thank you very much, Mr. Chairman.

Chairman PATMAN. On that point, Mr. Martin at one time stated that he considered the Federal Reserve Board a servant or agent of Congress. Necessarily that is true, because the Constitution is very plain that the powers that they now assume are powers that Congress

should perform and duties that Congress should perform, but Congress has delegated the powers to the Federal Reserve System.

On this study, Mr. Bell, that you have mentioned, I agree with you that a thorough study should be made, but I hope that you do not insist upon a Presidential Commission to make the study, for these reasons:

No. 1, it is a legislative matter, not an executive matter.

No. 2, people who are elected and have something to lose should be charged with the responsibility, rather than someone who is in no way connected with an obligation to directly or indirectly keep in mind the public interest.

It occurs to me that that makes a big difference, Mr. Bell.

MR. BELL. Mr. Chairman, I would like to respond to that. I have worked, as I think you know, in very close cooperation with the Legislature of the State of New York.

Chairman PATMAN. Yes, sir.

MR. BELL. I was for 7 years an official of the State, and I think that I have a very proper respect for the legislative branch, and I think I have some understanding of the problems that they deal with.

Now, the reason I suggested that this should be a commission which would not include members either of the legislature or of the administration, is that it seemed to me that it would be valuable at this time to get what, as far as it is humanly possible, would be an outside or detached viewpoint.

My point is that the Members of the Senate and the Congress will, of course, be studying these problems, as you are doing right now; but it is they who will ultimately have to pass upon the recommendations of this Commission, because the Commission will be meaningless except as its recommendations exentuate in constructive legislation.

It just seemed to me that it would be better if you could have this group that would study, not in terms of any legislative deadlines, not thinking of whether we have to get our recommendations in for this session or for that session, but who would work on this problem until they are satisfied that they have come as close to the answers as is humanly possible, and maybe there are no answers to some of those questions.

And they would then put forth their report and findings to be debated, and we would presumably have differences of opinion on the matter; and then ultimately these recommendations would, of course, come to the consideration of the committees like yours, sir, and if they had merit they would ultimately result in legislation.

But it seems to me that it would leave the leaders of Congress and the Senate freer to exercise their clear and unbiased judgment if they were not themselves participants in this study. That is my whole point.

Chairman PATMAN. I think they would feel very free, anyway; they usually do, Mr. Bell.

Here is the viewpoint I have on that: If you have an outside commission, you certainly delay action; because after that commission gets through, it must present its findings, and the reasons for the findings, to the proper legislative committees, House and Senate. It is going by a roundabout way, when the House and Senate, either by joint hearing or by the respective committees of the two bodies, could have the hearings and call before them the people that you

would normally select to serve on a commission. In that way you would get all viewpoints.

The Members of Congress have a responsibility to the people. They have something to lose, their own seats are involved if they make a mistake, why, it is too bad for them. On the other hand a commission appointed by the President, I am assuming that they will be public-minded people and that they would not have some ax to grind, at the same time do not have the responsibility that a Member of Congress has. They have not been elected to office. They are not under obligations to constituents. They have nothing to lose in the advocacy of what they present, like a Member of Congress, I believe that it would be better to have congressional committees, either joint or preferably each body conducting its own investigation, and calling all these people before them and getting all viewpoints.

That is just my opinion. You have yours.

Mr. BELL. Yes.

Chairman PATMAN. Which I respect, of course.

Mr. BELL. Well, I am quite sure that there is great force in what you said. It just seems to me that it would actually leave the legislative bodies freer to pass judgment upon these recommendations.

Chairman PATMAN. I understand your viewpoint. And furthermore, you know that they would be bankers, because they are the ones who would know about it.

Mr. BELL. They would have to be.

Chairman PATMAN. Well, bankers have a self-interest in this thing, and I think that is one of the bad features of the Federal Reserve System now, that the bankers have too much control, and I do not think we should necessarily consult the bankers about it.

We can hear them all right, and hear their testimony and listen to them, give consideration to their views, but I do not think they should be leading the parade, because they are too much interested.

Mr. Bell, you mentioned the inability of the central bank to control economic conditions through monetary changes because of the competitive situation with respect to those commercial banks over which they have no control.

I assume State banks would come first, and I agree with you that we should give serious consideration to that.

Mr. BELL. I merely mentioned that consideration should be given to the overall monetary system when so much of your commercial bank structure is outside of the banking system.

Chairman PATMAN. That is right. You take, for instance, the other day the interest rate was raised on time deposits.

Mr. BELL. Yes, sir.

Chairman PATMAN. In the 1935 act, you will recall, it is unlawful to pay interest on demand deposits, and it is also unlawful to pay an interest rate in excess of the amount that is fixed by the Federal Reserve Board. Heretofore that has been $2\frac{1}{2}$ percent, and the other day they raised it to 3 percent.

Senator O'MAHONEY. Mr. Chairman, may I interrupt, merely to remark that some of the banks are not taking advantage of the permission of the Board to raise the interest rate on certificates of deposit?

I have seen some certificates of deposit recently reissued which still carry only 2 percent.

Chairman PATMAN. Well, there is a little catch to that three, you know. That does not apply until about 6 months, does it, Mr. Bell?

Mr. BELL. It is effective January 1.

Chairman PATMAN. I mean only to deposits that are over 6 months old.

Mr. BELL. Oh, yes.

Chairman PATMAN. I think there is a little fine print on that.

Mr. BELL. May I make a comment on that. As an old supervisor, Senator, I think that authorities who have to place these ceilings would prefer, if they could, not to be in the position of actually fixing the rates, but rather, if possible, to fix a ceiling within which there would be variations. So that I would not think that it would be desirable that everybody should immediately go to the limit of the ceiling, because then what you would have, in effect, is the Federal Reserve Board not fixing ceilings but fixing rates.

Senator O'MAHONEY. I quite agree with you, and I did not want to interrupt the chain of questions that the chairman is following, but I make this further comment to call attention to the fact that the banks increased the rate of interest which the Government must pay, but they are not ready to increase the rate of interest which the small savers can receive.

They want their money cheap when they get it from the little people, and they want to get a very high interest rate return when the Government wants it from them. And I think the time has come for the banks, as well as the Federal Reserve Board, to cooperate with the Government in meeting the terrific financial problem that is now ours.

Mr. BELL. Well, sir, I do not know whether this statement will find any sympathy with you, but it is my opinion, truly, that the majority of the larger banks, at any rate, have been very reluctant to increase their loan rates, and have really gone along with reluctant feet.

Certainly as far as the last increase in the prime rate was concerned, the New York banks wouldn't do it long after they were really being pushed. It was left for a Boston bank to do it, and the thing was set up so that the Fed appeared to be following the market, but it was really the other way around.

Senator O'MAHONEY. Mr. Chairman, would you permit me to tell my story—

Chairman PATMAN. Certainly.

Senator O'MAHONEY (continuing). About Gene McCarthy, the sheepgrower in Wyoming?

Chairman PATMAN. Go ahead, Senator.

Senator O'MAHONEY. I think it is appropriate at this moment.

Gene McCarthy was a very wealthy grower and very successful woolgrower in the State of Wyoming. He was a member of the Wyoming Woolgrowers Association.

The members of this organization, like those who are engaged in the sheep industry throughout the public land States, raised their sheep upon the public domain, and they were always very much afraid of the havoc wrought among their flocks by the coyotes. So always their representatives in Congress were requested to secure appropriations for the Department of Agriculture to make war on predatory animals.

The woolgrowers association was holding a meeting, and the president thought it would be a good idea to call on Gene McCarthy to

make a speech on predatory animals. He accepted. It was a brief speech. He said, and he had a very nice, sweet, Irish brogue:

Mr. President, you have heard a lot of technical talk this morning about predatory animals. All I want to say to you is this: If you can keep the banks out of your flocks, you don't need to worry about the coyotes.

Mr. BELL. Well, Senator, some of my best friends are bankers. [Laughter.]

Chairman PATMAN. Yes. We are not against the bankers because they are bankers. I know Senator O'Mahoney feels the same way I feel about it. In fact, we cannot get along without the commercial banking system. We think it is the finest and best system on earth, at least I do, and I think they render great service to our Nation in time of peace as well as in time of war, and I do not want to change the commercial banking system.

I do not want to change the Federal Reserve System, except get it back to its original intentions, and leave it to public members to control. That is the only thing I want to change.

Now, on the increase in the time deposit interest rate to 3 percent, do you not think that is inflationary, for this reason: The object clearly is to induce depositors to bring their money from the Federal savings and loans or similar institutions, over to the commercial banks. Obviously that is the object.

Let us suppose that a customer does that. Is that deflationary or inflationary. It is inflationary, because the savings and loan can only make a loan of just this particular money, and it is unable to expand on it; whereas if the money is brought over to a commercial bank, I think the required reserve is only 5 percent now, is it now?

Mr. BELL. Yes, sir.

Chairman PATMAN. Then the commercial banks can expand 20-to-1.

So do you not think if the policy is effective, that it will actually be inflationary rather than deflationary, Mr. Bell?

Mr. BELL. Well, I don't think so, Mr. Chairman.

First of all, I would like to make sure that there is no implication here that I am criticizing the action of the Federal Reserve in changing regulation Q. I think that their ceilings had become obsolete, and if I had any criticism it was that they didn't act sooner.

Chairman PATMAN. I am not criticizing just on that.

Mr. BELL. No.

Chairman PATMAN. I am just bringing it out.

Mr. BELL. Yes.

Now, my point of view on this matter of these interest rates is perhaps a minority viewpoint, but again it goes back to my experience as a bank supervisor.

I remember, sir, that in the 1920's, our banking system did engage in a very destructive competition to see who could pull deposits away from the other fellow by paying the highest rate of interest.

Chairman PATMAN. Higher rate of interest, yes, sir.

Mr. BELL. And the result of that, sir, was that Congress, as you have pointed out, ended it by forbidding the payment of any interest rates on demand deposits at all.

Now, I think there is a danger—I won't say it is actually here—but I would say there is a danger of getting excessive competition for these time and thrift deposits by the payment of high interest rates which strain the capacity of the banks to earn and justify them; and

I am of the opinion, sir, that so long as we have an overall monetary policy which freezes the volume of money in the country, that you are not going to increase the volume of deposits by paying higher rates of interest.

I think you are merely, as you suggest, going to yank them from one institution to another, or convert a certain amount of demand deposits into time deposits in response to these higher interest rates.

So I am concerned about them on that score, sir, but I don't think they can be described properly as inflationary. That does not seem to me to be——

Chairman PATMAN. All right. Let me ask you this question, Mr. Bell:

We will take a thousand dollars in a Federal savings and loan, and that thousand dollars moves over to the commercial bank because the customer would just rather do business with the commercial bank; the commercial bank can offer so many more services than a savings and loan.

But is not the potential there, the inflation potential, we will call it, more than at the Federal savings and loan, for the reason that they can only lend it one time, and the commercial banking system can lend it 20 times?

How can you say it is not calculated to be more inflationary under those conditions, Mr. Bell?

Mr. BELL. Well, sir, this is rather a complicated question, and I tread very lightly here, but I do not believe, Mr. Chairman, that a transfer of a savings and loan share over to a time deposit in a commercial bank would give the commercial bank any additional reserves, and it would have to get additional reserves, would it not, in order for the system to multiply deposits?

Chairman PATMAN. That is true, it would have to do that. But they are capable of doing it because they have the means of doing it.

Now, I am talking about a commercial bank which has a savings department. I am not talking about one——

Mr. BELL. Yes, sir, I realize that.

Chairman PATMAN. I am not talking about one which does not have a savings department.

Mr. BELL. Yes.

Chairman PATMAN. In some States it is possible that they cannot do that. But generally, they can do that.

Mr. BELL. Well, I believe, sir, that one would have to follow this transaction through rather carefully, and I think we must assume that the savings and loan had that money invested, and that when somebody came in and took that money out, that the savings and loan probably had to decrease its investments in order to supply the money; somebody else had to take that up, and I do not think there is any increase in money involved.

Chairman PATMAN. Not just that particular money, but 20 times that much. You see, that becomes a base, if properly used, to expand 20 times, just like in a commercial bank now it is possible to expand 6 times.

Mr. BELL. On the basis of new reserves, I must say I prefer——

Chairman PATMAN. That is right; that is all I am talking about.

Mr. BELL (continuing). I must say I would rather have some licensed practitioner, like Mr. Ensley, answer that.

Chairman PATMAN. You made a very interesting comment concerning the holding company bill.

Mr. BELL. Yes, sir.

Chairman PATMAN. I am on the Banking and Currency Committee of the House, and we watched that bill closely, and I think the bill as it passed the House was all right. I did not keep up with it in the Senate, but I understand it was in the Senate that the amendment was made that permitted the acquisition of new banks by holding companies within the States without prior approval of the appropriate State banking authority; am I correct in that, Mr. Bell?

Mr. BELL. I am sorry, I am not sufficiently close to the course of that—

Chairman PATMAN. As a Member of Congress, and certainly as a member of the Banking and Currency Committee, I am disappointed. I think if this public law goes as far as the Federal Reserve Board seems to indicate, and as the banks seem to think, something should be done immediately to repeal that part of the law.

We were not trying to expand holding companies. We were trying to restrict them. That was your understanding; was it not?

Mr. BELL. Yes, sir; it was.

Chairman PATMAN. It is rather unusual that we would end up doing exactly what we said we were trying to stop.

Mr. BELL. Well, I think, sir, that as far as we in the State of New York are concerned, we do not fully understand what the implications of this bill may turn out to be, but we do have a particular situation before us at the present time.

When I say "we," I am still a member of the Banking Board of the State of New York, so I share some part of the superintendent's concern, and it gives us a great deal of concern. There is, as you know, in our State a joint legislative committee studying our banking law. I am on an advisory committee to that, and the members of the legislature in New York are very much concerned about this problem.

We do not know the answer. We don't even know for sure that we know the right questions yet.

Chairman PATMAN. Well, I am very much concerned, and I know other members are. This bill did not turn out as it was intended.

I am not trying to place responsibility and I am not criticizing or censuring any particular person or either body of Congress about it, but I do know that the object of that bill was to restrict and limit holding companies and retard their progress. Certainly there was no thought that a law should be passed which would permit the expansion of holding companies within a State and contrary to State laws.

I think that would be terrible, and I think you would find a lot of sentiment to change it quickly.

Mr. BELL. If I may make this suggestion, sir, I think that much help could be done if there were a general revision of all of our banking laws, to make sure that the Federal chartering and supervisory authorities did abide by the State laws with respect to branches.

Chairman PATMAN. I thoroughly agree with you.

Mr. BELL. That was done with respect to the national banks, but it was left very vague in other areas, and this causes a good deal of friction and unhappiness in the workings of our dual system.

Chairman PATMAN. It is depressing to me, particularly in view of the fact that in our State constitution—and we are very proud of this provision—it is impossible for a bank to be a chain bank or have more than one office. We have an independent banking system in our State, and they can only have one office.

Mr. BELL. Yes, sir.

Chairman PATMAN. Yet, if this law which recently was enacted by Congress is interpreted as many people seem to think it should be, that would even destroy our State constitutional provision, would it not, Mr. Bell?

Mr. BELL. If that is correct, sir.

Chairman PATMAN. In other words, it could be evaded through the holding company process, if that interpretation were correct which I do not concur in.

Mr. BELL. Well, I am not sufficiently sure as to the full implications of this bill, but I know that in the case of New York, the matter that arose there was such that the New York authorities are considered to have nothing to say about it at all, and the Federal Reserve advised them of the facts as a matter of courtesy only.

Chairman PATMAN. As a matter of courtesy only.

Mr. BELL. That is right.

Chairman PATMAN. Well now, that is pretty rough; that is pretty rough. If it goes that far, I am sure there will be plenty of sentiment in Congress—

Mr. BELL. The institutions involved, although two of them were State-chartered institutions, did not advise the banking department at all.

Chairman PATMAN. You mentioned the Federal Reserve System changes in 1935. I believe it is material to suggest at this point that you recognize, I know, in view of the fact that you have kept up with the banking laws, that we did not have a central bank until 1935.

Mr. BELL. That is correct, sir.

Chairman PATMAN. And in 1935, we completely changed the Federal Reserve System.

Mr. BELL. That is correct.

Chairman PATMAN. You agree to that, do you not?

Mr. BELL. Yes; I do.

Chairman PATMAN. You see, before that we had 12 regions, and we had 9 directors of each bank, and 6 of those, of course, were selected by the banking interests, 3 of them were appointed by the Board of Governors, class C directors. They were pretty big people, you know, then. The chairman of the board was the biggest man in that bank, was he not? He was the one who had to reach back in the safe and get the Federal Reserve notes to deliver. He was the only one who could—

Mr. BELL. Wasn't he the Federal Reserve agent?

Chairman PATMAN. That is correct. The chairman of the board was the Federal Reserve agent.

Mr. BELL. Yes.

Chairman PATMAN. And he was the only one who could handle the Government's money.

Well, in 1935 the law was changed so that these six bank directors could elect their president, who would become the big man in that bank, could they not?

Mr. BELL. That is correct. Under the 1935 law the president became the head of the bank.

Chairman PATMAN. So it was completely changed there. And then the regional banks used to have lots of other authority in the open market operations which were important. Under the 1935 act, they were, for all practical purposes, put in 1 pool, and 1 person controlled it, and now when there is an open market purchase—of a Government bond or anything else—this 1 person, who is a manager of the account in the New York Federal Reserve Bank, divides it through some system or formula that they have devised, among all the 12 banks; is that not correct?

Mr. BELL. Sir, I think you know more about this than I do.

Chairman PATMAN. And furthermore, the banks had something to do with the rediscount rate before 1935, and now it is only the Board here which has anything to do with the rediscount rate.

Mr. BELL. I believe the board still had a veto power in those early days, because as I recall, the Federal Reserve bank in New York tried several times to raise the rate in the summer of 1929.

Chairman PATMAN. They did not have what you might call the Russian type veto.

Mr. BELL. They did not stimulate spontaneous action on the part of regional banks.

Chairman PATMAN. That is right. They could discuss it.

But now, since 1935, the Federal Reserve Board absolutely controls it, and this business of saying 108 directors of the 12 banks and their branches initiated it and caused it, why, that is all hokum. They can do it, all right. But the Federal Reserve Board has the power to approve or disapprove. If they want the interest rate at 2½ percent, they can keep it there, just like Mr. Eccles testified.

They have the power to do it. If they want to let it increase, they can do that, too.

The 1935 act completely changed the System. I will not go into it thoroughly, but you do agree with me that up until that time it was not a real central bank, but since it has become a central bank?

Mr. BELL. Well, I certainly agree that prior to that time that the power lay primarily in the regional banks, especially the Federal Reserve Bank of New York, and then it was shifted to Washington. It still seems to me it is not quite accurate to call it a central bank because you have the regional setup, and so on, and there—

Chairman PATMAN. I would not want to embarrass these people in the regional system by asking what powers they have. It would be a source of great embarrassment.

Mr. BELL. Well, I think there have been—

Chairman PATMAN. Now, on this tight money, high interest policy, you are having a lot of trouble now getting money for your schools in New York. Mr. Levitt is to be here this morning.

Mr. BELL. He is right here.

Mr. LEVITT. Yes.

Chairman PATMAN. Glad to have you, sir. I know about your program and your schedule. You advised me when you were invited to attend.

Mr. LEVITT. Yes, sir.

Chairman PATMAN. With Mr. Bell's permission, we will permit Mr. Levitt to testify now, and then we will resume questioning you after he gets through, as well as Mr. Levitt, because he has a deadline to meet.

Mr. LEVITT. Thank you.

Chairman PATMAN. We promised to accommodate ourselves to his situation.

Senator O'MAHONEY. Before the transfer is made, will you permit me to ask another question of Mr. Bell?

Chairman PATMAN. Yes, sir.

Senator O'MAHONEY. This question is prompted by a desire to make absolutely clear your views as to whether or not tight money, otherwise known as the rising interest rate throughout the American economy, is or is not inflation.

I assume from what you say on page 8, and what you have said throughout the morning, that you do believe that the high interest rate is inflation.

You say at the beginning of the last paragraph on page 8 as follows:

The tight money policy thus far has hurt home builders, small business and municipalities that need to build schools and other improvements. It has not, as far as I can see, touched the capital goods boom.

It may actually have stimulated, rather than curbed, business borrowing because the prudent corporation executive, reading and hearing about tight money policies, has in many cases borrowed money he did not yet need just to be on the safe side.

Are we to interpret as an expression of your belief, that the increase in rate of interest throughout our economy is inflation?

Mr. BELL. Well, not without some modification, Senator.

I am of the opinion that the policy if persisted in will prove to be very deflationary, and if carried on far enough and long enough, I think it can halt any boom and bring you into a real depression.

I am sure there is no intention on the part of the Federal Reserve authorities to go that far.

What has happened in the present situation, it seems to me, is that an overall tight money policy has not operated very effectively or very smoothly to do what is claimed for it; namely to moderate this boom and to curb the excesses, because, as I say, it does not seem to me that it has as yet had any material effect upon the heart and driving force of the boom, which is the capital expansion program of corporations.

It has hit the fringes such as the home builder and the municipalities that Comptroller Levitt is going to talk about. I cannot answer your question "Yes" or "No," except the best thing I can say is that it does not seem to me up until this point that the overwhelming reliance upon quantitative credit control alone has proved to be a very successful device, and at the same time I think if we continue to rely upon that alone and to press it harder and harder we will at some point come to a point where the brake will grab and we are in trouble.

Senator O'MAHONEY. With that answer I agree. I realize that you come here with a paper which is largely confined to the discussion of the Federal Reserve policy, but when I find you pointing out as many of our correspondents have earlier pointed out, that the tight money policy has hurt home builders, small business, and municipalities, then it has been inflationary because it has increased the cost of building homes, of expanding small business or maintaining small business, and the efforts of local communities to build schools, thereby increasing the demand for Federal intervention in the school construction program.

That is all, it seems to me, inflationary. Do I misunderstand you in that regard?

Mr. BELL. That is a very ticklish problem because I think once upon a time when I was a newspaper man I counted up some 40 or 50 definitions of the word "inflation."

To me it means primarily a condition in which the money supply is expanding and that ultimately results in higher prices.

Chairman PATMAN. Wouldn't the phrase "undue expansion" be a good one?

In other words, what some people call inflation, is just necessary expansion.

But when you go beyond the necessary expansion, couldn't you call that inflation?

Mr. BELL. Well, I want to be very responsive here, Mr. Chairman, but I do not think I can quite follow your question.

I would like, if I may, to say this: I do not wish at all to give the impression that I am against efforts to moderate a boom. I do think this is part of the stabilization process.

Nor am I against quantitative credit control where it is useful and where it is supplemented by other things.

My difficulty with the present situation is that it does not seem to me to be working in the way it should work.

Senator O'MAHONEY. Let me interrupt you, because I know Mr. Levitt is coming; just to boil it down to one question.

Mr. BELL. Yes, sir.

Senator O'MAHONEY. Do you not agree that if the price of money goes up, it is equally inflation of it as when the price of food goes up?

Mr. BELL. No, sir. I am afraid I could not agree with that.

Senator O'MAHONEY. And why?

Mr. BELL. Well, because when the price of money goes up it is a reflection of the fact that the supply of money is smaller or is not expanding. And the ultimate results of that are bound to be deflationary, because if we are to have an expanding system as we hope for, we have got to have expansion in our money supply.

There comes a time when if you limit the money supply you won't get growth any longer. I think that is deflationary. The temporary effect of these higher interest rates may be, it is true, to add to costs, the costs of doing business, but the longer run—

Senator O'MAHONEY. We are not talking about the long run, but about the immediate effect. I have no disagreement with the theory that if this policy of tight money is carried on an ad lib and permanent basis, it would be deflationary. You say that; do you not?

Mr. BELL. Yes.

Senator O'MAHONEY. But, certainly, temporarily, it is increasing the cost of operating for our full economy, as you have so well pointed out here with respect to home builders, small business, and municipalities.

Mr. BELL. Well, I think that is correct; temporarily it does increase their costs.

Senator O'MAHONEY. Thank you very much.

Thank you, Mr. Chairman.

Chairman PATMAN. I had conferred with Mr. Bell before the meeting. He suggested that Mr. Levitt had to get back and he would be glad to yield. That is why I suggested that a minute ago.

Mr. Arthur Levitt, State comptroller of the State of New York, Albany, N. Y. We are very delighted to have you here, and we shall await your testimony, and we know we will profit by what you say.

**STATEMENT OF HON. ARTHUR LEVITT, COMPTROLLER OF THE
STATE OF NEW YORK, ALBANY, N. Y.**

Mr. LEVITT. My name is Arthur Levitt. I am the comptroller of New York State.

As chief fiscal officer of the State, I am responsible for the accounting of the receipts and disbursement of all State moneys, for the issuance of all State obligations, and the investment of all State money and moneys, such as trust funds, which are under the jurisdiction of the State.

The constitution and laws of New York State also assign the comptroller a number of duties affecting municipal finance. These duties include, but are not limited to, the following:

The examination of the fiscal affairs of all municipalities except the cities of New York, Buffalo, and Rochester, and the counties within the city of New York; enforcement of constitutional tax limitations; approval of the exclusion from the constitutional debt limitation of the bonds issued for certain revenue-producing purposes; and approval, together with that of the board of regents, of certain school debt in excess of the constitutional limitation.

In order to facilitate the performance of these duties, the law requires municipalities to submit annual financial reports to the comptroller, and to prepare such other reports as may be required.

A great deal of information about local finance and the problems of municipalities is gathered by the comptroller's office as a result of these duties. One of the divisions of my office, the division of municipal affairs, in addition to handling the municipal responsibilities of the comptroller, provides legal consulting services for local officials, and does research relating to municipal problems.

My duties and the services provided give me, as comptroller, a broad and thorough knowledge of current municipal financial problems.

My acquaintance with the problems which the present restrictive credit policy has created for the municipalities and school districts of New York State is based upon the facts which are continually being reported to me.

School districts are particularly affected by the Federal Reserve Board's policy, because school building cannot be postponed until a more favorable moment for financing arrives.

One indication of the urgency of the school-building problem in New York State is the anticipated expenditure during the next 2 years of over a half billion dollars in school construction.

School enrollments are expected to increase every year for at least the next 10 years. In 1952-53, there were 2,096,402 pupils enrolled in New York schools. Preliminary figures of the enrollment for this past September have just been announced—2,426,387 pupils.

By 1965 the New York State Department of Education estimates that we will need to provide for 3,184,500 schoolchildren. New schools must be built to house the anticipated growth.

The cost of borrowing to finance school construction has been rising alarmingly. In 1951-52, capital outlay for schools was \$170,123,548, and the average interest rate on the money borrowed by the school districts was 2.285 percent.

In June of 1956 the average interest rate on school borrowing was 2.760. Evidence that the tight money policy is placing more and

more pressure upon the money market is found in the interest rate which prevailed in school borrowings the past month.

In November 1956 the average rate was 4.078. Over the life of the bond issue it will cost school districts and taxpayers \$2,729,842 more for the \$13.8 million borrowed in November than it would have cost them in June.

During 1957 and 1958 school districts in upstate New York plan to spend \$314 million in school construction. The borrowing to finance this construction will cost \$62,077,800 more at the November rate than at the June.

The \$5.5 million bond issue of Union Free School District No. 5, in the town of Hempstead, was sold on November 15 at an interest rate of 4.30 percent.

Four years ago this same district sold its bonds at 2.70 percent. If the 1952 rate had continued, the difference in interest payments over the life of the bond issue would be \$1,383,767—enough to build a school for 900 pupils.

On November 28 another district in the town of Hempstead rejected all bids on a bond issue of \$2 million because the school authorities felt that the 4.30 bid was too high.

This is not an isolated instance. It is happening all over the State. But it is particularly revealing in Hempstead, which is located in the heart of Nassau County's rapidly growing, urban population and which possesses extensive tax resources.

Eventually, if the high cost of borrowing continues, I believe that some of the money which normally would be used to support classroom programs will be diverted for the payment of debt service in order to ease the tax burden. The quality of education will suffer if the cost of providing educational facilities rises excessively.

High interest rates do not reflect the soundness of the school bonds. The municipal securities market does not offer any safer investment than the bonds of New York State school districts.

Generally, the laws provide that schools always realize their tax levies because the taxes uncollected at the close of the tax period are turned over to the proper authorities, either county or town. These authorities pay the district the full amount of taxes due and then enforce collection in the regular manner.

School districts, in addition to being assured of receiving the full amount of taxes needed, receive substantial amounts of State aid. While I will not describe all the education aids given, I would like to point out that two are earmarked for debt service: the so-called building quota and the emergency school building advance.

The building quota provides central school districts with substantial amounts of State aid for the payment of debt service. The emergency building quota is intended to assist those districts which have to expand their facilities because of unusually rapid population growth.

During the school year 1955-56, the State paid \$8.6 million in building quota aid to control districts and \$2.6 million emergency building aid. The amount is expected to increase this year as more districts qualify.

Senator O'MAHONEY. What is the specific authority for that?

Mr. LEVITT. It is under the State education law.

Senator O'MAHONEY. How long has the State of New York been providing State aid for the building of schools?

Mr. LEVITT. Oh, for many years. Longer than I can remember. Always has been regarded as a function of the State to provide a sound system of education for the children of the State, and the medium through which the State exercises that function is the overall supervision of State aid through its department of education and the granting of financial aid to the school districts.

Senator O'MAHONEY. In other words, that has been the policy of the State for some time, for many years?

Mr. LEVITT. Yes, sir.

Senator O'MAHONEY. That the school districts are not wealthy enough to raise the taxes necessary to build the schools that the children ought to have; and, therefore, contributions from the State are required.

Mr. LEVITT. Yes, sir. It has been the policy of the State that each child, no matter where he lives, is entitled to an equal opportunity of education, and in the poorer districts the State makes up the difference.

Senator O'MAHONEY. Could you, at your convenience, after you have gone back to New York, furnish the committee with a table showing the amount of State aid for schools contributed by the State of New York since the program was first initiated?

Mr. LEVITT. Yes, sir; I will do that.

Senator O'MAHONEY. Thank you very much.

(The table referred to follows:)

State aid for school buildings—Total paid in New York State for school years 1926-27 through 1955-56

School fiscal year	Central school building quota	Additional aid for debt service ¹	Emergency building advances	School fiscal year	Central school building quota	Additional aid for debt service ¹	Emergency building advances
1926-27.....	\$4,983	-----	-----	1942-43.....	\$680,667	-----	-----
1927-28.....	31,203	-----	-----	1943-44.....	703,408	-----	-----
1928-29.....	67,139	-----	-----	1944-45.....	699,046	-----	-----
1929-30.....	62,535	-----	-----	1945-46.....	700,865	-----	-----
1930-31.....	102,685	-----	-----	1946-47.....	739,628	-----	-----
1931-32.....	172,211	-----	-----	1947-48.....	700,819	-----	-----
1932-33.....	294,482	-----	-----	1948-49.....	796,106	\$278,073	-----
1933-34.....	260,791	-----	-----	1949-50.....	811,590	330,770	-----
1934-35.....	310,909	-----	-----	1950-51.....	1,749,505	333,448	-----
1935-36.....	341,563	-----	-----	1951-52.....	2,821,685	324,230	\$169,356
1936-37.....	381,900	-----	-----	1952-53.....	3,849,691	324,807	91,458
1937-38.....	442,161	-----	-----	1953-54.....	5,446,161	282,997	748,377
1938-39.....	480,486	-----	-----	1954-55 ²	6,971,378	313,649	933,383
1939-40.....	536,503	-----	-----	1955-56 ²	8,570,344	171,260	2,610,175
1940-41.....	603,478	-----	-----	Total.....	40,022,267	2,359,234	4,552,749
1941-42.....	688,345	-----	-----				

¹ Additional aid for debt service on former debt to districts which have become centralized.

² Preliminary figures.

Mr. LEVITT. The State is attempting to do all that it can to help to bring the costs of school borrowing to reasonable levels. My office is preparing a brochure explaining the merits of investment in New York State school bonds. I expect to distribute this brochure to banks and investment houses for the information of their clients.

The Governor has appointed a committee, of which I am chairman—of which Mr. Bell is a member—to study ways to cut the interest cost of school bonds. This committee will explore alternative ways of financing school construction.

While the State government will do everything possible, some remedies are beyond our power. Federal action can enhance the municipal bond market and encourage the flow of funds, thus reducing interest rates.

The current demoralization of the tax-exempt bond market has created a serious problem in local government finance. Special consideration by the Federal Government is fully warranted in order to alleviate the results of this restrictive credit policy.

Without passing on the merits of that policy, I want to point out that there is a sharp distinction between public financing and private financing so far as the burden of increased interest costs is concerned.

Local government borrowing must bear the full brunt of the steady increase in interest rates which we have all witnessed in the course of this year. On the other hand, when private industry borrows, the burden of the higher interest rates is less than half of that which is borne by local government units.

This is so because the Federal corporate income tax rate of 52 percent means in effect that the Federal Government is sharing to that extent the increased interest costs of private business which are deductible from taxable income.

For example, when Hempstead School District No. 5 has to pay \$2 million more interest it means that the taxpayers of the school district must dig out of their pockets \$2 million more to pay the cost of the new school building.

But when a business corporation has to pay \$2 million more in interest, the stockholders of the company are out of pocket only \$1 million and the United States Treasury contributes the other million dollars through a tax deduction.

There is ample justification for considering the problem of local government financing separately from the overall problem of the consequences of the present monetary policy upon borrowing in general, business loans in particular.

Public finance is a special and separate subject, not only because of the cushioning effect of the Federal income tax law on private borrowings, but also because of the urgent social necessity of proceeding with the prompt construction of schools, hospitals, highways, water and sewerage systems, and other public works as a matter of high priority.

For one thing the Federal Reserve might require member banks to hold a certain reserve in municipal obligations. At present, in New York State the municipal holdings of State chartered banks range from one-tenth of 1 percent to 20 percent of the bank assets.

The average held by the State banks is 5 percent. I presume that there is a similar range in the municipal holdings of nationally chartered commercial banks and savings banks.

I recognize that individual banks have individual situations to meet, but consideration might be given to a modest requirement of investments in municipal bonds which would not significantly curtail their other loan activities while being of substantial benefit to the municipal bond market.

At the present time savings and loan associations under Federal charter lack the power to purchase municipal obligations. This should be remedied.

One of the proposals before Senator Robertson's banking subcommittee, now working to revise the Federal banking laws, would permit

Federal savings and loan associations to invest in municipals, subject to the rules of the Home Loan Bank Board.

This recommendation seems well taken and I respectfully urge your approval when a bill embodying such investment powers comes before Congress.

Another proposal which I believe demands serious attention is that of amending the Internal Revenue Code to permit share owners of investment companies which invest in tax-exempt bonds to receive tax free the interest earned on such bonds.

This is in line with the recommendation of the President in his 1955 Economic Report. Passage of such legislation, which is merely an extension of the conduit theory of taxation that now applies, would open an entirely new buyer's market for municipal bonds, one of major importance.

I will have more to say on this very important measure when changes in the Internal Revenue Code are considered by the House Ways and Means Committee.

Senator O'MAHONEY. In order that your testimony may be clear to those who read it, would you define the conduit theory? You have used that phrase.

Mr. LEVITT. The conduit theory, as I understand it—

Senator O'MAHONEY. For those engaged in finance, etc.

Mr. LEVITT. It is that which attaches to the particular security when it comes into the hands of the investment company, and follows it so that the benefit redounds to the advantage of the shareholder in the investment company.

That is to say, that when the investment company purchases a tax-free security, the income from that security, is tax free, to the investment company, and the tax-free quality follows it into the hands of the participant in the fund. And to the extent that the fund holds tax-free obligations, the participant in the fund benefits pro rata.

Senator O'MAHONEY. Thank you, sir.

Mr. LEVITT. There is one more suggestion that I feel must be made. If the tight money market continues for some months, and most of the people whom I have consulted agree that it will, conditions in the municipal bond market may be expected to worsen.

There is a great backlog of municipal bond issues which have been postponed. Circumstances may force these issues on the market. Then interest rates on municipal issues may be expected to continue to rise at the accelerated pace we have witnessed during the last 6 months.

Under these circumstances, I believe that the possibility of giving the Federal Reserve power to exercise selective credit controls, should be carefully studied. Selective credit controls, if feasible, would allow us to satisfy our needs for hospitals, mental institutions, highways, and schools without inflicting an unwarranted burden upon the taxpayer.

I appreciate this opportunity to discuss the problems which New York State school districts are encountering in marketing their bonds. I hope that this committee will find the time to give consideration to some of the remedies which I have suggested.

Senator O'MAHONEY. What do you mean by "selective Federal control"?

Mr. LEVITT. I mean the selective controls as distinguished from the quantitative controls that Mr. Bell spoke of. Selective controls

such as the power to control consumer credit, power to control investment buying, the power to control mortgage credit and the like, as distinguished from the broadside all-inclusive form of control that is in operation today. Quantitative, all embracing control.

Senator O'MAHONEY. Thank you.

Mr. LEVITT. Thank you, gentlemen.

Chairman PATMAN. Thank you very much, Mr. Levitt.

Now, since Mr. Bell is a member of the committee selected by Governor Harriman to study this question, I wonder if Mr. Bell would like to supplement the statement that has been made by Mr. Levitt.

Mr. BELL. No, Mr. Chairman. I think that Mr. Levitt has stated the case very well indeed.

I would like to say this, that the plight in which municipalities find themselves, particularly with respect to the financing of schools at a time when we all recognize the urgent necessity for more schools is to my way of thinking merely another illustration of the perplexities which surround our present condition, and another proof of the fact that we need to reexamine it and to give it a lot more thought.

Chairman PATMAN. Concerning the tax-exempt bonds, Mr. Levitt, I have always been opposed to removing the tax exemption but over the years I have had studies made and I find that the people in the school districts and States, counties and cities and political subdivisions, who have been beneficiaries of the tax-free income from those bonds get very, very little out of it. Have you come to any conclusion on that?

And possibly not enough to justify it being such a fine storm cellar for extreme wealth.

Mr. LEVITT. I would be very much interested in looking at those statistics. It has been my observation, though, that the tax-exemption feature does confer upon these securities an advantage in marketability which is appreciable.

My experience in the field does not extend beyond the 2 years that I have been in office, but I have noted a considerable margin of difference between the tax exempt and the nontax exempt, which it seemed to me redounded to the advantage of the issuing agency.

I confess that the advantage is not as great as it ought to be and I sometimes wonder why the market for these obligations is not as broad as it should be.

Chairman PATMAN. You mentioned savings and loans purchasing these obligations. Any organization that is built upon the cooperative principle, naturally, would not have the inducement to buy these tax-exempt bonds—

Mr. LEVITT. No.

Chairman PATMAN. That a commercial bank would have.

The commercial banks now hold about \$14 billion worth of tax-exempt bonds. Do you know that? I mean of local State school districts, cities, and political subdivisions.

Mr. LEVITT. I understand that.

Chairman PATMAN. Isn't it \$14 billion? It is right around \$14 billion.

Mr. LEVITT. I understand that the amount is large.

Chairman PATMAN. Furthermore, they hold about \$7 billion in addition to that, \$6 or \$7 billion, of Federal securities that are tax exempt, or partially tax exempt.

So the commercial banking system now holds approximately \$20 billion of tax-exempt or partly tax-exempt bonds. So they are not behind on the program, Mr. Levitt.

Mr. LEVITT. They are interested primarily in the early maturities.

The amazing thing to me is that when school district bonds of the quality I am speaking of are offered on the market at a rate of better than 4 percent that unless I support the market by buying them for the funds of which I am trustee, they have a hard time getting a bid from the bankers.

There are not enough takers for this fine security even at the prevailing rate.

Chairman PATMAN. Don't you think, Mr. Levitt, that the Reconstruction Finance Corporation performed a great public service when that organization purchased these bonds from all over the Nation and kept them and "cured" them for the market and then fed them out to the market, without anybody losing any money or taking any discount?

Don't you think that was a great service?

Mr. LEVITT. I think that is a tremendous service and that is the principle that the committee that Mr. Bell and I are on, is going to consider very carefully in connection with the plan we hope to devise for New York State.

Chairman PATMAN. I read very carefully what you have said about this and was impressed with it except I think you should broaden it out, since education is the whole Nation, it involves the whole Nation, including our military powers.

You know so many young men are excluded from military service because of the lack of ability to even read or write. And so education is a national issue, at least to that extent.

And I am hopeful that you will embrace in your recommendations, if you can confine it to the State of New York, what the Federal Government should possibly consider doing in that direction, to help the entire Nation including the State of New York.

Mr. LEVITT. We will be very glad to do that.

Senator O'MAHONEY. Mr. Chairman, may I ask Mr. Levitt if he will amplify the statement which he made on page 4 in the second from the last paragraph of that page that "there is a great backlog of municipal bond issues which have been postponed."

Were you speaking of New York alone or other States?

Mr. LEVITT. Yes, sir. There are school issues from districts which are fearful to come to the market with their bonds. And that fear I might add, is amply justified.

Senator O'MAHONEY. How many schools do you suppose are included?

Mr. LEVITT. In that category, sir?

Senator O'MAHONEY. Yes; in New York State.

Mr. LEVITT. It is difficult to estimate the number of school districts which postponed the building of schools because of the bond-market situation. We know several instances where boards of education rejected all bids on proposed bonds because of the high interest rate, but we also know that there were numerous districts which decided to delay the borrowing for school-building purposes. Because no formal announcement of intended bond issues was made by these latter districts, it is not possible to tell the number of school districts affected.

Senator O'MAHONEY. Because of the difficulty with marketing the bonds?

Mr. LEVITT. In my own position as State comptroller, I have State obligations which I hope to market but I have kept out of the market because of these conditions.

I have been obliged in July, to call off an offering of bonds for the thruway, because of adverse marketing conditions, in the hope that I would be able to market those bonds at a later date. But that time has not yet come.

So I am somewhat in the same position as the school districts, awaiting a better market.

Senator O'MAHONEY. My attention is called by Mr. Moore, to a story in the Wall Street Journal of Wednesday, December 5, bearing the headline, "Michigan fails to get any bids for \$52 million highway bond offering."

Perhaps it would be well, Mr. Chairman, to have that story made a part of the record.

Chairman PATMAN. Yes, sir. That will be made a part. They have a State limitation of 3½ percent. Even 3½ percent is quite high for tax-exempt securities. That is equal to 4.7 percent.

(The article is as follows:)

[From the Wall Street Journal, December 5, 1956]

**MICHIGAN FAILS TO GET ANY BIDS FOR \$52 MILLION HIGHWAY BOND OFFERING—
SPOKESMAN FOR GROUP THAT HAD OPTION ON ISSUE NOTES COUPON LIMIT, BID
REQUIREMENT**

By a Wall Street Journal staff reporter

LANSING, Mich.—A 3½ percent coupon limit and a required bid of par wert cited as key reasons for the State of Michigan's failure to receive any bids for its proposed \$52 million highway bond revenue issue yesterday.

Spokesmen for a seven-manager group that had planned to enter a bid for the bonds said, "Because of the coupon limitation and the bid requirements, we are unable to underwrite a bid for all or any part of the issue."

The syndicate had an option to purchase the entire \$52 million of bonds or any combination of three issues, one each for \$25 million, \$17 million and \$10 million. Blyth & Co., Inc.; Smith, Barney & Co.; Lehman Brothers; Halsey, Stuart & Co., Inc.; Drexel & Co.; Harriman Ripley & Co., Inc., and First of Michigan Corp., had been scheduled to manage the syndicate.

Charles M. Ziegler, Michigan State Highway Commissioner, said the issue will be reoffered for sale at the present 3½ percent coupon rate if there's a sufficient improvement in market conditions.

Mr. Ziegler added that if present market conditions continue, steps will be taken toward making the "necessary adjustment in the maximum interest rate to permit their sale."

As measured by the Dow-Jones municipal average of 20 representative 20-year bonds, tax-exempt prices are at 19-year lows. The index, which moves inversely to prices, stands at 3.29 percent, the highest point since early 1937.

The State last marketed a comparable issue on September 13 when a total of \$25 million bonds were sold at an interest cost of 3.04 percent. The Dow-Jones average then stood at 2.93 percent.

The bonds offered yesterday were authorized in proceedings that began last August and September. At that time, Mr. Ziegler said, the maximum rate of 3½ percent seemed "more than ample."

Senator O'MAHONEY. I think that it would be appropriate to insert in the record at this point, also a clipping from the New York Times, written for the Associated Press by Warren Bennett, on the continuation of the drop of United States bonds.

Chairman PATMAN. It may be inserted.

(The article is as follows:)

[From the New York Times, Sunday, December 9, 1956]

CORPORATE BONDS ADVANCE WHILE TREASURYS DROP

(By Warren Bennett, Associated Press Financial Writer)

NEW YORK, December 8.—Corporate bond prices advanced this week for the first time in 2 months. Government bonds continued to decline.

Corporate bond trading was heavy with volume of \$38,169,999 par value on the bid board, highest weekly total since December 17, 1954. This compared with \$35,020,000 last week and \$21,222,400 for the corresponding week in 1955.

Rails, investment quality issues and foreign dollar bonds wound up higher. Industrials were slightly lower while utilities, despite gains Thursday and Friday, were sharply lower for the period. Japanese issues climbed major fractions, with Oriental Development Co. 6s of 1963 posting an advance of $1\frac{1}{8}$ at $95\frac{5}{8}$ Friday.

Treasury obligations continued to drift lower on somewhat heavier volume in the over-the-counter market. Dealers said much of the activity stemmed from tax-swapping.

For the week the Government $2\frac{1}{2}$ s of 1963 dropped $\frac{1}{32}$ to a new low of the year, $93\frac{1}{32}$ bid. The Victory $2\frac{1}{2}$ s of December 1972-87, declined $\frac{1}{32}$ to $89\frac{1}{32}$. The 30-year $3\frac{1}{4}$ s last $\frac{1}{2}$ at $98\frac{3}{32}$ while the 40-year 3s were $\frac{3}{32}$ lower at $93\frac{1}{32}$ bid.

At these prices the $2\frac{1}{2}$ s of 1963 yield 3.64 percent, the "vics" 3.34, the $3\frac{1}{4}$ s 3.35, and the 3s 3.31 percent.

Chairman PATMAN. May I suggest, Senator O'Mahoney, the bonds of the British Government—you know about this, Mr. Bell—that are paying $3\frac{1}{2}$ percent, are now selling below 60.

You know our bonds, $2\frac{1}{2}$ percent, are selling below 90.

Do you not think that it creates a very unstable and unreliable situation when people have no way in the world to invest their money in a security that will always be at par, and to have the benefit of the knowledge that they can rely upon an interest rate within bounds of some kind?

How can they prepare and plan and contract for the future?

Don't you think it is rather a bad situation for us to be in, Mr. Bell?

Mr. BELL. Mr. Chairman, I am afraid I will have to take a little bit different viewpoint. We do have through our savings bonds, of course, an instrumentality for small savers, which is always at par, where they do not have to take any loss.

Chairman PATMAN. I will take issue with you on that.

Senator O'MAHONEY. The situation is this: A small saver who has a thousand dollars may buy a long-term bond today which will yield more than 3 percent.

Mr. BELL. Yes.

Senator O'MAHONEY. But if he invests in savings bonds, before he gets 3 percent he must have held them for 10 years.

Mr. BELL. Yes, sir. That is true. There are other avenues of savings, though,—you have the savings banks, for example, many of which in my State pay three percent.

I would just like to make it clear, sir, that I do not think as a practical matter we can or should think in terms of pegging Government bonds at a fixed rate. I really don't think that that is a good plan. I don't like to see our Government bond market bounce around the way it has in recent years.

Senator O'MAHONEY. I am not suggesting—

Mr. BELL. I am not in favor of pegging it.

Senator O'MAHONEY. I am not suggesting that, Mr. Bell. But I do call your attention to the fact that at the beginning of this administra-

tion the first act of the Treasury Department was to issue the long-term 30 year bonds at, what was the rate of interest?

Chairman PATMAN. Three and a quarter percent.

Mr. BELL. Three and one-quarter.

Senator O'MAHONEY. It sold immediately at a premium, and remained at a premium for some time.

Mr. BELL. Excuse me, didn't it go down first? I think it went down.

Senator O'MAHONEY. It might have gone down first. Yes, it did go down first, then went up to a premium, and now it is selling below 99.

Chairman PATMAN. Ninty-eight something.

Senator O'MAHONEY. It may be 98 but I know it is below 99.

Chairman PATMAN. Ninety-eight and twenty thirty-seconds.

Senator O'MAHONEY. That is below 99. This is the situation in regard to our Government bonds which on television shows, in factory campaigns for the sale of savings bonds, we are constantly telling the people are the most certain security that they can get for their savings.

And yet we are following a policy which has resulted in the steady decrease of the value of those bonds upon the market. Even though they may be maturing in a few years, they are still below par. That is a serious condition, is it not, Mr. Bell?

Mr. BELL. Well, sir, I think it is a serious condition when you have the degree of instability that you have seen in recent years in the Government bond market and when you have the thinness of the market that now exists.

Chairman PATMAN. And an unregulated market, too. It is unregulated.

Mr. BELL. I am not against that, sir.

Chairman PATMAN. The Securities and Exchange regulates the private securities market pretty well.

Mr. BELL. But I think that this, again I do not like to be monotonous about it, is simply another point that illustrates the weakness of this tremendous reliance we have had upon one thing, the quantitative credit control.

I think we ought to see if we can't be ingenuous enough to find another arrow to our quiver than just this one that seems to have certain boomerang qualities to it.

Senator O'MAHONEY. I am sure that the committee has not reached any decision, nor has any of its members, as to what should be done. But the fact remains that your Federal bonds are going down, at the same time the administration is suggesting new expenditures for economic aid abroad, while following a tight money policy which restrains economic development at home. It is a most serious question.

Mr. BELL. I think you are quite correct there.

Chairman PATMAN. May I suggest, Mr. Bell, that I have before me Mr. Lanston's statement about the bonds table based on yield and so forth. The $3\frac{1}{4}$ that Senator O'Mahoney mentioned are just now barely below 99— $98\frac{20}{32}$, but that is a yield of 3.34.

And now there are several bonds here in the list of Mr. Lanston's, where the return will be 3.59, 3.69. How can we with a straight face go out and try to induce people, small savers, to put their money into bonds that will only yield them 3 percent after 10 years, when they can go right in the market right now and buy bonds that will pay them up to much over $3\frac{1}{2}$ percent?

Senator O'MAHONEY. It is worse than that, Mr. Chairman, because of the huge issue of Government bills and notes which are given out by the Treasury and which yield more than 3 percent now.

Chairman PATMAN. Short term.

Senator O'MAHONEY. Ninety day bills are being sold only to a very limited group, namely, the banks and big corporations. The little fellow cannot invest in those. They are not available to him.

There is talk now about a new issue of certificates of some kind to be applicable on taxes which will be due in April. In other words, that means that the Treasury is proposing to issue certificates to those who have the idle money to buy them, certificates which may then be used to pay their taxes when these fall due for the current year. Meanwhile the certificates will draw interest during the period from now until the taxpayment is made.

Mr. BELL. I think that has been a fairly standard instrument.

Chairman PATMAN. It has been.

Senator O'MAHONEY. It has been adopted and dropped.

It was largely available only for the big taxpayers. It is difficult for the little fellow to get that.

You agree, of course, with the policy of the savings bonds which is its great virtue, that it is not affected by the market, and the holder of the savings bond may get the full amount that he paid plus a little interest whenever he wants to.

Mr. BELL. Yes, sir

Senator O'MAHONEY. The price of the bond in that respect is not affected by market fluctuation.

Mr. BELL. I believe that many people who invest in the savings bonds do so as a regular program, too, by buying a bond a month or something of that sort. And they are not so concerned with that.

Senator O'MAHONEY. That is true.

Mr. BELL. With the interest rate, I mean.

Senator O'MAHONEY. It is also true—and this I have read from the charts in Business Week, that the redemptions of those bonds have been rising at a very sharp rate.

You recall that, do you not?

Mr. BELL. I believe I do.

Chairman PATMAN. Have you finished, sir?

Senator O'MAHONEY. Yes.

Chairman PATMAN. Mr. Levitt, in your group, and Mr. Bell's group, too, I hope you gentlemen consider these trust funds to be used in investments like school bonds and even housing, guaranteed by the Government.

The social security fund, of course, is more than \$40 billion. The national service life insurance fund is \$5½ billion.

There is an ironical situation where the veterans who contribute to that fund, who paid into it, are not able to get home loans at a reasonable rate of interest at all. Yet their NSLI funds are only drawing 3 percent.

It is one of these pigeonhole devices where the Treasury uses money and puts its I O U in the lockbox and they only get 3 percent, and if they were privileged to invest in housing loans guaranteed by the Government, they can get a minimum of 4½ percent.

It occurs to me that these trust funds could be used that way.

I hope you keep in mind and consider that in your deliberations.

Mr. LEVITT. Yes, sir.

Chairman PATMAN. Any more questions of Mr. Levitt.

Senator O'MAHONEY. No.

Chairman PATMAN. Mr. Frischknecht, would you like to ask some questions for Senator Watkins?

Mr. FRISCHKNECHT. No.

Chairman PATMAN. We will excuse Mr. Levitt.

I would like to ask Mr. Bell just a few more questions, if you please.

Do you think, Mr. Bell, that the brakes are working well or do you think we may be headed through the windshield as you said one time?

Mr. BELL. I am sure I don't know the answer to that question, except that as for the first part of it, I don't think that the brakes are working as well as they should.

The thing that bothers me is that I think we are in danger of building up certain distortions in our economy as a result of this overall credit restriction policy. As I have pointed out it seems to take hold rather sharply in some directions, and up to this point it does not seem to take hold at all in other directions.

I think this is bad for two reasons: First, when you have brakes that grab unevenly you develop distortions.

And second, you develop a resistance, it seems to me, on the part of the public to this type of instrumentality that seems to fall so inequitably.

We know perfectly well that you can't have any policy of restraint that is going to be painless. Surely, if you are going to try to moderate a boom, it is going to go against the grain with a lot of people.

But it does not seem to me that the present policy has been ideal.

Chairman PATMAN. Mr. Bell, where is this boom and where is this inflation? It certainly is not on the farm or on the ranch. Certainly not in small business. It is not in the home building. Where is this inflation that the Federal Reserve is trying to stop?

Mr. BELL. Well, I think it is really up to them to answer that question, sir, but I do think that we have had a period of long sustained activity, certainly in the capital goods field.

Chairman PATMAN. I know but this does not restrain capital goods. That is where the inequities come in and discrimination is—

Mr. BELL. That is right.

Chairman PATMAN. And injustice is.

You see the capital goods industry, they rely not on bank loans, except to take some short loans, which denies the little fellow funds, but two-thirds of their investment capital comes from—two-thirds from retained earnings and depreciation.

Mr. BELL. That is right.

Chairman PATMAN. So they don't have to look to the market. They don't have to look to anybody.

And then if they need more they can go to the bank. They have entry there that the other people don't have and they can get what they want in short term loans which denies the little fellow that opportunity.

So the capital goods market that you mentioned, the present policy is not restraining the capital goods market at all. They will go right ahead expanding. They are not restrained a bit. Don't you agree with that?

Mr. BELL. Not at the moment. I think there is very little evidence there has been any restraint there.

Chairman PATMAN. It is the little fellow that is hurt, and the big fellow is not hurt at all.

Mr. BELL. I think that is about right.

Chairman PATMAN. Yes, sir.

Let me ask you this question: What do you think has contributed most to the recent rise in prices, capital goods investment, consumer spending, wage increases in excess of productivity, profit margins, or high interest rates?

Mr. BELL. Well, I think that a great many of those factors have contributed. Mr. Chairman, it seems to me that when you have an economy like ours that is going ahead at such an active rate, with full employment or very high level employment, with an expanding tendency it is hard to imagine that prices will remain completely level.

I would hope that no one would mistake me for a fellow who is reconciled to or an advocate of perpetual inflation. But I frankly don't get terribly alarmed at what we have had in the way of price increases in the past few years.

Chairman PATMAN. Mr. Bell, you may recall that when the campaign was on, to take off all of the controls, the argument was made that will lower prices; you recall that.

But it did not lower prices. They kept prices up. And whispered around, you would hear this suggestion, that they could not afford to lower prices because it was possible we would have another emergency and they might be frozen like they were one time at a low level. They didn't want to be caught again.

So they kept prices up. Then we were told that if we repealed the excess profits tax, you recall that, prices would go down.

But prices didn't go down. They stayed up. Because of that the big fellows got plenty of money through retained earnings, and depreciation, to carry on any expansion program that they wanted.

But that makes it harder on the others, because of the limited supply of materials and labor.

Mr. BELL. Mr. Chairman, I would not describe the situation in quite the terms that you have used. It seems to me actually that we had a rather remarkable price stability here for a number of years, and indeed, in the light of the type of economy that we have had, with the great expansion that has taken place, my own feeling is that it is quite remarkable that prices haven't gone up more, rather than that they have gone up somewhat recently.

Chairman PATMAN. After all, there is conscience involved in these things. I don't see how they could put them up in good conscience.

Mr. BELL. I am sorry. I don't quite get that.

Chairman PATMAN. I don't see how they could in good conscience put them up higher than they have, because they have collected from the consumer enough to pay all of their expenses, and had enough to pay a good dividend to their stockholders, which they should, and enough left to put over into retained earnings, which is costless capital to them, a very large amount. I don't see hardly how they could in good conscience take more.

Mr. BELL. I don't quite visualize the process as you are describing it, sir.

Chairman PATMAN. Mr. Bell, the hour is getting late.

Senator O'MAHONEY. Before you dismiss him, may I call his attention to several matters?

Chairman PATMAN. Yes, sir.

Senator O'MAHONEY. I have before me the November issue of the Economic Indicator. This, as you know, is prepared for the Joint Economic Committee by the Council of Economic Advisers. Dr. Burns, until recently, was the Chairman of the Council and had a large share in the preparation of these statistics.

On page 28, there is a graph and tables on consumer credit. For the purposes of this question, I will just read the increase in consumer credit beginning at 1950:

The total consumer credit then outstanding in 1950 was \$21,395 million. In 1953, the total outstanding was \$31,243 million. In 1955, \$38,648 million. The latest figure for 1956 is for the month of September, \$40,074 million.

In other words, since 1950, to September 1956, outstanding consumer credit had almost doubled.

That means that in many instances purchasers of consumer goods are obligating themselves for a long time in the future, and may be obligating themselves for more than the income they can actually expect for the period of the credit.

That frequently results in the recovery by the seller of the goods that was sold. That was one of the marks which preceded the depression of 1929, the extension by business beyond the capacity of the people to whom the credit was made to repay.

In your statement on page 8, discussing the last paragraph, this question of the tight money policy, you pointed out that so far as you know, as you have seen, tight money has not affected the production of capital goods.

Your language is this:

It has not, as far as I can see, touched the capital goods boom. It may actually have stimulated rather than curbed business borrowing, because the prudent corporation executive reading and hearing about tight money policy has in many cases borrowed money he did not yet need, just to be on the safe side.

Do you think in the face of this picture of the consumer credit such an executive who borrows money that he does not need can be called a prudent corporation executive?

Mr. BELL. Oh, yes, sir, because he knows he is going to need it but he may not actually need it for another year.

Let us say he is the head of a corporation that is expanding as most of our corporations are. He has got a program ahead of him. He knows that in 1957 he is going to enlarge his plant, in Dubuque and in 1956 he thinks he will perhaps put a plant in the Midsouth or something like that. He knows he will need money.

Senator O'MAHONEY. But, Mr. Bell, if as you say in the sentence before that, the tight money policy has hurt homeowners, small business, and municipalities, does that not raise the question as to whether there will be a market for the capital goods which the prudent corporation executive is borrowing money in order to have the plant to produce?

Mr. BELL. Yes, sir. This is what hangs like the sword of Damocles over the economy.

Senator O'MAHONEY. You will acknowledge, will you not, there is a serious danger in it?

Mr. BELL. Yes. I have stressed that, but can I say a word with respect to these consumer credit figures?

Senator O'MAHONEY. Yes, I wish you would.

Mr. BELL. I would like to say that I certainly am not wise enough to know whether \$40 billion of consumer credit is too much, whether this Nation can afford it or not. I don't know that anybody else can.

Senator O'MAHONEY. May I suggest that as the editor of Business Week, you assign someone from your staff to go into that question and—

Mr. BELL. Sir, I think this is like the question of what is truth and what is virtue. It is not susceptible to a positive answer.

But what I think you can say, you can ask yourself whether the trend seems to be excessively sharp. And I think that on the basis of the figures you have cited there is room for concern in this thing.

Chairman PATMAN. There is what?

Mr. BELL. Room for concern. Certainly, there has been a remarkable expansion of consumer credit. I won't say that this creates a disastrous situation.

But I will say it is something to be concerned about. I say again—

Chairman PATMAN. One premise is wrong.

Mr. BELL. What is that?

Chairman PATMAN. That is, that people have obligated themselves beyond their ability to pay. That was the premise that Senator O'Mahoney had. I think that is incorrect, Senator.

I think you will find that people are paying their bills regularly, that there is no evidence of inability to pay, there is no evidence that people cannot meet their terms and conditions.

Do you know of any evidence like that?

Mr. BELL. Not at this point; no, sir.

Chairman PATMAN. As long as people can carry out their obligations, why should we be alarmed about it?

Senator O'MAHONEY. Are there not television sets and other commodities of that kind for sale in secondhand stores which have been taken back from the original purchaser by the seller?

Chairman PATMAN. Yes. And automobiles. But it is not alarming. What I mean, generally, they are keeping up with their payments.

Senator O'MAHONEY. We are talking about trends here. They have to surrender the television set or automobile—they are not paying.

Chairman PATMAN. People generally who have installment obligations are meeting them and meeting them satisfactorily.

Senator O'MAHONEY. I think it is important for us to get the facts.

Mr. BELL. The thing that worries me about it is a tendency on the part of people who are selling things on credit to extend the terms further and further as they meet with resistance.

I think if you sell a man a car, on a term of payment, that is going to outlive the usefulness of the car or going to leave him more money owing on the car than he can get in trade-in value, it seems to me that clearly is not to his interest, or anybody else's.

Chairman PATMAN. We don't want to be his guardian.

Mr. BELL. No.

Chairman PATMAN. No reason why we should try to regulate. That is private enterprise. You see the fellow who buys should have some say and the fellow who sells should have some say.

Mr. BELL. Yes, sir.

Chairman PATMAN. But when they come together, why should we object?

Mr. BELL. I think in the Securities and Exchange Act we do modify the free market.

Senator O'MAHONEY. I am afraid that the point of my question has been lost. The question was based upon the fact that the witness has testified that some prudent corporation executive is borrowing more money than he needs because he is afraid the interest rate will go higher.

And there is a business boom, according to the witness, on the construction of plants for the production of commodities to be sold.

At the same time we have the definite report that the consumer credit is steadily increasing. I didn't say it was at the danger point. But it is a trend, which did precede the collapse of 1929, when people were encouraged by businessmen to pledge themselves and their incomes and their families' incomes for things for which they could not pay. Overstraining credit brings about such a situation.

Chairman PATMAN. I agree, when credit is overstrained. I look upon consumer credit as the healthiest part of our economy.

The people who sell these television sets and radio sets have to take some of them back, but they do pretty well in the business. They get pretty good profits.

Senator O'MAHONEY. Sometimes they have to pay high rates of interest.

Chairman PATMAN. We like to see people have the benefit of those comforts of life and those conveniences. I would rather see people buy what they want and pay cash; that is preferable, of course, and I am not encouraging people to go into debt.

But the reason I say installment credit is the healthiest part of our economy is that at one time when we were considering the OPA, in 1941, before Pearl Harbor, we had Leon Henderson on the witness stand, one of the smartest witnesses I ever heard in my life—he always had a good answer to every question—and it came up, and it was appropriate for me to ask him, that in our capitalistic system that our money is based on debt. If everybody paid their debts we wouldn't have any money. No debts, no money.

And I asked Leon what he would do about that if we paid all of our debts. He said, "Well, anybody that paid his debts ought to go right back into debt." In other words, create debts, pay them off.

And that is our economy.

And the reason I think that installment buying is about the healthiest part of it, is because the people actually pay those installments. And they go into debt. They pay their debts, and they go into debt again. It is their method of saving, in many instances. And I am not afraid of it at all. I look with favor on it.

As long as people are substantially meeting their payments, I do not think we should be disturbed about it. But I am willing to keep watching it, just like Senator O'Mahoney suggested; we should not have it get to alarming proportions.

One other question, Mr. Bell.

Senator O'MAHONEY. I thought you turned the questioning over to me for a minute.

Chairman PATMAN. Do you want to ask some more?

Senator O'MAHONEY. We reserve our debate for executive session.

Chairman PATMAN. That is right.

Senator O'MAHONEY. Mr. Bell, I wondered what reaction you have had from that very fine speech you made to the American Bankers' Association at Los Angeles. What have you heard with regard to that suggestion for a combination of the Council of Economic Advisers and the Federal Reserve Board?

Mr. BELL. Well, sir, I have had a great many letters from people who wrote in and said that they had thought well of the speech and that they thoroughly agreed with me and wished something would be done about it. I also have been denounced, it seems to me, with a great deal of heat by some of my good friends among the more orthodox economists and financial writers.

And I have also had the curious experience of various highly placed people coming up to me like conspirators and whispering in my ear, "I am all for you, I think you are exactly right."

Senator O'MAHONEY. "But don't quote me"—was that also a part of the response?

Mr. BELL. Well, it seems to have stirred up quite a lot of conversation.

Senator O'MAHONEY. Is there any official interest in the matter, may I ask?

Mr. BELL. Not to the best of my knowledge. There was no official connection of any sort with the speech, sir. This was simply the case of a fellow who had an assignment to make a speech, before a bunch of bankers, and tried to make it interesting.

Senator O'MAHONEY. You certainly did make it interesting. In fact, the opening of it was very interesting to me, because I was in charge of the Employment Act when it was passed by the Senate, in a Democratic Congress, and it was signed by a Democratic President.

I understand that the slip you made was in saying that it was passed by a Republican Congress—

Mr. BELL. Yes, sir, I remember that.

Senator O'MAHONEY. Has been corrected by you—

Mr. BELL. Yes, sir.

Senator O'MAHONEY. In other fields. I thank you for that, but I felt it ought to be corrected on the record here.

Mr. BELL. Quite right.

Senator O'MAHONEY. It was a Democratic Congress which passed it.

Mr. BELL. I regret that a Republican Congress did not.

Senator O'MAHONEY. That is one thing I can properly state, I think, with respect to it. I was the first chairman of that committee, and Senator Taft was the second chairman, because the 80th Congress came into existence immediately after this became an effective law.

I want to say that, both on the part of Senator Taft and on the part of myself, and those who have succeeded as chairman of the committee, there was always an effort to secure a staff which would be competent, and which would be concerned not with merely partisan arguments but with the objective study of the economy of the country.

And I am happy to say that that has been the policy throughout the life of the Joint Committee on the Economic Report.

Members of the staff, which were selected at the beginning, still are with the committee, no matter what the turn of the wheel of fortune was at the ballot box.

Mr. BELL. I think that it has been generally recognized.

Chairman PATMAN. Frankness compels me to admit, too, Mr. Bell, that I was the author of the bill in the House. We had bipartisan support for the Employment Act.

In fact, I was amazed at the strong support we had from both sides of the aisle. And I think that is to the credit of both major political parties.

And I think it has worked out quite well. This question that I wanted to ask you, you discussed a little with Senator O'Mahoney, a matter of this great importance, and in view of the fact that there are differences between the administration people about certain things, I just had an idea that you discussed this proposal with some of the administration people before you made it.

For instance, Arthur Burns. I wonder if you did discuss it with him.

Mr. BELL. I have known Arthur very intimately since long before he came down here, and I have discussed a great many things with him. And the answer to your question, sir, is "Yes," but the speech was entirely my own—everything in it was my own, my own concept.

You recognized there are a great many ideas there that are not new, and that have been discussed before, and nobody in the administration at any point either said, "This is fine, go ahead," or, "Aye, yes, or no."

Chairman PATMAN. Mr. Bell, in rounding out the record or for any other purpose if we should want to submit to you questions to be answered before the record closes you would be willing to do that?

Mr. BELL. Yes, sir.

Chairman PATMAN. Do you know of any other questions?

Senator O'MAHONEY. No.

Chairman PATMAN. Would you like to ask any?

Mr. ENSLEY. No.

Chairman PATMAN. Thank you very kindly. Your testimony has been very helpful and we appreciate it.

Mr. BELL. May I thank you? It was a great courtesy.

(Supplementary questions later asked of Mr. Bell and his answers to them are covered in the following letter from him:)

McGraw-Hill Publishing Co., Inc.,
New York, N. Y., December 18, 1956.

Hon. Wright Patman,
House of Representatives,
Washington, D. C.

DEAR MR. PATMAN: The two questions you have asked me are not easy ones and I am not sure that my answers are very good ones; but they are about the best I can produce at the present moment without going to inordinate lengths. Here they are:

Question. First, assuming that, at any particular time, economic forces are recognized and accepted as predominantly inflationary, warranting thereby some measures of restraint on the supply of credit, what type of borrowers should get the available credit and, under our present system, who actually does get it? In other words, what form of machinery should we look for rationing the curtailed supply?

Answer. Except in time of war or extreme national emergency, I would not favor any overall system of rationing credit. My objection to the present tight-money policy is that it does in effect provide a discriminatory rationing of credit by making credit difficult to obtain in certain areas such as housing, municipal

financing, and small business, while it places very little restraint upon large corporations. Credit restraint, as I see it, is justified merely as a means to an end. That end is the prevention of a runaway boom in the economy that could lead to a subsequent collapse. Accordingly, my approach to the problem would be as follows: First, when there is a predominantly inflationary condition, overall measures of restraint should be applied but they should include not only quantitative credit restriction but also appropriate fiscal measures, including refunding of the debt from short-term to long-term obligations, restraint of Government expenditures and tax measures. This overall restraint should be supplemented by selective credit controls directed toward particular areas of the economy which appear to be advancing at too rapid a pace.

Question: Second, what policies or institutional setups should we have, if any, to insure that certain social demands for schools, housing, highways, etc., do not get lost in the scramble for the relatively scarce credit resources?

Answer: This is the type of question that needs to be examined by a national monetary commission such as I have suggested. It is clear to me that by congressional action in the past we have accepted as national policy the proposition that certain types of economic activity, such as housing, represent a social good that entitles them to special consideration not accorded to other types of economic activity. It is a fact, however, that many conservative-minded people do not recognize that such national policies exist and see no reason why housing, for example, should get any special consideration in a period of credit stringency. Such people can see nothing wrong in the fact that a veteran may not at the present time be able to get a GI mortgage to finance the purchase of a \$12,000 home, while a big corporation has no trouble in borrowing millions of dollars to set up a new finance company. Before we can have appropriate policies or national setups to protect these social demands, we need, I think, a clear statement of what our national policies are.

Sincerely yours,

ELLIOTT V. BELL.

Chairman PATMAN. The subcommittee will stand in recess until 2 o'clock when Mr. Robert Young will be the witness.

(Whereupon, at 12:30 p. m., the subcommittee stood in recess, to reconvene at 2 p. m., this day.)

AFTERNOON SESSION

Chairman PATMAN. The subcommittee will please come to order.

Mr. Robert R. Young accepted the invitation of this committee to be our witness this afternoon. Mr. Young is chairman of the board of the New York Central Railroad Co., in addition to which he has many other interests.

We are mighty glad to have you, Mr. Young, and you may proceed as you desire.

Mr. YOUNG. Thank you, Mr. Congressman.

Chairman PATMAN. You may take your seat, if you desire.

STATEMENT OF ROBERT R. YOUNG, CHAIRMAN OF THE BOARD NEW YORK CENTRAL RAILROAD CO.

Mr. YOUNG. My invitation here today came, as you gentlemen know, as a result of some remarks I made before the Economic Club in New York on the night of November 19 when I was requested to address myself to the problems which business will face during this coming administration.

While the subject of my talk was "inflation," I had time to deal only with its three most important causes: Wages, taxes, and the export of our capital. I did this at some risk of being painted as an enemy of labor, which I am not; an enemy of the administration,

which I am not; an enemy of Congress, which I am not; and an enemy of our allies, which I am not.

I was prepared to take this personal risk for the sake of labor, the administration, Congress, and our allies, and I hope that as I amplify these remarks today, consideration will be given to the fact that time limits continue to make it impossible for me to elaborate on all of my views with which, if I had the time to fully explain them, I believe every well-meaning American citizen would agree.

I started as a day laborer in the days when a man could rise out of the ranks of labor through his superior productivity without offending its seniority rules. I have been associated with big business. I have even been in Wall Street. And, while I have never been in government, I have frequently been before it and understand its problems and the tremendous handicaps and pressures under which all of you work.

The problems you face today are so complex and the imponderables so interminable that it seems presumptuous for me to attempt to diagnose our mounting illness. Some of those who imagine they benefit from this illness may think I exaggerate its critical nature.

I appear here only because I was urged to. And nearly 2 years elapsed before I accepted the repeated invitations of the Economic Club, so sure I was that any honest expression of my views would only make me new enemies, with which I am already well supplied. Yet, as controversial and complex as the total situation is, there are a few basic principles on which maybe even my critics and I can agree.

Our economy in its abundance is the eighth wonder of the world. Any threat to that abundance is inflationary and retrogressive. Monopoly in all its forms, because it hamstring and corrupts enterprise, is the greatest threat to this abundance, whether it be monopoly of government, agriculture, labor, production, distribution, transportation, communications, or credit.

Judging from the background of your other witnesses here today and tomorrow, it is this last problem of credit which presently engages you. On this subject: Under a Government-managed plethora of money, our banks and other lenders suffered many years of famine. It is hard now to begrudge them a few years of clover. But if, as it did in 1929, the whole house comes tumbling down about their ears as a result of a famine or panic of credit, what will the benefit in earnings have been to the moneylenders if it is ultimately to be measured in terms of dollars that are worthless?

It is not hard to see why you are concerned with the recent increases in the cost of credit and the rapid shrinking of its supply. Further increases in interest rates can make the already enormous carrying charges on our Government debt more than we can bear, to say nothing of what might happen to confidence should the bottom drop out of Government bond quotations.

British Consols, their prime Government security, which once sold for par, are now selling at 50. Can we be sure of where the kind of a run such an eventuality could start in our economy will end?

It is adaptability and versatility which are the peculiar American genius. They have made our country great, and our highest achievements have had the tiniest beginnings. It is an alarming trend, therefore, when so many new developments today seem to favor bigness at the expense of the little fellow.

I have been both, and can see the value of both. Only the big corporations, which already enjoy many competitive advantages over their smaller rivals and which interlock through their boards of directors with the big sources of credit—banks, insurance companies, investment houses, pension and charitable funds, trust funds, ad infinitum—seem to be able to get credit today.

Yet, our productive resources are more than just this close-knit web of big business. Some of our finest products and best citizens are found in the thousands of middle-size and smaller enterprises which are progressively being squeezed out of the credit they so badly need. The mortality of such independent enterprises can lead to further inflation and concentration of power in still bigger business.

Just as the inflation of wages, taxes, and the export of capital threaten to beggar the white-collar classes, agriculture, the pensioners and the service industries, so is the concentration of big business driving a large segment of our population out of small business and into the rank and file of big business, subject to all of the rules of the "club," and you can define "club" either way.

Therefore, the most important domestic problems facing the new Congress are the rising interest costs and shortages of credit which add powerful new inflationary forces to an already hardship situation. There is not only the direct cost of higher interest, but also the reduced productivity that must eventually flow from postponed capital projects.

There are other far more inflationary forces, however, which are ignored by most of our fiscal authorities. Indeed, there seems to be a calculated effort to suppress the facts about inflation.

Mr. George Humphrey, in a recent speech, boasted of the stability of the Republican dollar, implying that the rise in the cost of living under the Democrats was due to, I quote him, "arbitrarily cheap and plentiful money."

Dissenting from this view as a businessman, and not as a partisan, my experience is that easy money under the Democrats encouraged increased capacity and automation which made operations less costly, thus slowing the rise in the cost of living.

If you knock automobile sales down by restricting consumer credit, all you accomplish is to reduce factory volume which, by increasing overhead, forces an increase in selling price.

The same inexorable law operates in housing, furnishings, appliances, and elsewhere; for ours is an economy of abundance, not scarcity, in which prices can only be held down in the face of spiraling wages by increasing both volume and productivity. Only thus can the huge capital costs of automation be absorbed.

Business today must have volume to meet its overhead just as our Federal Government, dependent on income taxes, must have a vital and prosperous economy. It is only through a continuation of recent growth trends that either business or Government can keep from going broke if we go on inflating wages.

Surprising as it may seem to most businessmen, it looks now as though our Federal Reserve has brought the mature economy fallacy of Keynes and Hopkins, long after the Democrats themselves abandoned it; for in all their mummery about controlling inflation through the manipulation of the rediscount rate, I have not heard our fiscal

authorities once mention the real inflationary force, the wage spiral, taxes, and the export of capital, which go on unabated.

Here is a gathering typhoon of inflation beside which the policies of the Federal Reserve are no more than an electric fan; they cannot possibly check, but might start the cyclone.

Wage increases have not been a necessary adjustment to inflation, as they would have us believe, but are its prime cause. Since 1932, wage rates have risen an enormous 320 percent, while the increase in consumer prices has been only 100 percent. Thus, it is plain that wages have led and prices only sluggishly followed.

The only possible way to maintain this favorable relationship if wages continue to be forced up is to still further increase productivity. Tight money discourages it.

And as for the export of our savings, which now threatens to check our domestic expansion on which the defense of the world depends, Republicans were once so high-principaled, they said, that they opposed Democrats on a few millions of badly needed relief for the unemployed.

Last summer they bemoaned an appropriation of \$4 billion of foreign relief for Heaven-knows-whom because, as they alleged, it was not enough. Any economist knows why the "handout" overseas, because it does not fill a domestic need, is more inflationary than a "handout" at home.

For example, I would guess that perhaps 25 or 30 percent of our steel production has gone overseas since 1940 in one form or another. The price of structural steel has tripled since 1929. Think how much lower steel prices, to say nothing of wages, might have been if that huge volume had been allowed to influence the price the other way in home markets.

Already Suez has caused our oil producers to talk about jacking up the price of oil. Only weeks ago they were restricting production to keep the price up.

If the oil the New York Central is about to carry to Boston—to take care of the foreign policy mistakes of France and Britain—were allowed to go into our furnaces at home, the cost of living this winter in Harlem and on Park Avenue would be correspondingly lower than inevitably it must now be.

Our fiscal authorities have correctly attributed our capital shortage resulting from these exports of capital to a deficiency in savings, but they behave like stern fathers pointing to our piggy banks; saying nothing about the fact that the old-fashioned American savings that once went into common stocks, bonds, life insurance, and time deposits, continue to be siphoned off in taxes to find their way eventually through foreign war lords, bureaucrats, and entrepreneurs into the Swiss banks and the gambling casinos and wine cellars of the Riviera.

You remember that wry line that came out of 1929, "Where are the customers' yachts?" Now, on those rare occasions when I can make the Mediterranean, I wonder "Where are the Americans' yachts?"

No; business cannot be made the scapegoat for inflation because of its abuse of credit or its failure to save. It has been as frugal in its demands on bank capital as it has been efficient in reducing costs; for we find that our gross national product since 1929 has risen nearly four times as fast as bank capital.

It has been mostly out of corporate savings that this vast expansion in production has been financed, while the Government has plowed under abroad what might have been our individual savings.

Savings, capital, and credit are synonymous. When you export capital gratis in the form of raw materials, wages, or currency, you disrupt the normal channels of trade, penalizing some foreigners while enriching others.

The unfavorable balance of trade which results is reflected in drains upon our bank balances and gold reserves, thus abnormally depleting the monetary expressions of savings here at home and depriving the home economy of exactly those same values in terms of local credit.

It is those shortages reflected in tight credit and higher interest rates which now block our smaller businesses and many municipalities from building sadly needed facilities.

Our money managers flatter themselves when they pretend that they check today's inflation by the orthodox measures which they should have used to stop the flow of credit into the stock market in 1929. It was those 10 percent margins which brought us Keynes and Hopkins; hence most of today's troubles.

Parenthetically, I would like on another occasion to present to your committee the reasons why banks and brokers even today should be prohibited by law from making demand loans on anything so intangible as current market prices, which inevitably must crash with the first bomb.

If it is sound to make a 30-year loan to the United States Steel Corp., why is it not equally sound to make at least a 3-year loan on United States Steel Corp. stock without the usual fine print sell-out clause?

Such a law might avert the next depression. If the Federal Reserve would really check inflation, it would call upon Congress to curb the excesses of labor and taxes. Only thus can our savings meet the capital needs of constantly growing demands.

There is no failure to appreciate the dangers of inflation; for, Mr. Humphrey has described it as—

the cruelest form of theft—a theft with the greatest harm to those least able to protect themselves.

Yet in a Treasury bond advertisement, built around his personal signature and photograph, the Secretary characterizes savings bonds as, "a reservoir of future purchasing power." Perhaps his legal advisers helped him with that word "reservoir"—a receptacle which can be drained down to the last drop—for half of the original purchasing power of these savings bonds has already gone down the drain.

Your congressional concept of truth in securities as expressed in the Securities Act is so sound that I have already urged that it should be expanded to deal with those in Government as well as those governed. Certainly Congress is inconsistent when it allows the Treasury Department to make questionable representations in the sale of government securities which the truth in Securities Act prohibits investment companies from making.

If it is moral for the Government to defraud pensioners to finance overseas adventures and placate labor, why does the Government find it any the less moral to allow a private corporation to mulct them?

To inflate labor at the expense of agriculture, housing, transportation, the service industries, and the white-collar class, all of those

income lags far behind labor's, is also a cruel form of theft; as cruel as it is to strip those who retire of their hard earned pensions.

It is only by such thefts that Mr. Humphrey's boasted honest Republican dollar has been temporarily sustained—to go aglimmering when these tardy segments catch up, as they must, if their wornout facilities and denuded purchasing power are to be renewed.

The alleged benefits of this built-in wage inflation in which most must lose for a few to gain are wholly immoral. And as Mr. Humphrey says, the losers inevitably are those least able to protect themselves.

Already some of our pensioners seek congressional relief and, frankly, they are entitled to it. It is doubtful if our economy, with all the genius of business, can remain vital many years longer, even with further sacrifices by the people, in the face of the imbalances created by the wage monopoly.

One by one the unprotected areas—housing, transportation, the white-collar class, and even many of our municipalities—will come to you for relief; and agriculture, already helped so much, will require even more of your scarce tax dollars.

Then, the philosophy of Karl Marx, as he predicted, will have won the crucial last battle through our own folly, and our monuments to Lincoln, Washington and Jefferson will be overturned.

Those who believe—or pretend to believe—that our present full economy is based on rising wages, lavish defense and careless foreign relief, should be reminded that we spent on our defense establishment in 1929 less than 2 percent of what we spent last year, and foreign relief was undreamed of.

The prosperous twenties were founded on falling prices and taxes, paradoxically accompanied by huge reductions in Government debt—three stimulants time-honored in their integrity, now widely feared as deflationary.

We might have expected our economic defeatists of the school of the “mature economy,” still plagued by unemployment after 6 years of the New Deal, to tell us that to avoid a recurrence of 1929 we must accept wage inflation, wartime taxes and a foreign policy of universal meddling; but here in 1956 we hardly expected the Federal Reserve Board to imply that the dire consequences of these policies can be cured by a rise in the rediscount rate. Do they think that we are just country boys at a carnival?

The great depression was not, as many would have us believe, a normal phase of the old-fashioned economy, because the brief downswings of all but 1 or 2 out of our many economic cycles were more salutary in their aftermaths than otherwise.

With new legislation prohibiting the call feature of collateral loans that I urge, it is not a new 1929 crash we have to fear. Rather it is the creeping stagnation which accompanies wage inflation once it necessitates new subsidies, higher carrying charges on the Federal debt and higher taxes.

I am not an alarmist when I warn that it may come to a climax in price, wage, and credit controls; in loss of confidence in the Government debt; and finally in a flight from the dollar—then the printing press and a completely managed economy.

Our freedom, our wealth, our pride in achievement and joy of accomplishment—all will have gone with the wind.

Lest some of you think that inflation and foreign policy are of no concern to a railroad man, let me remind you of this: While our politicians in their subsidy and tax discrimination have held first-class passenger fares since 1929 down to a puny raise of only 18 percent, they have encouraged rail wages to triple. Coach fares are actually lower today than they were 27 years ago.

The big steel companies whose biggest easy-going customer is the United States Government, face no problem in absorbing these wage increases. They raise their prices and their profits the very same day they begin paying the wage increase.

But what about the railroads, on which the steel companies depend? We must endure the mockery of lengthy and costly hearings before the ICC months, even years, after our own wage increases have started running, in order that special and selfish interests who seek to sponge on the railroads by ICC license may have their wishes heard.

These protests have not the slightest relationship to the public interest, but since they lead clear to the Cabinet and Defense Department, they are too powerful for the ICC to ignore.

Our railroads no sooner stagger up from one of these perennial wage increases than they are met by the bludgeon of the next; payoffs to our congressionally licensed monopolists, a process of exploitation of the less-favored unctuously called negotiation.

And what could be more inflationary, more degrading, more destructive of the joy of accomplishment, than a work rule which requires 2 men where 1 is needed? To subvert man's enterprise is to corrupt his divine gift of aspiration, the quality which elevates him from the animals. Crush this precious gift entirely and we become no more than bovine chewers of the cud, easy prey to the voracious and insatiable State, police or patronizing.

Gentlemen, when Russia has most of the manpower of the world, this Nation cannot longer afford featherbedding any more than it can afford, as Congressman Patman has told me, the education of many more technicians and engineers in Russia than we have in our own country.

Chairman PATMAN. Mr. Young, may I interrupt you just a moment, since you mentioned that.

Our committee, I think, was the first congressional committee to go into the question of automation, in November of last year, and we were shocked to learn that the Russians are graduating engineers and scientists, about twice as many this year as in the United States, at least that number.

And the most disturbing and alarming situation was the fact that they are graduating 32 times as many technicians in Russia this year as we are graduating, 50,000 here compared to 1,600,000 there.

Mr. YOUNG. Well, I would like to take some of these surplus firemen in our locomotives and put them over into engineering school where they could do the country some good.

What is the end result to labor of these policies? War, galloping inflation, and eventually forced labor? Who then will be remembered as the friends of labor—those who furthered these policies, or those who warned against them?

If anything can be more inflationary than a wage monopoly it is taxes. Under the Monroe Doctrine our taxes were virtually nothing. Under present policies they eat up a third of the national income. As

a result, consumer prices are grossly higher than they would otherwise need be.

And those who think taxes, the price we pay for our constant failures in foreign policy, do not warp ambition and curb enterprise, have never sought to pry a man out of a good job by a big salary increase. Nor can I blame a family for not wanting to pick up and move just to serve as a conduit to the United States Treasury, and thence to some Greek syndicate.

So little is the material reward left for high attainment, I would pause before advising a young man to put a productive career very much ahead of that of a golf pro. Why should the family doctor respond to calls at all hours from neighbors who practice the organized slowdown and, consequently, yearn for Mr. Nixon's 4-day week?

And speaking of the idle rich, the big houses of the lords of England, who have just missed getting us into the third world war and who are asking us now to pick up the tab for their latest blunders, can be converted into museums without any loss to their economy. Yes; they can go; but we must preserve the material rewards of our pioneers of business if we are to go on enjoying their miracles. If they must be leveled down, let's be selfish about it and wait until their death, as God does.

The last cut of any consequence in the steeply graduated income tax, the joint return, came away back in 1948. It is one thing to work overtime in wartime, or from force of habit; but in this new peacetime culture of universal mediocrity imposed upon us by Mr. Humphrey's tax guillotine, will coming generations aspire to promotion with its accelerating responsibilities at decelerating rewards?

Just as the railroad man cannot forget inflation and taxes, how can you forget your dependence on cheap transportation when its urgency is registered in all the bloody pages of history?

Go back far beyond Suez to the legendary days of Troy whose site, at the entrance to the Dardanelles, dominated the dark waters that flow down out of Europe and Asia, the world's greatest land mass. The lading of ships, however, in those days was mostly light merchandise, and it was not until the last half of the past century, when the rails enabled us to tap our coal, cement, and ore, that heavy industry evolved.

Fortunately, our form of government, so wisely founded, was yet too young to hamstring business after the foreign fashion. Hence our native enterprise, stimulated by the prospect of unlimited and untaxed gain, took advantage of that cheap transportation and our natural resources to create a standard of living that can only be appreciated by traveling abroad.

We can be grateful that this combination of circumstances took form about the Great Lakes and not the Black Sea. Our ton-mile rate by rail is only a fraction of what it is in other countries; explanation in itself of the vast disparities in our standards of living.

Those Americans who loathe capitalism should be confined, say for 10 years, to some of these overgoverned and underrailroaded foreign countries they prod us into emulating.

Penalize Ford, Du Pont, General Electric, with British or French socialized rail rates and service, and their wonder products would wither into a fraction of their present volume, conceding that they could have been achieved in the first place.

It would take 450 truckdrivers to move the coal that can be moved by only 5 men in a 150-car train, and 2 of these 5 are featherbedded. Neither the truck nor the bus could possibly compete with the rails if they paid for their own rights-of-way; nor could our subsidized airports have been brought into being if their steel and concrete had not reached them by rail.

It is only because our harbors and waterways are served by the railways, built and dredged by the taxpayer and protected by our rate-makers, that even water can survive rail competition. The boat not only consumes more fuel, but it requires 34 men to move the ore that 15 men move by rail, and the rail moves it faster.

You would think, then, reward being a function of service, the railroads would be rich. Instead, since 1929 their rate of return on investment has averaged only 3.4 percent, and in no peacetime year since 1930 has it exceeded 4.3 percent, a shocking contrast to the 9.7 percent justifiably enjoyed by all other public utilities.

Because of political pressures from members of the Cabinet and Congress on the Interstate Commerce Commission, and because of the resulting timidity of railroadmen, the traffic of this rich country has not been made to bear its fair share of transportation costs—a sop to the pressure groups which in the end has meant only higher rates and poorer service.

This Republican year, supposedly favorable to business, was ironically not nearly so good for us as our last years under Mr. Truman. Could there be a greater warning against rapidly encroaching Government than this sorry record of our first big regulated industry?

More than one-third of the Nation's freight cars and two-thirds of its passenger cars are over 25 years of age. Many are 35 and 40; and the rust and rot advance. Superimpose a national emergency, and where would we be?

If current rate relief requests are not granted in full, your two largest railways may be forced to stop buying passenger equipment for all time. Already millions of passenger train-miles have been lopped off our mainline schedules.

Yet, in New Jersey and New York we are compelled to run trains some of which average only 4½ passengers a day, less than the train crew.

The Nation has just faced a shortage of at least 100,000 freight cars, \$1 billion worth, from which nearly every business suffers. To replace every car over 20 years of age would require \$12 billion, and it would pay for itself out of savings.

Large immediate expenditures in many other areas of railroad physical plant would be no less self-amortizing; but how can you borrow at 5½ percent to renew a plant which earns 3 percent?

A 10 percent decline in our carloadings and most of us would be at the brink of bankruptcy, so small are our reserves and narrow our margin of profit.

And in the face of all these well-known needs of our railroads, there are those who advocate defense and relief expenditures just as a means of keeping our people employed.

Local public servants pressured by selfish and special interests force us to continue marginal rapid transit services of a trolley car type which they themselves have long since abandoned. At the same time, other public servants under similar pressures grant subsidies to

the airways and highways which threaten the continuance of main line trains.

Our revenues in New York State have dropped 8 percent since the throughway was finished a few months ago.

Can such discrimination and regulation by any stretch of the imagination be in the public interest?

What a mockery these protracted and destructive public rate and service hearings, which Congress and our States intended to protect the public, have become in the face of our hazardous financial plight.

Yes, these hearings have been perverted into devices to protect the special interests at the expense of the public interest, as the record clearly shows.

So far has the will of Congress been perverted that the ICC publicly announced, with unconscious irony, that the recent hearings in Kansas City were to be held in order to hear shippers. What on earth do they expect the kind of shipper to say who puts his heel on our 3 percent rate of return so that he may earn 20 percent?

And at the top level, supposedly, of national enlightenment, Congress recently threw out the excise taxes on admissions to movie theaters, but continued them on admissions to passenger and freight trains, the one forced to carry more than 95 percent of our troops and the other more than 90 percent of our freight in the last war.

Imagine, imposing a special excise tax on our only all-weather freight and passenger service, essential to troop and civilian movement, which already loses \$700 million a year on its passenger trains.

The tax on freight is an added inducement to already rich industries, like those Mr. Humphrey came from, to go into self-transportation so that they get richer and the rails poorer. His former companies, as self-transporters by rail, belt, water, truck, and air, save this tax and hence enjoy that much of an advantage over their smaller competitors.

I am told that Mr. Humphrey opposes the lifting of this tax, in surprising contrast to his predecessors, Mr. Snyder and Mr. Morgenthau, who saw that the tax, in peacetime, was not in the public interest.

Cannot those responsible for such follies see that if the most remunerative traffic is skimmed off the rails by the truck and the private carrier, the traffic which the rails are left to carry must finally come to bear an intolerable burden?

This I know: sound railways in America are a hundred times more important to us than the Suez Canal, as is demonstrated by the fact that it is our railroads that now are called upon to carry oil to our ports for delivery to France and England.

Yet, the money to buy equipment is left to the mercy of these mock hearings. Indeed, Mr. Malenkov is smiling. How can the Department of Defense close its eyes to our Achilles' heel, our railroads? They know that current rates are not keeping our physical plant alive, particularly in the passenger field. Yet their own underlings come in and oppose our passenger fare increases in the face of a wage rate which has tripled.

They act as though the Defense Department had no higher obligation to the public interest than a coal operator, some of whom do not have enough judgment to see that if they do not pay fair rates the railroads cannot continue to provide cars with which to ship their coal.

A railroad without cars is as useless as a skyscraper without ele-

vators. Can it be that the Department of Defense has been taken over in the way in which the Carnegie Foundation was once taken over?

Yet, this great rail service that does so much for our defense, at no cost to the taxpayer, has been pauperized and made the butt of politicians, newspapers, taxing authorities, ambulance-chasers, college professors, and Government agencies for a full generation, while its rapidly growing competitors are subsidized and tax-exempted—even rescued by the United States Navy.

The rails being the very core of our capitalistic system, it is not hard to see why its enemies have made them their first line of attack; but it is difficult to see why the Defense Department and the Treasury Department should persecute them. Or do I see ghosts of Harry Dexter White?

Even if Defense and Treasury fail to see, you gentlemen concerned with economic stabilization will not fail to see the importance of strong railroads to the economy and defense of the Nation. If the railroads go, the rest will not be slow to follow.

Forgive me for using the railroads as my illustration. It is only because they are so symptomatic and I am most familiar with them. There are scores of other areas of our economy, such as our schools, in which the deterioration that results from wage and tax inflation has gone about as far.

Our inflationary troubles, then, are not of business, for it is the inflation and abuse of credit by Government, not by business, which threatens to stall our rising standard of living and to strike at the heart of private enterprise.

The miracles of transportation and business have so far checked the degenerative forces of progressively burgeoning Government, but the beginnings of capital shortage indicate that the string has about run out.

We can stop inflation, we can reduce taxes, we can stop squandering abroad our essential resources and the flower of our youth. Indeed, we can return peace to the world.

But we can do these things only if Congress and business join together and sell economic truth and a foreign policy of national sanity. Like charity, the voice of America should begin at home.

For it is as alarming as it is incredible that 61 percent of our high-school seniors, for example, do not believe in the need for profits; 82 percent do not believe we have competition in business. This can only reflect equally misinformed parents—or, are they precocious youngsters only anticipating the economy into which they may mature?

The President of the United States has already urged upon Congress the only constructive transportation legislation ever to originate in the White House. It remains to be seen if Congress will be as constructive as the President in trying to restore sanity to our national transportation system.

Again, forgive me for using our railroads as my illustration.

Chairman PATMAN. That is perfectly all right, Mr. Young, and we thank you for your very interesting statement.

What are the advantages or disadvantages to the alternative way of combating inflationary forces, Mr. Young, which are listed in the chairman's opening statement this morning, if you were here? Were you here this morning when I read it?

Mr. YOUNG. Unfortunately, I was not here.

Chairman PATMAN. Anyway, I mentioned increased taxes and general credit control through manipulation of the interest rate, open-market-policy reserve requirements, and selective credit control applying to specific segments of the credit structure, such as installment buying, real-estate financing, plant and equipment.

In other words, what are the advantages and disadvantages of those three in comparison with the present method that is being used by the Federal Reserve System?

Mr. YOUNG. Well, I would say that almost anything is better than our artificially tightening credit.

Chairman PATMAN. You mentioned a while ago something about the direct cost. It reminded me that if this is a short-run credit squeeze of tight money, as some would like to believe, then it means that during this short run we have still got to have schools, and we must vote bonds and sell the bonds in order to build the school buildings, but these bonds run 30 and 40 years, so it looks rather burdensome, does it not, Mr. Young, to make taxpayers pay higher interest rates for a 40-year period on account of what many of them claim is just a short-run credit squeeze.

They have got to do it for 40 years instead of just a short period.

Now, when you, as a big-business man—you stated that you were a big-business man. Of course, we all know that you are, and you were small business, too, and you know something about both—when you can see in the future that there is going to be a scarcity of credit, and possibly a higher interest rate, would you, using what you consider good business judgment, go into the market and borrow funds in advance of your actual needs, or would you wait and pay the higher rate?

Mr. YOUNG. Well, if I could foresee it surely, I would certainly go into the market and borrow.

Chairman PATMAN. And do you not think that that has caused a tighter money market, the fact that some of the larger concerns, knowing that interest rates are continuing on the way up, are not only anticipating it but, knowing it, they are going into the market and borrowing funds they do not actually need now, but expect to use a year from now or 2 years from now?

Mr. YOUNG. There may be some of that. I don't believe there is too much of it yet, sir.

And on that subject of schools, I would say that the national peril is going to increase rapidly over the next 10 or 15 years or over the next generation, certainly, and that certainly the last place we should economize is in our schools, for the very reason you mentioned, Congressman.

Chairman PATMAN. Yes, sir.

Mr. YOUNG. That we need technicians and engineers badly, and we must have them.

Chairman PATMAN. And we must encourage our school system.

Mr. YOUNG. Yes, sir.

Chairman PATMAN. And we need plenty of buildings.

Mr. YOUNG. Yes, sir.

Chairman PATMAN. Lots of school construction.

Mr. YOUNG. Yes, sir.

Chairman PATMAN. And on the interest rates in particular, Mr. Young, do you not think there are other ways of restraining an

inflationary condition, if there is an inflationary condition, rather than just arbitrarily raising interest rates there across the board?

Mr. YOUNG. Again, I think that is the last thing we should do—

Chairman PATMAN. The last thing we should do.

Mr. YOUNG (continuing). Is to artificially make credit tight in this Nation, because I am afraid that the policies that have already been followed and are still being followed are going to make it plenty tight enough without any artificial tightening.

Chairman PATMAN. The Federal Reserve Board—I believe you have served in the Federal Reserve bank as a director.

Mr. YOUNG. No, sir, that requires a banking invitation and I don't qualify.

Chairman PATMAN. I understand. [Laughter.]

Anyway, the Federal Reserve System—you are acquainted with that—and you know that, for instance, if they wanted to just make credit a little tighter to meet an inflationary condition which they really believed was in existence, they could increase the reserve requirements of banks.

In other words, instead of permitting banks to expand their loans by really creating or manufacturing money equal to \$6 for every \$1 in reserve, as they can do now, they could change that, they have the right to do it under existing law, to where they could only manufacture \$5 to \$1, or \$4 to \$1, or \$3 to \$1.

Mr. YOUNG. Correct; I believe that is true; yes, sir.

Chairman PATMAN. Would that not be preferable to just automatically increasing interest rates?

Mr. YOUNG. Well, of the two, I think it would—well, no, I am not sure that that would be preferable.

Chairman PATMAN. Anyway, that is one of the tools they could use.

Mr. YOUNG. I would say they are equally, they could equally be damaging.

Chairman PATMAN. They could be, I know they could be.

Mr. YOUNG. And equally inflationary.

Chairman PATMAN. But through rediscount rate increases the interest rate is raised immediately.

Mr. YOUNG. Certainly we know that is inflationary, because we know higher interest rates increases the cost of doing business.

Chairman PATMAN. And it comes immediately.

Mr. YOUNG. Yes, sir; I agree with you. I think I would agree with you; yes, sir.

Chairman PATMAN. And the other one is at least a lot slower if it comes.

Mr. YOUNG. There the effect would be several years later, not immediately.

Chairman PATMAN. Yes, sir, several years later.

Mr. YOUNG. I agree with you a hundred percent.

Chairman PATMAN. Now, another thing they have, another tool, is the open-market operations. They can buy and sell Government bonds to make money scarce and dear, or plentiful.

Mr. YOUNG. Yes, sir. I remember very well we embarked on a selling operation in 1953 which knocked Government bonds down to 90.

Chairman PATMAN. That is right.

Mr. YOUNG. Which hurt business.

Chairman PATMAN. And they can do it either way. They can make Government bonds worth more or Government bonds worth less.

Mr. YOUNG. Yes, sir, within limits.

Chairman PATMAN. Mr. Eccles testified—and Mr. Eccles should know something about the Federal Reserve System. He was Chairman longer than any other 1 person; 12 years.

Mr. YOUNG. I think his views on that have been very sound.

Chairman PATMAN. Yes, sir. And he said that the Federal Reserve System could keep the interest rate at any level it wanted to, if it wanted to keep the Government bonds at 2½ percent, it could do it, or 2 percent, or any other rate, by using the open-market operations.

Mr. YOUNG. That was certainly true during his administration.

Chairman PATMAN. Yes, sir.

I insist that arbitrarily increasing interest rates is certainly cruel and brutal in comparison to the use of the weapons they have at hand and are not using.

You know the danger of raising interest rates, because you mentioned about the school construction and about your own business. What incentive have you to borrow money at 5½ percent to earn 4 percent?

Mr. YOUNG. We have reduced our building of boxcars recently just because of the increased cost of money.

Chairman PATMAN. You have? How much would that run into, in dollars, Mr. Young?

Mr. YOUNG. Well, more importantly, it deprives the Nation of boxcars when there is a 100,000-car shortage of boxcars.

Chairman PATMAN. I believe you said \$12 billion would be required to bring the boxcars up to standard.

Mr. YOUNG. Yes, sir. Yes, sir.

Chairman PATMAN. Twelve billion dollars.

Mr. YOUNG. Yes, sir.

Chairman PATMAN. And you have canceled orders, or at least you have not—

Mr. YOUNG. We have slowed down the scheduling of our building of boxcars just because we cannot afford to pay 5½ percent for money when the Interstate Commerce Commission gives us a 3-percent return. It is just that simple.

Chairman PATMAN. Yes, sir.

Mr. YOUNG. If the figures were reversed, we would start building; if we paid 3 percent for money and we were allowed to earn 5 percent, we would cure the boxcar shortage overnight.

Chairman PATMAN. And other utilities, in the position that you are in, of course, they evidently are doing the same thing.

Mr. YOUNG. Well, since they earn 9.7 percent, they will not do it as quickly or as drastically as we are forced to do it; but I am sure their minds operate in the same way—as money gets tighter, they do not make improvements which they would make if money was easier.

Chairman PATMAN. Yes, sir. But all the railroads are in the same position that your railroad is in, I am sure.

Mr. YOUNG. The big passenger railroads are all in the same fix that we are in, and that includes such as the Pennsylvania and New Haven, most of the railroads in the Northeast, where we carry the heavy burden of mail, passengers, and freight.

Chairman PATMAN. As an investor, Mr. Young, with considerable experience in the money market, do you believe that banks and security dealers are able to anticipate Federal Reserve actions and thereby avoid the consequences that the Federal Reserve hopes to achieve by raising rates and causing bond prices to fall?

Mr. YOUNG. Well, I would say there are some influential bankers in New York who might know in advance what the Federal Reserve policy was going to be.

Chairman PATMAN. Again speaking as an investor, do you think it is possible for someone with access to restricted information about the intentions of the Open Market Committee, trading this, to make a lot of money speculating in the Government securities?

Mr. YOUNG. I would say that it was almost inevitable.

Chairman PATMAN. It is impossible to keep secrets like that.

Mr. YOUNG. Yes, sir.

Chairman PATMAN. Just like it is here on the Hill.

Mr. YOUNG. Yes.

Chairman PATMAN. If there are two people involved, why, it is not a secret any more.

Mr. YOUNG. Yes, sir; particularly when so many of these Government officials come out of influential New York law firms with many banking partners and affiliations.

Chairman PATMAN. In connection with that, you see, the person who actually runs the Federal Reserve open market operation is selected by the Federal Reserve Bank of New York. He is not selected by the Federal Reserve Board. He is not selected by the Open Market Committee. He is selected by a board of directors, six of whom are selected by the private banks, and he is placed in that position of running the desk, the open market operation.

Now, that is for the whole Nation. These banks, individual banks, they have no power over that. They have no control at all. The 1935 act made the system of a central bank, and they have practically no power now; and the one person there in New York, selected by the Federal Reserve Bank in New York, has complete control over running these operations, running into billions and billions of dollars a day sometimes, and you do not think that they can keep that information from leaking very well?

Mr. YOUNG. I would think it would be very difficult.

Chairman PATMAN. Very difficult.

You take the bond market, Mr. Young, you mentioned a while ago about 1953, 1954. What can a businessman do to protect himself in a situation we are faced with now, of such uncertainty? He does not know how low these bonds will go. They are already below 90.

In England, 3½ percent bonds are down below 60, and England, of course, has been following the same kind of hard money policy that we have been following; in fact, very similar. And this interest rate keeps going up and up and up. How can a businessman intelligently plan for the future, faced with a condition like we have right today?

Mr. YOUNG. It is very difficult. It is certainly a great temptation to go to Florida.

Chairman PATMAN. There is certainly no way that you can anticipate what is going to be done.

The Federal Reserve seems to be adamant; they just go ahead and let the bonds go down, interest rates go up. We do not know how far it will go. There is no way to tell.

They claim they are independent, of course. Independent from whom? They claim they are independent from the executive. You know, they seceded in 1951; but they cannot secede from Congress because they are the agents of Congress.

And Congress, realizing that the Members of Congress are responsible for their actions, I imagine will take definite action in the foreseeable future if something is not done to change this trend which is so devastating to the economy right now.

Mr. YOUNG. I think we will be forced to do something about it, sir.

Chairman PATMAN. Senator O'Mahoney?

Senator O'MAHONEY. Thank you, Mr. Chairman.

I am very much interested—

Mr. YOUNG. Mr. Senator, how are you, sir.

Senator O'MAHONEY (continuing). In your paper. I am sorry I was not here at the beginning, but I have been checking back on it before proceeding, and I find many stimulating statements in it.

Mr. YOUNG. Thank you, sir.

Senator O'MAHONEY. The problem which confronts us is undoubtedly one of the greatest that this country has ever faced, and not many people realize it, particularly, I think, in New York.

My questions are intended only to clarify statements which you have made today and previously, and to develop the facts that as a person holding the important position that you do, and having the important experience that you have, can help lay before the Congress and the country.

On the last page of your statement, page 18, I notice 2 or 3 statements which I would like to ask you to amplify.

Our inflationary troubles—

you say—

then, are not of business, for it is the inflation and abuse of credit by Government, not by business, which threatens to stall our rising standard of living and to strike at the heart of private enterprise.

Do you mean by this to place all the responsibility for the abuse of credit, which you find to exist, upon the Government and not on business?

Mr. YOUNG. Well, I wanted to exclude business in the sense of, let us say, productive business. I would not exclude certain monopolistic influences in business, which I regard more as banking influences than business influences.

Senator O'MAHONEY. I see. Well, then, you feel that the banking interests—

Mr. YOUNG. I think banking influences—

Senator O'MAHONEY (continuing). Have contributed a responsibility to this abuse of credit?

Mr. YOUNG. I do. I think, as a matter of fact, most, many of our Government policies, that the responsibility is fully shared by these, let us say, these monopolistic banking interests.

Senator O'MAHONEY. You spoke in your testimony today and previous testimony that you had given Congress, of men—sometimes lawyers, sometimes others—flitting back and forth between the law firms and the business houses of Wall Street and the Government.

Mr. YOUNG. Yes, sir. There is a constant path, well worn, between Washington and New York, between partners of these law firms and banking houses that made it their business to interlock in some of our big industrial corporations, all of which I spelled out in my last appearance before Congress, and gave Congress a chart at that time of how they interlock.

Senator O'MAHONEY. You are referring to your testimony at the hearings before a subcommittee of the Committee on Banking and Currency of the Senate in the 1st session of the 84th Congress?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. In June or July?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. I was aware of the fact that you were having a proxy fight at that time to gain control of the New York Central Railroad, and that you had testified at that hearing that the banks and investment houses and other railroads had combined against you—

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. (continuing). In the war to prevent you from gaining control of the railroad by the votes of the stockholders of the railroads.

Mr. YOUNG. Yes, sir. They organized against me, and almost unanimously, and that included the big insurance companies, the big banks, and all the railroads. They operated hand in glove to keep any independent stockholder interest from getting into this railroad field which they had dominated for two or three generations.

Senator O'MAHONEY. In order to get your language into this record, since you brought it up, I would like to read one or two extracts from your testimony. The first one is from page 1459.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. You were speaking here of competitive bidding for bonds. You said:

The records on competitive bidding, railroad reorganization and the Pullman case, are as complete as they are revealing of corporate collusion against the public interest.

You meant that, of course.

Mr. YOUNG. Yes, sir; I meant that sincerely, and I think I have said that under oath.

Senator O'MAHONEY. And you still mean it?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. "It is indeed shocking," you went on—

that while no two railroads can get together on such constructive things as through service at Chicago—

and since I am a citizen of Cheyenne, Wyo., I may say to you that I would like to have through service from Washington, through Chicago, to Cheyenne.

Mr. YOUNG. The Nation's security requires it.

Senator O'MAHONEY. What?

Mr. YOUNG. The Nation's security, if not your comfort, requires it, Senator.

Senator O'MAHONEY. Well, why don't we get it?

Mr. YOUNG. For the reason I gave you, the reason that you will soon read.

Senator O'MAHONEY. To resume:

It is indeed shocking that while no two railroads can get together on such constructive things as through service at Chicago, mechanical refrigeration, or sealed bidders, 131 of them can be brought into unanimous agreement to serve the bankers at the expense of their own railroad shareholders.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. You found that to be the case?

Mr. YOUNG. I found that to be true, and I still believe that to be true.

Senator O'MAHONEY. You still believe that to be true?

Mr. YOUNG. Yes, sir; almost, I might make it, 129 instead of 131.

Senator O'MAHONEY. Another paragraph:

Here was the New York Central, America's second largest railroad, dominated by 4 personalities, all bankers, holding among them only 450 shares of Central stock, less than \$2,500 worth apiece, through their subordinates and fellow bank directors. As you see from this chart over on my left, they interlocked with the directors of 14 other railroads, including Central's most powerful competitors, and with 56 other mammoth corporations having assets of more than \$107 billion.

Mr. YOUNG. Yes, sir. It was against the law for me to serve on another railroad, but those bankers can interlock all over the lot with impunity.

Senator O'MAHONEY. You told this story:

Several great insurance companies—

I am reading from page 1462—

through their financial vice presidents, two of whom also served on the board of directors of railroads competing with Central, filed petitions alongside the old Central management in its frantic but unavailing attempt for Interstate Commerce Commission help against us, all to the accompaniment of wide publicity damaging to our cause.

Let me interpolate there and draw your attention to the effrontery of that action of these two insurance companies who had named boards of directors to 17 railroad reorganizations, and the directors of these companies interlocked with many railroads and interlocked with these corporations which interlock with all the railroads, and those gentlemen had the effrontery to come down to the Commission and demand that we be found in violation of the Clayton Act because I once knew Mr. Eaton and had once owned some stock in the C. & O. Imagine the effrontery of them, and compare that with the fact that a Mellon Bank president sat on the Central board when Mr. Mellon himself sat on the Pennsylvania board with another president whom he controlled, of the Pittsburgh Plate Glass Co.

You named the insurance companies.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. A little while later you said they were the Metropolitan Life and the John Hancock.

And I would like to say this—

you went on—

I would like to say this, that I had the pleasure of dining at the White House during the proxy fight and President Eisenhower was so determined to maintain neutrality that he asked Mr. Vanderbilt to dine there first. And I discussed the New York Central proxy fight with members of the White House staff, and they said that the strictest orders had come down from Mr. Eisenhower to maintain the strictest neutrality in that proxy fight.

Do you attribute your victory to that intervention?

Mr. YOUNG. Well, I would say this—well, I couldn't say that, sir, but I would say that—

Senator O'MAHONEY. That was only—

Mr. YOUNG. That was a little light atmosphere I was trying to throw in there, sir.

Senator O'MAHONEY. Yes, sir. I so interpreted it. But what I am driving at is to find out whether you still believe that that condition exists.

Mr. YOUNG. I do, and it exists just as dangerously today. And I think it is that influence that is behind our tight money credit, at the moment. I think it is that same group that are behind this policy.

Senator O'MAHONEY. Well, now you see you jump ahead of me. You have given me the answer to the question I was about to ask. I was referring to men in Wall Street coming to Washington in Government and fitting back again. And then I was going to ask you whether you thought that Mr. Humphrey, the Secretary of the Treasury, and Mr. Randolph Burgess, the Under Secretary of the Treasury, who are issuing the bonds with the high rate of interest, are to be listed in that same category of big leaders of business coming to Washington to run the Government?

Mr. YOUNG. They are members of the club, sir.

Senator O'MAHONEY. You are much better than I am—much more succinct and much more direct, sir, in characterizing the situation that confronts us. You are concerned about monopoly.

Mr. YOUNG. Deeply, sir. I think that is the greatest threat we have to the great genius of American enterprise and we have got to curb it in all its forms.

Senator O'MAHONEY. And in this testimony which you gave some years ago—it was not so many—it was 1954 or 1955—2 years ago—you drew attention to the changing character of some businesses.

Once they were family businesses, and later in the "public domain," a phrase which I thought was very apt.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. That is a correct statement of your views.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. There are corporations now holding dominant positions in the trade and industry of the United States which are managed not by their owners or by their stockholders but by the bankers.

Mr. YOUNG. There is a group of men up there that make it their business to get and secure the control of the biggest business in the country. And they are allowed to interlock freely.

And the real owners, the voice of the owners is kept out. And I say that that kind of bureaucracy is far more dangerous than the kind of bureaucracy they like to criticize, because that bureaucracy does not have to answer to the electorate as the Washington bureaucracy does. At least, we get a chance to change them.

But I don't know of any great corporation in America that ever had to face the stockholders until it happened in the New York Central. And then—

Senator O'MAHONEY. Isn't it a fact that many of these corporations now are endeavoring to change the face value of the stock so as to get it in the hands of small stockholders—they reduce the face value of the stock?

Mr. ZELL. That may be one of their motives, sir. I know that they just hate to have a large stockholder. They just hate to have a stockholder walk into their office and ask them any questions.

Senator O'MAHONEY. Isn't that the case with the New York Central?

Mr. YOUNG. No longer, sir. No, sir. As a matter of fact, the management of the New York Central has me walking into their offices every day. And I ask them a lot of questions.

Senator O'MAHONEY. Then you wish this committee to understand, so far as the New York Central is concerned, the latchstring is always out for the stockholders?

Mr. YOUNG. Yes, sir; it is, indeed.

Senator O'MAHONEY. He is treated as an owner?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. Where do your stockholder meetings take place?

Mr. YOUNG. In Albany.

Senator O'MAHONEY. But in the State of New York.

Mr. YOUNG. I want to say there with pride that—this was 2 years after this heated proxy fight—at the annual meeting there last May, despite the fact that many of them voted against me and hated me during the proxy fight, for the first time that I ever knew it to happen, there was not a single dissenting vote in 60,000 shareholders of the New York Central against a single New York Central director.

Senator O'MAHONEY. Let me read another paragraph from your testimony of 2 years ago. This is from page 1467:

To repeat, a vice president of 1 of the 4 banks represented on Central's board who was also chairman of the executive committee of Central's competitor, the Erie, took a leave of absence from his bank to give the Central full time assistance in its fight to prevent our victory which he publicly declared would be a national calamity.

The Central has since cut the cost of transportation \$70 million in 10 months.

Was that the national calamity he foresaw?

Let me ask you, has there been any other calamity under stockholder-office management?

Mr. YOUNG. The only calamity was, sir, we paid \$2.75 in dividends last year and we continuously have paid a dividend since we took control. And the Central had not been on a regular dividend basis under the bankers for 25 years.

We are improving service on the Central. And I want to tell you some of the things we found in the Central were disgraceful. I want to give full credit for what is happening up there to Al Perlman.

Senator O'MAHONEY. Returning to your statement, on page 18 of your testimony today, would you say that the abuse of credit by the Government is the responsibility of the Government itself and not of the business, or by the intervention in directing the Government of men who have come from this category of interlocking banks and directors and producers of materials that have fallen under monopolistic controls?

Mr. YOUNG. Well, sir; I think I had better say that that kind of monkey business I did not include in the productive side of business which I have reference to there, sir.

Senator O'MAHONEY. Further, down on page 18, you say of the students of the high schools, high-school seniors:

Eighty-two percent do not believe we have competition in business.

Do you believe we have?

Mr. YOUNG. I believe that we have in the vast areas of business, sir.

Senator O'MAHONEY. What are the "vast areas of business"?

Mr. YOUNG. Well, I would say that we have it in virtually all small businesses.

Senator O'MAHONEY. Do you realize that many people in the category of small business are complaining?

Mr. YOUNG. They are complaining—they are probably complaining about these big businesses. And to the extent that we do not have competition in these big businesses it is due to this interlocking and there is a lot of that.

And I think it should be eliminated.

Senator O'MAHONEY. They are complaining about the high cost of money, too.

Mr. YOUNG. That affects small business as well, sir. And there the effects of noncompetition in business affect all businesses, small as well as large.

Senator O'MAHONEY. What would be your suggestion to this committee as to the best way for Congress to act to bring about the stimulation and growth of privately owned, as contrasted with collectively owned, private enterprise in the United States?

I ask you that question because you made a very pertinent remark here about the danger that unless these abuses of which you speak are not eliminated we may lose our system—

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. To others other than the Communists.

Mr. YOUNG. Yes.

Senator O'MAHONEY. What did you mean by that?

Mr. YOUNG. I think that first—one of the things that we must eliminate is this imbalance in our economy created by these perennial wage increases.

Two, I think that we have got to reduce our taxation from a third of the national—

Senator O'MAHONEY. Which is the worst, the wage increases or the credit increases—the interest rates that lie at the basis of all tight money?

Mr. YOUNG. I would say they are equally bad.

Senator O'MAHONEY. Would you reduce wages?

Mr. YOUNG. No. No. On the contrary, now, I do not think you can do that. I would just stop increasing them until these other areas catch up.

I believe—believe me, understand I am in favor—

Senator O'MAHONEY. You are not making the fight on wages?

Mr. YOUNG. No, sir. All I am making the fight on is the constant hiking of wages. In other words, I thoroughly believe with Mr. Ford, what I would like to see is the other areas catch up with labor.

It is the fact that we have a turtle and rabbit here. And most of us are turtles.

Now, I would like to see us all rabbits.

Senator O'MAHONEY. I beg your pardon?

Mr. YOUNG. I would like to see all of us rabbits. When it comes to this wage inflation I'd like all of us to have more money. But—

Senator O'MAHONEY. I suppose that anybody who has anything for sale, whether it be services, commodities or transportation, wants to have a purchasing power?

Mr. YOUNG. That is what I mean, sir. I think it is very dangerous to the economy to throw agriculture out of balance—to throw the

white-collar class out of balance—or to throw our aging out of balance.

I think it is very dangerous to have all of our aged sometime in the next 10 years suddenly find that the money they had from their pension and their savings is not going to keep them.

Senator O'MAHONEY. I remember very well when I was a youngster, in the State of my nativity, Massachusetts, living in a community where a dollar a day was about the customary pay for a wage worker. You remember those?

Mr. YOUNG. Yes, sir. I started out at 28½ cents an hour.

Senator O'MAHONEY. I started out at about \$10 a week.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. That—

Mr. YOUNG. But your \$10 probably bought as much as my 28½ cents an hour.

Senator O'MAHONEY. Absolutely.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. The value of money as a purchasing medium has constantly declined, has it not?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. According to all of the theories it has.

Mr. YOUNG. It certainly has.

Senator O'MAHONEY. So it is probably a question of how we will manage the money, rather than how much the wages will be or how much the interest may be.

It is the question of seeing that no one group gets more than its share.

Mr. YOUNG. There is the point. I would say that if the white-collar class, agriculture, transportation, service industries, the pensioner had all gotten 300 percent increase with labor since 1929, I would be all for it.

And it would not make the slightest difference to anybody if the prices were 3 or 2 or 5 times higher than they were, so long as we all had the same currency with which to buy it.

It is only when one gets more than another that I think that the situation becomes dangerous. And that goes for bankers as well as laborers.

Senator O'MAHONEY. What is the attitude, according to your experience, of the leaders of business in New York, a central city of business activities of the United States, with respect to the existence of monopoly and its bad effects upon our whole economy?

Mr. YOUNG. I think that the officers of the very institutions which are part and parcel of this great banking monopoly disapprove of it and resent it. I know that I found that some of these railroad officers resented the fact that they had to come down here to Washington when the bell rang and help the bankers fight competitive bidding.

But since, so long as they know that this interlocking control has the power to hire or fire them or promote them, they are going to let their true feeling be subordinate to their own personal good.

And I think that you would free, let us say, the General Electric Co. tomorrow, if you saw that no one served on that board who interlocked with any bank or insurance company or any other corporation. And that all of the directors of that corporation were substantial shareholders.

Senator O'MAHONEY. And you are saying in effect then—

Mr. YOUNG. And I think the president of the General Electric Co. would be the man who would be most highly gratified.

Senator O'MAHONEY. You are saying that the board of directors of the General Electric Co. has interlocking directors among its members?

Mr. YOUNG. I would rather say that I would rather not use that as a specific example, but let the chips fall where they may and let us say the XYZ electric company.

Senator O'MAHONEY. I can understand your unwillingness to specify one.

Mr. YOUNG. But I would say I would be surprised if the General Electric did not interlock all over the lot as most big corporations do. And on my chart I think you will find that General Electric there, but I would rather call it here today, say, the XYZ company.

Senator O'MAHONEY. In spite of your successful fight to win control of the New York Central from banker control, you still believe that banker control operates in the country among the big corporations?

Mr. YOUNG. I know it does.

Senator O'MAHONEY. You know it does?

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. What are we going to do about it?

Mr. YOUNG. Well, I think that the way to cure it is the one I have suggested, that no one should be allowed to serve on the board of one of our great American corporations and serve on any other great corporation board or on any bank, or insurance company board. It is just that simple.

I think that a man can have only one master, and that he should not be allowed to serve on several great corporations. Some of these investment bankers do on the boards of sixty companies.

Senator O'MAHONEY. And you would support legislation which would prohibit any banker or investment banker to sit upon the board of directors of any corporation with which his bank did business?

Mr. YOUNG. Well, I would go a little further than that perhaps. There was once a law passed which prohibited a banker from serving on an insurance company board.

Well, that was all very simple. The banker went on the General Electric board and they then put the president of the General Electric on their insurance-company boards.

It is that kind of thing that you have to stop.

So I would say that you ought to keep bankers, brokers, and insurance-company executives off of any board. I just do not believe any man is going to get—any corporation is going to get a square deal from a banker if the banker sits on the board and makes the deal with himself.

That was the way they tried to operate and did operate until we broke it up with the competitive bidding.

Senator O'MAHONEY. These are the words in which you made the suggestion in your previous testimony, and I am reading from page 1472, paragraph 7 of your suggestion at that time:

Prohibit the interlocking of directors and officers of banks, investment bankers, investment companies, insurance companies, mutual savings banks, pension funds and endowment funds and foundations with or through other large corporations.

Mr. YOUNG. Yes, sir.

Senator O'MAHONEY. That is your recommendation?

Mr. YOUNG. I would amplify that to say that no one should serve on the General Electric board and on the Du Pont board; and on the Du Pont board and on the General Motors board.

Senator O'MAHONEY. Do you think —

Mr. YOUNG. I would like to strike that last out, sir, because of being a former Du Pont man. Let us say on the General Motors board and on the General Electric board.

Senator O'MAHONEY. Thank you very much.

Mr. YOUNG. I correct my statement about Du Pont and General Motors so long as that 30 percent interest is there. That stockholder interest, I think, entitles them to interlock.

But where there is no stockholder interest, I do not think one great corporation should interlock with another, for example.

Senator O'MAHONEY. Am I correct in summarizing your opinion by saying that in your belief the abolition of monopolistic practices would be an effective way of stopping the abuse of credit and of stimulating actual free independent enterprise in the United States?

Mr. YOUNG. Yes, sir. And I would go so far as to say it might straighten out our whole foreign policy. [Laughter.]

Senator O'MAHONEY. Thank you very much.

Chairman PATMAN. Concerning the foreign policy, Mr. Young, I notice you said this, and I will just read the two sentences from your statement on page 5:

Last summer they bemoaned an appropriation of \$4 billion for foreign relief, for Heavens knows whom, because as they allege, it was not enough.

Any economist knows why the handout overseas, because it does not fill a domestic need, is more inflationary than a handout at home.

Under present conditions, big concerns in the United States can get plenty of money for overseas operations. That is correct, isn't it?

I refer to the World Bank, to the Export-Import Bank, its capital wholly United States funds, and the new International Finance Corporation, through those three big organizations, sponsored by the United States Government, they can get unlimited funds, up to billions of dollars, right now?

Mr. YOUNG. Yes, sir.

Chairman PATMAN. To deal with foreign countries overseas or to permit foreigners to have the loans?

Mr. YOUNG. Yes, sir.

Chairman PATMAN. And to make loans to big business and little business in foreign countries?

Mr. YOUNG. Yes.

Chairman PATMAN. But that same service is not available to the people here in the United States.

Mr. YOUNG. The American citizen is getting to be the forgotten man, sir.

Chairman PATMAN. For instance, I know a place where they have a perfect location for a cement mill. They have the natural limestone—they have everything. But you know, the cement people, they are on these boards of directors, too, of these insurance companies, and do you think they can get that loan?

Of course they cannot get that loan. They do not have a chance of getting that loan.

Mr. YOUNG. I know how it operates.

Chairman PATMAN. You have been through it.

Mr. YOUNG. It has been used against me, sir.

Chairman PATMAN. And you mentioned a while ago about the "Club" and about the members of the "Club" and how they operate and so forth.

May I remind you that when Mr. Humphrey came in as Secretary of the Treasury of the United States, he brought with him to run the monetary policy which meant deflation in 1953, bonds going up in 1954 and a few banks making \$260 million by buying low and selling high—he brought down here 5 of the 9 directors of the 1953 directors of the Federal Reserve Bank of New York, headed by Mr. Burgess to be the architects of this monetary policy.

And that is the policy that has made this system so uncertain.

Do not the bankers thrive on uncertainty? Do not they make more money that way by everybody being doubtful about what is going to happen and trying to protect themselves? Is it not better for the bankers and money lenders to have uncertainty than security and stability?

Mr. YOUNG. They are certainly the only ones that make money out of tight credit.

Chairman PATMAN. And the only ones making money out of this high interest. And what I can't understand is out of all of the different methods and vehicles and tools that the Federal Reserve System could have used to fight inflation, if there is actual inflation—I am not saying there is inflation, I don't think there is—and if there is, I am willing to do anything because we do want to stop it—but out of all of the tools that they have, they picked out the only one that would automatically increase, and arbitrarily increase interest clear across the board, in every household in America.

It will unbalance every budget in America, the higher interest rate. Six times they have raised interest rates and six times they must have considered it. "This is the only way we can do this." And six times they have agreed on the method that would unbalance the Federal budget, the State, the county, the city, the political subdivisions, all corporations, individuals, partnerships, even the household budget. Whenever you increase interest rates 1 percent the ultimate effect of that is over \$7 billion annually. Divide that by the number of people we have, over 160 million, and you will find that it costs \$40 a year for every man, woman, and child to have a 1 percent interest rate increase.

Now, that higher interest is paid by them, whether they know it or not. Talk about hidden taxes—this is the worst sort of a hidden tax. If they own a home, they have to pay increased taxes to the city in which they live, because the city is having to pay more interest.

And that is reflected in the tax bill, whatever the person pays. Every utility serving that city is having to increase its rates, because of higher interest. It goes all over the Nation in every home.

I cannot conceive of anything that is halfway as detrimental and destructive to the economic interests of our country as an arbitrary interest increase.

Would you like to make any additional statement?

Mr. YOUNG. All I can say is that it has increased the cost of our running the New York Central Railroad.

Senator O'MAHONEY. May I merely make this comment, Mr. Chairman?

I think it ought to be in the record at this point.

As I remember the statistics of the interest upon the national debt and the appropriations of Congress, the estimated interest on the national debt made by the Bureau of the Budget for the fiscal year 1957, which will be the period terminating on the 30th of June next, will be \$7,200 million.

That estimate was made before the President had recommended the cancellation of all interest upon the payment on the British debt which is presently to be made, and before it was released from the White House that the administration is planning to ask for a substantial expansion of economic expenditures abroad.

It was made before the request for a new loan which was announced last Saturday by the Treasury was contemplated.

So that it is quite evident that the interest upon the national debt of the United States for fiscal 1957 will be much more than \$7,200 million.

Before we became involved in World War II, the entire appropriation—this I would say was for fiscal year 1939—the appropriation for the entire cost of the Federal Government (the legislative branch, the executive branch, the judicial branch, all of the boards and commissions, and all of the services, including the Interstate Commerce Commission in which you are so personally interested) amounted to less than \$11 billion.

And now our interest upon the national debt alone is almost three-fourths or two-thirds of what the entire cost of Government was only 15 or 16 years ago.

The national debt, it was estimated in the papers yesterday, as the result of this new proposed issue, would be about \$278 billion.

The national debt was limited by Congress, by law, to \$275 billion under the Truman administration. The Congress on several occasions within the last 2 years has had to pass special legislation in order to permit the Treasury to go above the debt limit.

The debt of the United States is greater than the national debt of any country or people in all history.

And it is evident now that nobody can predict what the national debt will be for fiscal year 1958. Not only is it planned to make these additional expenditures abroad, but it is also planned to increase the appropriation for national defense.

Guesses upon that from Secretary Wilson and others in the Pentagon are rather vague as to what the exact amount will be. As a matter of fact, the President has gone so far as to prohibit any of the people in the Pentagon from giving out any information with respect to that.

But Congress will receive the information when the budget message is received. I have no hesitation in saying that it will be much greater because of this crisis than was dreamed possible when the Budget Bureau gave out its report just before the election.

But this thing I am quite sure will result from the facts which have been developing with respect to tight money. Unless we find a way by which the Federal Reserve Board will cooperate with the Government in financing the added debt which it seems as though it would be impossible for us to avoid, the burden upon the people and upon the economy will be greater by far than what was estimated.

The effect will be felt by every branch of the economy, from top to bottom. And the big banks, the big insurance companies, will not escape the bad effect, if this is permitted to go on.

I have been creditably advised that the Federal Reserve Board has held 3 or 4 executive hearings with economists—economists from the universities, economists from one group and from another group.

That is a very good sign. It indicates that the Federal Reserve Board realizes that the trouble is at hand.

But one thing, certainly, it seems to me to prove, Mr. Chairman, and that is, that restraint upon monopolistic practices by big business to gain control over all business of the United States must be found and imposed.

Chairman PATMAN. Thank you, sir.

I wonder how many automobile manufactures there were 14 years ago. I notice they only have 3 or 4 now from the last night's automobile show?

Mr. YOUNG. If you will go back 40 years you would find 50 or 60. There has been a constant attrition since then.

So there is almost a straight line.

Senator O'MAHONEY. Some of these automobile manufacturers, Mr. Chairman, are dependent upon the award of Government contracts to exist.

Mr. YOUNG. Correct. Really—really 2 or possibly 3 are able to survive in the automobile business so concentrated has that business become.

Speaking of your point, Senator, this may sound a little fantastic, but I do not believe we would have gotten into World War II had it not been for this banking control in New York.

It is that banking control that endorses these international policies and puts the stamp of approval on them.

And I say that our foreign policy is made more by that international group up there, than it is here in Washington. And we consistently blunder in all of our—the whole foreign policy area.

And I put the blame right up there in this interlocking.

Chairman PATMAN. Do you see any interlocking between the people you speak about and the dollar-a-year men in Washington?

Mr. YOUNG. They are virtually the same crowd.

Chairman PATMAN. Virtually the same crowd?

Mr. YOUNG. Yes.

Chairman PATMAN. Senator O'Mahoney—

Mr. YOUNG. That went for both administrations.

Chairman PATMAN. Yes, sir. I understand.

Of course, we had them under the Democrats, the same as under the Republicans.

Senator O'Mahoney brought up a point I think should be mentioned about the national debt, where it is doubly cruel to increase the interest on the national debt, it is because the national debt probably will never be paid.

In our capitalistic system, which is the finest and best system on earth that we have ever been able to find—and we all agree that it is the best—we must have debt in order to have money.

And we cannot afford to pay off the national debt. It would just cancel that much money and cause hard times.

And until the slack can be taken up by other loans, by other debts, in business or in industry or by the big folks, it would be detrimental to the country to reduce the national debt.

Therefore, considering the expansion, the next expansion and the natural expansion we will have, it is very doubtful that we will ever pay any part of this present national debt.

There is no sincere desire being manifested now to pay it—no effort made, because everybody knows it would be highly deflationary. That is the way to answer your inflation problem, if you have one, is to pay some on the national debt. That will help a lot.

But nobody is suggesting that, because we are keeping this debt in order to have a sufficient medium of exchange. Plenty of money.

And since this is for the convenience of the people only—and that it what it is—certainly, the Government should not be required to pay these excessive rates of interest on it—2½ percent is enough, because it is used for the convenience of the people.

Mr. YOUNG. It is certainly burdensome.

Chairman PATMAN. Yes, sir; it is burdensome. And it is getting more burdensome. Imagine paying 3¼ percent and then imagine going out here and asking these people to continue these savings bond drives, by getting 3 percent, if they keep their bonds 10 years, when they can go in the open market today and buy bonds, the bonds which they will receive 3.69 percent on.

So it is unstabilizing and uncertain and confusing everything.

Mr. Young, we certainly appreciate your testimony and your coming here. And if after reading your remarks, you desire to make changes or additions, why you may do so.

So again the committee thanks you very much for your attendance and testimony that you gave.

Mr. YOUNG. Thank you both.

Chairman PATMAN. The subcommittee will meet tomorrow at 10 o'clock. Mr. Martin will be our first witness and with him there will be the Open Market Committee.

(Thereupon, at 3:55 p. m., the subcommittee adjourned, to reconvene at 10 a. m., Tuesday, December 11, 1956.)

MONETARY POLICY: 1955-56

TUESDAY, DECEMBER 11, 1956

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

The subcommittee met, pursuant to recess, at 10:10 a. m., in the Old Supreme Court Chamber, United States Capitol Building, Washington, D. C., Hon. Wright Patman (chairman) presiding.

Present: Representative Patman (chairman), and Senator O'Mahoney.

Also present: Grover Ensley, executive director; William H. Moore, staff economist; and Reed L. Frischknecht, legislative assistant to Senator Watkins; John W. Lehman, clerk.

Chairman PATMAN. The subcommittee will please come to order.

At the start of yesterday's hearings I made a statement on the background and purpose of these hearings, which I shall not repeat since I understand that you all have had an opportunity to look it over.

I pointed out that this is only one of a series of studies made by the Joint Economic Committee, and emphasized that the determination of monetary policy is an important public function to be exercised in the public interest by public-minded servants.

I pointed out, moreover, that we must guard against the danger of making high interest rates and tight credit a permanent habit in the United States.

Now, Mr. Martin is here. We have with us Mr. Martin, Chairman of the Federal Reserve Board, as our first witness this morning, accompanied by the other members of the Federal Open Market Committee.

Without asking you to go into a complete analysis and giving your reasons, would you say whether you regard the forces in the current economic situation as predominantly inflationary—I will get back to that, Mr. Martin, if you please.

As today's hearings begin, I presume it is safe for us to continue on the assumption that the Open Market Committee and the Reserve authorities are currently pursuing a policy of monetary restraint in line with the policies of the past year or 18 months.

Perhaps you have answered these questions in your statement, Mr. Martin. I have not had the time to examine it. It has just arrived here. But we want these questions answered before you conclude your testimony.

You have supplied us with brief biographical sketches of the present members of the Federal Open Market Committee which I believe should be included in the record at this point, but I think it would be desirable for you to introduce for the benefit of those present each one of the gentlemen accompanying you, Mr. Martin, if you please. (The material referred to follows:)

**BIOGRAPHICAL SKETCHES OF MEMBERS OF FEDERAL OPEN MARKET COMMITTEE AS OF
DECEMBER 11, 1956**

MEMBERS OF BOARD OF GOVERNORS

William McChesney Martin, Jr., Chairman. Effective date of appointment, April 2, 1951. Reappointed effective February 1, 1956. Term expires January 31, 1970. Formerly president of New York Stock Exchange, chairman and president of Export-Import Bank, and at the time of his appointment was Assistant Secretary of the Treasury.

C. Canby Balderston. Effective date of appointment, August 12, 1954. Term expires January 31, 1966. Formerly director and deputy chairman of Federal Reserve Bank of Philadelphia, and at the time of his appointment was dean, Wharton School of Finance and Commerce, University of Pennsylvania.

M. S. Szymczak. Effective date of appointment, June 14, 1933. Reappointed effective February 3, 1936, and February 1, 1948. Term expires January 31, 1962. Formerly professor, College of Commerce, DePaul University, Chicago, Ill.; officer and director of bank; and at the time of his appointment was comptroller of the city of Chicago.

James K. Vardaman, Jr. Effective date of appointment April 4, 1946. Term expires January 31, 1960. Formerly engaged in business and banking in St. Louis, Mo., and at the time of his appointment was naval aide to the President of the United States.

Abbot L. Mills, Jr. Effective date of appointment February 18, 1952. Term expires January 31, 1958. Formerly engaged in banking since 1920, and at the time of his appointment was first vice president of the United States National Bank, Portland, Oreg.

James Louis Robertson. Effective date of appointment February 18, 1952. Term expires January 31, 1964. Formerly special agent of FBI; counsel to the Comptroller of the Currency; and at the time of his appointment was First Deputy Comptroller of the Currency.

Chas. N. Shepardson. Effective date of appointment March 17, 1955. Term expires January 31, 1968. Formerly director and chairman of Houston branch of the Federal Reserve Bank of Dallas; and at the time of his appointment was dean of the School of Agriculture of Texas A. & M. College, College Station, Tex.

PRESIDENTS OF FEDERAL RESERVE BANKS

Alfred Hayes, Vice Chairman. President, Federal Reserve Bank of New York since August 1, 1956. He was engaged in banking activities since 1933 and since 1949 he served as the vice president in charge of the Foreign Department of the New York Trust Co.

J. A. Erickson. President, Federal Reserve Bank of Boston since December 15, 1948. At the time of his appointment as president he was executive vice president of the National Shawmut Bank of Boston, having been associated with that institution since 1920.

Wilbur D. Fulton. President, Federal Reserve Bank of Cleveland since May 14, 1953. He began his service with the System as an examiner at the Federal Reserve Bank of Cleveland in 1933, advancing through the positions of chief examiner, vice president in charge of the Cincinnati branch, and first vice president.

Delos C. Jones. President, Federal Reserve Bank of St. Louis since February 1, 1951. He was in general law practice in Kansas City until 1945, when he was appointed general counsel and secretary of the Federal Reserve Bank of Kansas City.

Oliver S. Powell. President, Federal Bank of Minneapolis since July 1, 1952. He has been associated with the Federal Reserve Bank of Minneapolis in various official capacities since 1920, except for his service as a member of the board of governors from September 1, 1950 to July 1, 1952.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY ALFRED HAYES, VICE CHAIRMAN, FEDERAL OPEN MARKET COMMITTEE, AND C. CANBY BALDERSTON, J. A. ERICKSON, W. D. FULTON, DELOS C. JOHNS, A. L. MILLS, JR., OLIVER S. POWELL, J. L. ROBERTSON, CHARLES N. SHEPARDSON, AND M. S. SZYMCAK, MEMBERS OF THE FEDERAL OPEN MARKET COMMITTEE

Mr. MARTIN. All right, Mr. Patman.

I would like to say that Governor Vardaman, a member of this committee, is unable to be here today.

Chairman PATMAN. He advised me of his reasons, and I think they were valid and good ones, and he was excused.

Mr. MARTIN. Right.

On my left, I have Alfred Hayes, president of the Federal Reserve Bank of New York, and Vice Chairman of the Federal Open Market Committee.

Going counterclockwise, to my left is Leif Erickson, president of the Federal Reserve Bank of Boston, member of the Federal Open Market Committee.

D. C. Johns, president of the Federal Reserve Bank of St. Louis, member of the Federal Open Market Committee.

Oliver Powell, president of the Federal Reserve Bank of Minneapolis, member of the Open Market Committee.

Wilbur Fulton, president of the Federal Reserve Bank of Cleveland.

Coming to the right side and down toward me, Governor Charles N. Shepardson, of the Federal Reserve Board.

Governor James Louis Robertson, of the Federal Reserve Board.

Governor Abbot L. Mills, of the Federal Reserve Board.

Governor M. S. Szymczak, of the Federal Reserve Board.

And Vice Chairman of the Federal Reserve Board, C. Canby Balderston.

All of these are members of the Federal Open Market Committee.

Chairman PATMAN. You do have a prepared statement, Mr. Martin?

Mr. MARTIN. I have one.

Chairman PATMAN. Would you like to present it first?

Mr. MARTIN. I would like to present it first; and I would also like to say that it encourages me to have these gentlemen here, because it demonstrates that this is not a one-man operation.

Chairman PATMAN. That is right, and you may do it in your own way. And let me see if we can come to this agreement.

Mr. MARTIN. Fine.

Chairman PATMAN. We will have 2 hours this morning, and then we will recess for 2 hours and then we will come back this afternoon, after a recess of 2 hours, and continue on until we finish.

I believe that on the agenda we have you for 10 o'clock, and have Mr. Hayes for 2 o'clock this afternoon, but I think we can very well just go along, all of it together, and make it a continuous thing. Is that all right with you?

Mr. MARTIN. Perfectly all right, sir.

Senator O'MAHONEY. Mr. Chairman, may I ask a question?

Chairman PATMAN. If you please.

Senator O'MAHONEY. Does the statement of Mr. Martin that this is not a one-man operation, mean that the paper you are about to read, sir, is unanimously supported by all of those who surround you?

Mr. MARTIN. I can't truthfully say, Senator, that every word of it has been, but the gist of it is unanimously supported.

Senator O'MAHONEY. There is no important disagreement?

Mr. MARTIN. No important disagreement of any sort.

Senator O'MAHONEY. Thank you.

Mr. MARTIN. On behalf of my associates of the Federal Reserve System I want to express our appreciation for these periodic opportunities to appear before committees of the Congress. The Congress has placed a great responsibility upon the Federal Reserve System—a trusteeship, as I conceive of it, over money.

The Reserve System has always benefited from thoughtful inquiry. These hearings are not merely a public forum—and that all to the good. They provide a means of keeping the monetary machinery of the country abreast of the times. The Federal Reserve Act provides that we shall report directly to Congress and thus, through it, to the country.

The task of the Federal Reserve System, under today's conditions, is to determine the volume of credit that needs to be made available in order to keep the economy running in high gear—but without overstrain.

Too much credit would intensify upward pressures on prices. Too little could needlessly starve some activities. We have to rely on human judgments in this determination. There are bound to be differences in judgment—sincere differences.

We do not undertake—and I do not see how it could be otherwise, short of some form of dictatorship—to say how a given supply of credit shall be allocated.

Experience would seem to demonstrate that allocations of credit determined through the market process are to be preferred to judgments—or guesses—of public authorities, however well-intentioned.

I was told recently of a tongue-in-cheek sign that hung in a Washington office some years ago. It read: "Our guess is always best." It may be that collective judgments expressed through the market process are not always best, but that process is consistent with our heritage and our institutions under which direct governmental intervention in economic affairs is confined largely to broad, general policies necessary to protect and promote the public interest.

At any given time the economy is capable of producing a volume of goods and services limited by currently available resources, human and material. The difficulty throughout this year has been the attempt to crowd too much into a given time-period—demand, in brief, has been pressing strongly against the supply of labor and materials.

Creating more money won't produce more things when the economy is running at peak levels. A choice has to be made—and the public in the end has to make the choice of whether we shall have more of this and less of that.

We can have, in a given period, just so many houses, automobiles, household appliances, schools, manufacturing plants, and a myriad of other things, including ships, planes, submarines, and other essentials of defense. Under present conditions, something has to be given up at least for a time.

Throughout this year the combined demand for funds—for credit—coming from virtually all sectors of the economy has been at an all-time high. It has outrun the available supply.

Contrary to some impressions, the Reserve System has not reduced the money supply; in fact, the money supply has continued to increase this year though at a lesser rate than in 1955.

Moreover, the turnover—that is, the velocity—of the existing money supply has greatly increased. Although the so-called tightness of credit is often attributed to an insufficient supply of money, the fact is that the tightness results from the volume and intensity of demand.

The great bulk of loanable funds represents savings of the community made available to borrowers directly or through financial institutions other than commercial banks, such as mutual savings banks, insurance companies, savings and loan associations, private and public pension funds, finance companies, corporations, and individuals.

It is often forgotten that when the commercial banking system expands its loans and investments, it generates new money. When, as has been the case this year, aggregate demands for credit have exceeded savings, the only way to finance them all would be by an even greater expansion of bank credit—that is, by generating still more money.

And, as I have emphasized, creating more money will not create more goods. It can only intensify demands for the current supply of labor and materials. That is outright inflation.

The Reserve System—and it is a nationwide system of 12 Federal Reserve banks with 24 branches having all told some 260 directors representing varied walks of life—is united in the conviction that the best course is to do what the System can do, to restrain excesses arising from monetary causes.

It has been estimated that a rise of only 1 point in the consumer price index, Bureau of Labor Statistics, would cost the American public \$2½ billion a year.

The Federal Reserve System has been devoting its efforts, through varying times and circumstances, to assuring monetary and credit conditions that would help to foster high levels of business and employment, maintain the stability of the currency, and promote sustainable growth in the economy.

The System has sought to keep constantly alert to changes in economic and financial conditions, and to adapt its operations accordingly—leaning against the breezes of inflation and deflation alike, as I have put it a number of times.

Thus, when the economy had a downturn in 1953, the Reserve System acted promptly to stimulate credit expansion to help halt the decline and foster the recovery that began in 1954 and carried through into 1955.

As we moved from recovery to boom in 1955 and on through 1956, and as the economy in general pressed against the limits of immediate capacity, the System took steps to keep expansion of credit within the limits of the growth in resources so as to discourage excesses that would inevitably produce higher prices and severe economic maladjustments.

Focusing more closely on the events of 1956, it was apparent there were positive inflationary dangers inherent in superimposing a mas-

sive increase in business investment on an economy already featuring high utilization of resources and upward price pressures.

In this situation, to supply on easy terms all of the credit desired by prospective investors would have increased inflationary bidding for available resources, especially in the sectors of capital equipment and construction. It also would have involved a rise in the volume of outstanding credit, and in commercial bank credit and demand deposits in particular, that would compound the threat to economic stability and sustained growth.

Despite the restraint on credit growth and spending capabilities imposed by monetary policy, demands in many sectors have risen more rapidly than was consistent with price stability. The price advances that began in 1955, after several years of stability, continued during 1956, as output in a number of key areas pressed against the limits of capacity.

Price increases have been particularly marked in sectors affected by investment expenditures, in machinery and construction lines and, affected in part by them, in metals and metal products.

These are the areas in which the restraint imposed upon current expenditures by monetary policy was, quite possibly, the heaviest. It is in these sectors that such additional demand as would have resulted from easier credit would have been concentrated.

Despite the strength of credit demands, growth in total commercial bank credit was limited to a moderate rate, below the average of the postwar period.

Thus, the increase in total loans and investments of commercial banks in the 12 months ending with October was held to 2 percent, and growth in the privately held money supply—demand deposits and currency—to about 1½ percent.

Restraint on expansion in bank credit and the money supply this year contrasts with the rapid increase that occurred from mid-1953 through 1954, even though loan demands then were generally less active. During that period, policy was directed toward assuring ready availability of credit in the economy generally, and toward creating liquidity conditions favorable to revival and expansion.

In part, the developments since 1954 should be interpreted as a transition from a time of ready availability of resources, reduced demands for credit, and a monetary policy of active ease, to a time of intense utilization of resources, very strong credit demands, and a monetary policy directed to restraint of inflationary forces.

Just now, the year is coming to a close with demands still outpacing savings, with personal income at a new high annual rate of over \$332 billion in October—\$21 billion above the rate a year ago—and international disturbances that could add to further overstraining of our resources.

It is a situation that calls for alertness, as well as prudence and restraint, on the part of Government, business, finance, labor, and agriculture.

Basically, the problem confronting us now—in contrast to that of the early 1930's—is not one of creating millions of jobs overnight to cure mass unemployment, but one of sustaining the millions of jobs we have today and fostering new job opportunities for an expanding working force tomorrow.

Meeting that problem requires that the efforts of all of us be directed to preserving the stability of the economy, and the stability

of the dollar that underlies it, so that we may move steadily along the road to a higher standard of living for all of us.

That concludes my prepared statement, Mr. Chairman.

Chairman PATMAN. Complying with your suggestion that you want to make sure it is not just a one-man organization, I think it would be well at this point to suggest if any member of the Federal Open Market Committee, including members of the Board, have a substantial difference, if they would like to present that, they will be recognized at this time.

If they do not have a substantial difference that they want to bring up, they can either not say anything about it or wait and prepare something for the record. That will be acceptable.

But if either a member of the Board or of the Open Market Committee wishes to be heard in opposition to anything which has been said, the Chair would be very glad to entertain anyone who desires to do so.

I assume it meets with the approval of the Board.

Now, Mr. Martin, I read a statement the other day, I wrote it down, as coming from the Federal Reserve Board. It said the Board, through its control over the supply of money available to banks, has sought to discourage borrowing in an attempt to control inflation. It feels the labor force already is fully employed, and that further expansion in business activity would push up prices.

Is that a fair statement of the policy of the Board at this time?

Mr. MARTIN. I want to say on policy, Mr. Patman, that our policy is adapted from day to day, and that the policy of the Board at the moment is alertness to the general situation.

That has been a policy statement which would generally apply to the period we are coming up to, the year-end money market, and I don't want to in any way forecast what the policy of the Board may or may not be with the money market in the present condition, but I want to point out—

Chairman PATMAN. I did not ask for the future.

Mr. MARTIN. Our job—

Chairman PATMAN. I am asking for the past, if that has been the policy.

Mr. MARTIN. That has been the policy in the past.

Chairman PATMAN. That has been the policy in the past.

Another statement was that the Board felt that if the production of housing was increased by easier credit or easier terms or by making loans available which are not now available, that it would not cause an increase in housing because there is only a limited supply of labor and materials anyway, being fully utilized at this time; is that correct, or not?

Mr. MARTIN. Our feeling has been that the price of labor and materials would be—the price element is such that you would not create, by money, additional housing or any other—

Chairman PATMAN. You would just take it away from other production?

Mr. MARTIN. That is right.

Chairman PATMAN. That has been your feeling in the past?

Mr. MARTIN. That is right.

Chairman PATMAN. You state that you are trying to stop inflation, is that correct, that your activities have been directed in trying to

stabilize the dollar and the economy, and particularly by stopping inflation?

Mr. MARTIN. We have been trying to prevent the gap between savings and investment from being covered by bank credit, and adding to the money supply in a way that would produce upward pressure on prices.

Now, inflation comes from demand, not from costs, you see.

Chairman PATMAN. Yes, sir.

Wait just a minute. Say that again, please.

Mr. MARTIN. I said inflation, in its essence, comes from demand factors, not from cost factors. When the demand exceeds the supply, then—

Chairman PATMAN. When there are too many dollars chasing too few goods, I believe you said.

Mr. MARTIN. That is right. That is another way of saying that.

Chairman PATMAN. Well, you have said that.

Mr. MARTIN. Yes; I have said that.

Chairman PATMAN. Yes, sir.

Mr. MARTIN. Yes, sir.

Chairman PATMAN. Now then, if you have been fighting inflation, just name where the inflation, indicate to us where the inflation, has been. Naturally, we know it is not in the small business, it is not in agriculture, it is not in home building. Where is this inflation that you have been resisting?

Mr. MARTIN. Prices, Mr. Patman, have risen far more than I would have liked to have seen them rise in the last year and a half.

Chairman PATMAN. All right. Let's break that down. What kind of prices? Monopolistic prices, fixed prices, or prices in the open, free market, like agriculture? Certainly agricultural prices have not gone up. Which prices do you mean?

Mr. MARTIN. Well, recently agricultural prices have gone up slightly, but that is a demand-supply situation.

But in the overall economy, as evidenced by the general price index, the pressures on prices have tended upward for the last year and a half.

Chairman PATMAN. And you have been fighting the price increases?

Mr. MARTIN. We don't want those price increases to come about through credit expansion.

Chairman PATMAN. Through credit expansion.

Now, do you feel that in fighting inflation, you have all the weapons or tools that you need to do an effective job as an Open Market Committee or as a Board of Governors?

Mr. MARTIN. Well, we have general monetary controls which we apply. I think there are selective controls, such as housing credit and consumer installment credit, which we had at one time which could be used as supplements, but certainly not as alternatives to general controls.

But in an overall sense, the Federal Reserve Board has at the present time authority which we have been exercising in the field of overall money policy.

Chairman PATMAN. Do you feel that is adequate, Mr. Martin, to do an effective job?

Mr. MARTIN. Well, it is not adequate to do an effective job if the budgetary policy and the fiscal policy of the Government run com-

pletely counter to it, because money and credit policy is only one of the factors, important factors, in the problem.

I think fiscal and budgetary problems are—

Chairman PATMAN. Equally important?

Mr. MARTIN (continuing). Equally if not at times more important.

Chairman PATMAN. In your conferences with the Treasury, and since you have mentioned housing in particular, do you have in your conferences Mr. Cole, who is head of the Federal Housing Administration?

Mr. MARTIN. I have conferred with Mr. Cole once or twice. I have not recently had the privilege.

Chairman PATMAN. Once or twice.

You confer with the Treasury regularly?

Mr. MARTIN. I confer with the Treasury regularly, that is correct, sir.

Chairman PATMAN. Well now, if your object is not increasing interest rates, No. 1, which I am not charging but I think it has resulted in that, but if your object is to reduce the demand for housing, why did you not prevail upon Mr. Cole and the administration to raise downpayments, which they had the authority to do, on homes, and also shorten the term of the mortgages which would increase the monthly payments and certainly retard the production of homes? Why did you not consider that, instead of just arbitrarily raising interest rates, Mr. Martin?

Mr. MARTIN. Well, we have no responsibility, direct responsibility, in the mortgage field or the housing—

Chairman PATMAN. Did you try to do that? Did you try to reach Mr. Cole and try to do that?

Mr. MARTIN. No; I can't say that I directly talked to Mr. Cole; but the Board has from time to time, in our conferences with the Government, expressed its general point of view that in a time like the present, we should be careful.

I want to point out we don't want to reduce the level of housing at all. We merely want to have as much housing and as much of everything as we can have without producing inflation.

Chairman PATMAN. I know. But your statements, your statements, Mr. Martin, do not—of course, they do not contradict your desires or wishes, but they make them impossible.

Mr. MARTIN. Well, it is a complex operation, and what we are trying to do here—

Chairman PATMAN. And your statement is that you have not made an effort to get the administration to stop the housing boom, if you call it a boom, in the way and manner that I have indicated, by shortening the terms of the mortgages, which they have the right to do, or raising the downpayments, which they have a right to do.

Mr. MARTIN. Mr. Patman, in several meetings with administration officials, I have stated that to be one of the desirable objectives, in my opinion. But again, it is not my specific responsibility.

Chairman PATMAN. I realize that.

Mr. MARTIN. And only an opinion that I am basing—

Chairman PATMAN. Mr. Martin, what you have done every time has been to raise interest rates. Now, you mentioned over here that it has been estimated that a rise of only 1 point in the Consumer Price Index would cost the American public \$2½ billion a year.

May I invite your attention to the fact that the only weapon that you have used has been to arbitrarily and automatically increase interest rates, and with the knowledge that a 1-percent increase in interest rates on debts of \$700 billion, means ultimately an increase to the American people of over \$7 billion a year, not just \$2½ billion a year on a 1-point cost of living increase. It means a \$7 billion increase, which amounts to a \$40 increase for every man, woman, and child in America. For a family of 5 it is \$200 a year, in hidden taxes—in hidden taxes—the worst kind of hidden taxes, and that means that purchasing power has been diverted from the purchase of necessary things, conveniences and comforts, and even luxuries of life, to the payment of interest and service charges. I cannot see why you would not try to find some other tool to use, some other weapon to use, which would not be so devastating or destructive to the economy and to the individuals.

Did you try to find other weapons to use, Mr. Martin?

Mr. MARTIN. We have always avoided endeavoring to see interest rates go up. I have repeatedly stated—

Chairman PATMAN. You have raised them 6 times in the last 2 or 3—how long has it been since you raised the interest rates?

Mr. MARTIN. The interest rates were not raised by us specifically, Mr. Patman.

Chairman PATMAN. What is the discount rate?

Mr. MARTIN. The market process—the discount rate is the rate we charge member banks, Mr. Patman.

Chairman PATMAN. I know. You are not expecting us to be that naive. Now, what is it done for? You raise the discount rates to raise the interest rates; do you not?

Mr. MARTIN. We have tried very hard, Mr. Patman, to let the interest rates follow the course of supply and demand, and to see that money was available, but at a price so that we did not vitiate the forces of the market.

Now, when the demand became so much in excess of the supply of savings, there were obviously pressures on interest rates. I would like to see interest rates as low as it is possible to have them at all times. I am not in favor of high interest rates. I want interest rates as low as it is possible to have them without producing inflationary pressures.

But you must remember that when the demand and supply factors, which are always with us, are tipped in the direction of demand exceeding supply, that the saver, as well as the borrower, has some influence and some rights in the economy, and that the interest rate, the role of interest rates, comes into play at that time in terms of a higher interest rate.

Our discount rate has tended to follow the market, not to lead the market, in my judgment. We have attempted minimum intervention in the market, not trying to make the rates.

We do not believe we make business; we do not believe that we make interest rates.

Chairman PATMAN. All right. Let's see.

The President, at a news conference during the election, told a reporter that his administration did not set interest rates. You remember that; do you not?

(The article referred to follows:)

[From the Washington Post and Times Herald, December 6, 1956]

IKE DISCLAIMS ANY ROLE IN FRB CREDIT MOVES

(By Bernard D. Nossiter, staff reporter)

President Eisenhower yesterday disclaimed responsibility for the Federal Reserve Board's credit-tightening moves, declaring that the agency is independent.

He did not comment directly on a reporter's statement that the administration had helped lift interest rates. But he said at his news conference, "The Federal Reserve Board is not under my control, and I think it is proper that the Congress did set it up as an independent agency."

He thus reaffirmed a position he took last April. Mr. Eisenhower characterized a suggestion that he could influence the Board as a "premise that isn't quite correct."

DEMOCRATIC CHARGES

He thereby sought to blunt Democratic charges that his administration had fostered tight money policies hurting local governments, home buyers, small business, farmers and other.

The President's replies dealt with a relationship that has troubled congressional committees.

Legally, the Board is responsible solely to Congress. The President's only formal connection is the appointment of the 7 Reserve Governors to their 14-year terms. The present Chairman, William McChesney Martin Jr., was named by Mr. Truman and renominated by Mr. Eisenhower.

As a practical matter, close links are maintained between the Board and the executive branch. Martin has testified that "in taking any important action, the Board gives careful consideration to policies indicated by the executive * * * in order that its policies and those of the Government as a whole may be integrated to the fullest extent practicable."

Martin lunches with Secretary George M. Humphrey at the Treasury on Mondays; Under Secretary W. Randolph Burgess returns the call on Wednesdays. In between, there are continuous consultations between the Treasury and Reserve staffs. Martin also consults frequently with Arthur F. Burns, Chairman of the President's Council of Economic Advisers.

BOARD'S INDEPENDENCE

But a dramatic example of the Board's independence was displayed in April when it approved increases in discount rates despite administration opposition. The discount rate is the charge paid by commercial banks on loans from Federal Reserve banks.

Both Humphrey and Burns questioned the move before it was taken. The President's economic aide, Gabriel Hague, was present at one of these talks. Secretary of Commerce Sinclair Weeks and Secretary of Labor James P. Mitchell criticized the rate rise later.

When the rate was raised again in August, the administration maintained a discreet silence, although it is believed it approved.

In a speech Thursday, Burgess pointed to the heavy loan demands and said if the Federal Reserve "encouraged an expansion * * * the result would be inflationary." He added that "too freely available loans would make matters worse by encouraging even more feverish bidding for scarce resources at higher and higher prices."

While discount rate changes which affect all other rates get major attention, a major Federal Reserve influence over money supply today is achieved through its open market operations. By buying and selling Government securities with newly created money, the Board adds or subtracts to commercial banks' reserves. Since banks must keep a specified portion of their deposits on reserve with the Board, their power to lend depends on the amount of these reserves.

Mr. MARTIN. I think I probably do, yes, sir.

Chairman PATMAN. And you also remember that he had to accept the interest rates that you establish at the Federal Reserve. You remember that, do you not?

Mr. MARTIN. Well, I would have to have the President's statement directly in front of me. But, regardless of who said it, the interest

rates are not set apart from the forces of the market. If they are, we are not—

Chairman PATMAN. Well, the President thinks so.

Mr. MARTIN. What?

Chairman PATMAN. The President thinks so. He thinks the Federal Reserve establishes the rates.

Mr. MARTIN. Well, I won't comment on the—

Chairman PATMAN. He said he was not responsible because the Federal Reserve establishes the rates, and I think everybody else thinks the Federal Reserve establishes the rates. I think so.

And Mr. Eccles testified one time—I think he knows a little bit about the Federal Reserve System—he said that you could establish the rate at 2½ percent on Government bonds and keep it that way indefinitely if the Federal Open Market Committee had the same power it has now, just keep it there indefinitely.

Mr. MARTIN. Mr. Patman, as I have testified before, we could do that if we want to depreciate the dollar at the same time.

Now, I assume we are trying to have a dollar whose purchasing power is maintained in the interest of all of us.

Chairman PATMAN. Certainly.

Mr. MARTIN. The little man, the pension fund, the saver.

Chairman PATMAN. But in doing that, we do not want to create more injustices and inequalities and discriminations; and the view of many people right now is that this is creating more injustices and inequalities than necessary.

You have raised this rate six times, Mr. Martin.

Now, the first time, did you seriously consider other tools and methods that you had to deal with it, and without raising the rate?

Mr. MARTIN. Well now, again, we are not responsible or we have no direct authority in the field of the budget or fiscal policy or other instruments outside of the money and credit field. But I insist that in raising the rate, the rate was moving up—and don't forget, this is the rate at which we permit banks to borrow from us.

Chairman PATMAN. That is right.

Mr. MARTIN (continuing). The rate was moving up in response to the demand for credit.

Now we are living in a period of prosperity, and the problems of prosperity—I regret any injustices or inequities that occur at any time in the community, but the economic problems of prosperity are frequently more difficult than those of adversity.

I am awfully glad we are wrestling with the problem of prosperity, however, and not with the problems of deflation at the moment, but these inequities and inequalities we always regret. What we are dealing with is a highly prosperous economy, and we are trying to serve the interests of all of us by having a dollar which we believe underlies everybody's stability and which is of benefit to the little man as well as to the big man.

Chairman PATMAN. We do not argue with you about your objective. We are all in accord with your objective, Mr. Martin.

Mr. MARTIN. You and I are in complete agreement with our objective.

Chairman PATMAN. The only argument we have with it is the method used.

Mr. MARTIN. The method.

Chairman PATMAN. In other words, a lot of people think you are just doing it to help the money lenders and the bankers. I do not charge you are doing that at all. I think you are acting conscientiously and sincerely.

Mr. MARTIN. Right.

Chairman PATMAN. But at the same time, when you are doing it six times and you never can find any other method, there is a lot of corroboration to people who just want to make that charge.

Mr. MARTIN. Well now, let me just make one comment there, Mr. Patman, because you and I are seeking the same objectives.

Chairman PATMAN. That is right.

Mr. MARTIN. During the last year and a half, we have had a steady increase in the gross national product, and tight money, so-called tight money, which has been an excess of demand over supply, has not been a sign of bad times or of disaster or of collapse.

It has been one of the strengths in our economy, an indication that we could have rising interest rates and that the saver could benefit as well as others, and that the economy could go ahead.

At no time have we wanted to see the economy strangled or the standard of living reduced. We have tried to induce saving and to reduce spending so as to sustain our prosperity.

Chairman PATMAN. You have not exhausted all your methods by any means, to handle this thing without increasing interest rates, if I know anything about it at all.

You take, for instance, the margin requirements, although it is a minor matter, yet if you have inflation the first thing you want to do is to make your regulation so that people cannot speculate in the stock market, because that is certainly something which creates an inflationary condition.

That is number one. Of course, it is small, I will admit that.

Mr. MARTIN. We made two changes in margin requirements.

Chairman PATMAN. I know, but not lately, not lately.

Mr. MARTIN. But also, the volume of credit in the stock market has—

Chairman PATMAN. I say it is not a major one, but if you were really fighting inflation, that might show that you are not as much interested in that portion, you are not willing to stop that part of inflation; that you are willing for that to go ahead.

Mr. MARTIN. We don't think this—

Chairman PATMAN. We have from 4 to 6 billion dollars in the banks of the country at all times without interest. Now, if you want to stop inflation, why is that money not withdrawn? There is no reason for it being there, anyway, with the use of the Federal Reserve for that purpose, to take care of any tightness in the banking system. It is not necessary. They are not needed. They are not drawn on—from 3 to 6 billion dollars there at all times.

If you are fighting inflation, why do you not have that money withdrawn, because as it is, it is a basis for an expansion of six times that much in new money, and that is very inflationary. Yet you let that go ahead. You do not say a word about that, and the stock market; but you jump on the home builders and the small-business man and agriculture.

You talk about farm prices going up. They haven't gone up to the farmer; they have gone down for the farmer.

Mr. MARTIN. Well, I pointed out the demand-supply situation in farm products, and the—what we have tried to do is to let the forces of supply and demand have some play, and intervene to a minimum in the market.

Chairman PATMAN. I am talking about methods that you could use. You could suggest more taxes. That is the best thing against inflation.

Mr. MARTIN. Well, I have—

Chairman PATMAN. Or you could reduce the national debt. That is a good thing to stop inflation. And you have not suggested either.

In other words, the Board has arrived at only 1 conclusion, high interest, every time, 6 times—high interest. And you never considered any of these others, so far as I know.

That is what I am asking you, if you considered the taxes, reduce the national debt, reserve requirements. You have the power. It has been used by the Board a number of times. Reserve requirements; a good method.

Mr. MARTIN. Well now, take reserve requirements—

Chairman PATMAN. Let me name them all first, and then you can— if it is all right with you, Mr. Martin.

Mr. MARTIN. Yes.

Chairman PATMAN. And then the open market; it is a natural. You can do anything with the open market. You have unlimited power to buy and sell securities; you can make the money tight, money easy. You have complete control over it, and you have the Bureau of Engraving and Printing over here to back you up in it.

And not only that; these housing payments can be changed, and you have a number of ways.

But as it is now, if you make it hard for everybody by raising interest rates, the inequalities and injustices, the way I see it, are that the little man is hurt, the farmer is hurt, the home builder is hurt, but the big-business man who is expanding about 35 or 36 billion dollars a year is not hurt at all. He is going right ahead. He is not stopped for the reason that he has retained earnings, which is costless capital to them. He has depreciation. And then he can go into the banks; he can see that money is going to be tighter, and a prudent businessman will go into the bank and say, "Money is going to be tighter. I am going to tie up some funds for the next year or two." That is what they all do.

That makes it harder on all the other people. So it looks like you are favoring the big-business people who can get the benefit of all this; and the rank and file over the Nation are harmed and hurt by it.

Mr. MARTIN. Well, now, would you like me to comment on those, Mr. Patman?

Chairman PATMAN. Yes, sir; if you will. [Laughter.]

First, here is what I want you to comment on. I want your comments on why, every time, you just found the only weapon to use was to raise interest rates, and you could not at any time use one of these others.

That is what I would like you to comment on, in particular.

Mr. MARTIN. Well now, I want to start by saying that fiscal authority is not ours, and the budget authority is not ours. I have discussions with the Secretary of the Treasury in those fields, but those are important devices that can be used that are not within the control of the Federal, and I am limiting my remarks to the authority and respon-

sibility of the Federal Reserve, not to the whole gamut of devices that can be used.

Now, we have tried to approach this with a sincere desire to build as high levels of employment and as high a standard of living as is possible, recognizing that we have a responsibility in the money and credit field here, but that we are not all-controlling; that business has got to make its own decisions and develop its own technology.

Let's take the items that you suggest. We have operated in the open market—

Chairman PATMAN. You have what?

Mr. MARTIN. We have operated in the open market consistently.

Chairman PATMAN. But only in short-term securities.

Mr. MARTIN. We have tended to confine our operations to short-term securities.

Chairman PATMAN. How long have you confined your operations to short-term securities and not gone into the long-term market at all?

Mr. MARTIN. With very few exceptions, for a period of several years, because we have preferred to deal in the nearest equivalent to money that there is, so as to have the minimum of interference in the market itself, give the market an opportunity to have as much of a play as possible.

Let's take reserve requirements. Supposing we had, instead of raising the discount rate, supposing we had raised reserve requirements. We would have put much more pressure on the market. We would have forced interest rates higher.

Chairman PATMAN. It would not have automatically done it, Mr. Martin.

Mr. MARTIN. Almost automatically.

Chairman PATMAN. It would have been gradually in certain areas. It would not have hit every area at the same time.

Mr. MARTIN. Oh, yes; in my judgment it would, Mr. Patman. It would have been a blunter and a more severe instrument than the modest adjustments that we made in the discount rate, permitting the money supply to expand so that money continued to be available, but that the cost of it rose gradually in terms of the demand for money.

Now, if that demand slacks off, why, the interest rate will tend to go down also; and if the demand continues, it will go up.

Now the minor adjustments we have made through our open-market operations: We have been consistently and persistently in the open market trying to keep our operations to a minimum, but to see that the money supply had a reasonably steady flow.

That is why we avoided in this period the more blunt instrument of increasing reserve requirements. We want the banks to have adequate reserves. We do not want to starve the economy, but also we don't want this gap between saving and investment to be closed by bank credit, because that endangers the solvency of all of us, and is bound to have an impact.

Chairman PATMAN. All right.

Now, on that bank credit, the other day you authorized an increase to 3 percent in the payment of interest by commercial banks on savings and time deposits.

Mr. MARTIN. Yes.

Chairman PATMAN. Well, now, I do not see how you could consider that meeting and trying to stop inflation, because, No. 1, whenever

you raise it you induce people who have their money in a Federal savings and loan to bring it from the Federal savings and loan, where it can only be loaned 1 time, to put it in the savings department of a bank where it can be loaned 20 times, do you not? And not only that, you cause a race between the savings and loans and the commercial banks on the interest rates that they will pay, just like you have got it now on the housing loans; you have got the FHA in competition with the Veterans, raise one and then raise the other. You have got a race on between the savings and loans and the commercial banks.

How does that help to fight inflation, Mr. Martin?

Mr. MARTIN. Mr. Patman, that regulation Q had not been changed for roughly 20 years, as you know.

Chairman PATMAN. I am talking about the present situation right now, when you are fighting inflation.

Mr. MARTIN. All right. I welcome your interest in that as to whether it will fight inflation or not. We have to experiment a bit and see—by “experiment,” I mean we are not absolutely sure, ourselves, what will be produced by that adjustment.

But no change had been made in that rate for a period of about 20 years. Now, this is a permissible rate. The banks do not have to pay the 3 percent. This is a limit which they can authorize, or not, as they see fit.

But in 1933 and 1935, in order to protect the solvency of the banking system, we eliminated the payment of interest on demand deposits, and I think that should be retained.

Chairman PATMAN. Well, the law did that, Mr. Martin.

Mr. MARTIN. The law did that. I didn't mean the Federal; I meant the law.

Chairman PATMAN. I think it was just put in there for the emergency, and it has remained there ever since. I do not think it was ever intended to stay on the books.

Mr. MARTIN. Well, I think it has some advantage, but when you come to the time and savings deposit area, certainly the interest-rate structure has changed in the last few years, and to deny banks that want to pay more interest the right to pay rates that would be more in line with the current rate seemed to us to be an unwarranted intrusion on our part in their managerial capacity, and we felt that we were warranted in doing that.

Chairman PATMAN. For that reason.

Mr. MARTIN. Now, it may create some of the problem that you are talking about, and I welcome and share your apprehension as to whether it might not—it may not achieve all of the things that we think of it.

But our purpose there—and I am inclined to think in the long run it will—our purpose is to reduce spending and increase saving, with a little higher rates.

Chairman PATMAN. All right, I am going to ask about that later.

Mr. MARTIN. All right.

Chairman PATMAN. At this time I want to ask other members of the Board if they are in accord with your statement that the Federal Open Market Committee should only engage in buying and selling short-term paper, and not engage in long-term paper.

Mr. MARTIN. Well, any member—

Chairman PATMAN. If all members are in accord with you on that.

Mr. MARTIN. I won't speak for all the members. They are at liberty to speak for themselves.

Chairman PATMAN. Is there any member who wishes to be recognized on that point?

Mr. HAYES. Yes, Mr. Patman. I would just like to say this: As you know, I am brandnew in this System. I haven't had more than, much more than, 4 months to get acquainted with it.

I am aware, in a general way, of some of the discussion that has gone on in the past on that subject. But I certainly haven't had an opportunity to form any strong conviction on it.

I would like to add this: that in my observation during these months, the present policy of sticking to, practically sticking to, short-term securities has worked very well. There has been no occasion that I have seen to bring up the point.

It doesn't seem to me that it has been a practical consideration. I think things have worked well under the present technique of short-term issues.

Chairman PATMAN. All right. Thank you, Mr. Hayes.

One other point, and I want to yield to Senator O'Mahoney, because he has a crowded schedule today and he wants to ask some questions.

Mr. Goldenweiser was recognized as one of the greatest experts of the Federal Reserve System; was he not, Mr. Martin?

Mr. MARTIN. He was one of the top men.

Chairman PATMAN. Dr. E. A. Goldenweiser. And his writings and views are always respected by those in the banking fraternity.

Mr. MARTIN. Always respected; but Dr. Goldenweiser was not always infallible, any more than any of the rest of us.

Chairman PATMAN. You are anticipating what I want to read. [Laughter.]

You see, Dr. Goldenweiser said in this book on Banking Studies; he said:

It is generally true that a period of very high interest rates is followed by a business recession, while a period of low interest rates is likely to be followed by business recovery.

Now, where that is important—just like some of the businessmen here testified yesterday, that a prudent businessman, when he can see rising interest rates, goes in and borrows money in advance. Sometime you are going to reach the top; we do not know when it will be.

I want to ask you about that after Senator O'Mahoney gets through, but sometime we are going to reach the top, and then it is bound to be just like Dr. Goldenweiser says here, there is going to be a recession, because as you start down people will not be anxious to borrow funds, because they will pay more for them by borrowing them in advance; they will be anxious just to hold tight, sit tight, and wait and see how low they finally go, and this will tend to be a depressing situation.

Do you not agree to that?

Mr. MARTIN. Well, let me comment on that, Mr. Patman. If we think that the Federal Reserve Board, or any other agency of Government, has the power to eliminate all recessions in the economy, I think we are making a serious overstatement of our ability. Recessions come from a great many causes, among them being overcon-

fidence and incompetence and inefficiency, and all the other factors that human beings engage in that lead to maladjustments.

Now, those who attach so much importance to monetary policy as to think that it will destroy the economy and create a recession have more faith in monetary policy per se than I have, and they have less faith in the economy than I have.

It is my conviction that, with the normal ingredients of growth which we have in the economy today, and with the human fallibility of people such as we have, there may be mistakes made in money and credit policy from time to time; but that, as long as we provide a reasonable availability of funds, the demand and supply factors in the economy are such that the ingenuity and the ability and the competence of the American businessman will be able to overcome those mistakes, and that we will rebuild and go back up.

Now, I have a great deal of faith in the American economy. I don't think any of us has found a means of pulling a lever to make these adjustments.

You remember that you and I discussed the 1953-54 recession at length. Now, regardless of whether the Federal Reserve, and the Treasury had been perfect in their handling of the money market, and I don't think we were, as I testified before you, I still think there would have been a recession at that time, because there had been an ebullience in the economy in the post-Korean period which had to be corrected; it had to be corrected by the minor recession, inventory recession, that we had, because these forces of demand and supply are the only means we have —

Chairman PATMAN. You are overlooking higher interest rates, too.

Mr. MARTIN. That adjustment was made by the market. If business starts declining actively in this country, interest rates will start declining also. I hope it won't.

Chairman PATMAN. Let me make this statement; I want to yield to Senator O'Mahoney.

I am not objecting to the unavailability of money so much as I am to the fact that only a few people can get that money; and I am not objecting to the fact that construction money is not available so much as I am objecting to the fact that only a few people can get that construction money, and it is not for home building, it is not for small business, and it is not for agriculture; it is for the people who are spending for plant and equipment and who are getting their funds mostly from the consumers in the form of high prices.

I want to yield to Senator O'Mahoney.

Senator O'MAHONEY. Thank you, Mr. Chairman.

May I say first that I feel personally very grateful that all of the members of the Board and your associates have come to us today, Mr. Martin, to testify with respect to this problem. I think that there is probably no problem, save only the Middle East problem, that demands more public attention than this one.

That explains why television wanted to take your picture this morning while you were testifying.

In preparation for this hearing, I hastily sent out, toward the end of last week, a letter to the president of every bank in the State of Wyoming, in order that I might have the benefit of the advice of these gentlemen with respect to the problem.

I am not going to read all of these letters to you. I am going to read extracts from only two.

The first one which I choose comes from a banker whom I have known many years, in an agricultural area, and I read his because he is a Democrat, a riproaring Democrat, and a good supporter of mine. Now, this is what he says:

I have given this matter consideration, and in my opinion the Federal Reserve Board is taking the proper steps. A runaway inflation, probably followed by a bust, would cause more suffering and dislocation of business than will likely result from the policy of tight money now being pursued by the Federal Reserve Board.

I thought it might make you feel good if I should read that to you at the start. [Laughter.]

Now I am going to read an extract from a Republican banker [laughter] who takes a good deal of interest in politics. Some people seem to think there is a difference between politics and business and between politics and government; but, of course, under the American system, politics is only the art of making the Government do what the people think the Government ought to do in their best interests.

Now, this is the Republican banker. You see, I refrain from giving the names, but I will be glad to show the letters to you personally.

Mr. MARTIN. Right.

Senator O'MAHONEY. I have not received all of the letters yet.

A look at the statements—

I am reading now from this letter—

A look at the statements of commercial banks throughout the Nation will reveal that the relative percentage of deposits they have invested in Government securities is going down, and the amount of funds invested in loans is going up. In other words, our banking system is becoming less liquid.

It would be bad indeed if the time should arrive when, because of this stringency, the banks will be forced to resort to selling Government bonds on the present market in order to provide cash for their deposits.

These extracts I have read are just for the purpose of having a little interlude here before I refer to some of the statements made in your testimony, Mr. Martin, and some of the testimony which was offered to us yesterday.

I would like to ask you to turn to page 4 of your statement. In the middle of the page there is this paragraph:

The System has sought to keep constantly alert to changes in economic and financial conditions, and to adapt its operations accordingly—leaning against the breezes of inflation and deflation alike, as I have put it a number of times.

Now, what are the technical steps which you take to keep alert to the changes throughout this vast country of ours?

Mr. MARTIN. Well, every 3 weeks, and sometimes oftener, Senator, the Open Market Committee meets. They have economists in the 12 banks and the 24 branches that are reporting to them constantly. This committee meets as a committee of the 7 members of the Board and the 5 members of the Open Market Committee, and also the other presidents of the Reserve banks come in to those meetings. They do not have a vote, but we ask them to come in, also.

It places a particular hardship on those in the Far West, from San Francisco or Texas and other places, who fly in, but they have been very regular in their attendance.

We review, we have a Department of Research and Statistics in the Board, and we review all these reports that we are getting daily, and go over them and try to assess them, evaluate them, and try to bring to bear all of the best thinking that we have in the System.

We do that formally every 3 weeks.

The head of our Department of Research and Statistics is doing it daily. We also have directors from all of these banks. There are 12 banks and 24 branches, roughly 260 directors. We ask those men to send us, either to the Board or through their local Reserve bank, any straws in the wind that they see, because we are dealing with the future as well as present, you see.

Our statistics at the present may be very good, but there may be signs of danger in the future. So that we are trying to bring in, to get as many straws in the wind as we can.

We also have a Federal advisory council. Mr. Fleming, here in Washington, is the president of that. That is composed—that is a statutory group which is—

Senator O'MAHONEY. You mean Mr. Fleming, the president of the Riggs National Bank, or chairman of the board?

Mr. MARTIN. Of the Riggs National Bank, or chairman of the board.

Senator O'MAHONEY. We have several Flemings in the Government. This man is outside of Government?

Mr. MARTIN. That is right.

And this is a statutory group that was set up in the Federal Reserve Act. They are 12 men. They meet with us quarterly, and we ask them to send us any straws in the wind that they get.

Senator O'MAHONEY. Now then, Mr. Elliott Bell testified yesterday and expressed the opinion that the tight-money policy, so-called, has been injurious to the building of homes, it has been injurious to small business, it has been injurious to the building of schools by municipalities and local districts.

Has that been reported by your various members?

Mr. MARTIN. We have had constant comments on that, on those points, and there are differences of opinion.

Senator O'MAHONEY. I felt sure that, of course, you had the information about it.

Now, is it your opinion that if the high-interest rate on school bonds prevents communities and States and school districts from building schools which the schoolchildren of the Nation need, nevertheless you should follow a policy which would keep the rate on such bonds up?

Mr. MARTIN. Well, Senator, the point there is whether it would help to have a school issue financed, say at $3\frac{1}{4}$ percent, and then, after the money was raised, to have the price of the materials that go into that school increased by, let's say, 15 percent?

Senator O'MAHONEY. Is it a necessary conclusion that they would increase?

Mr. MARTIN. Certainly that is the tendency—if the demand for credit—if there is intense utilization of resources, certainly that is the tendency. And it is happening all around the country.

Senator O'MAHONEY. I come from a State the resources of which have not begun to be developed.

I can say that for the whole Rocky Mountain area.

I can say for Texas that the resources of that State have not been developed.

Would it be inflationary if schools could be built to make a new demand upon those resources?

Mr. MARTIN. I am completely with you, Senator, in believing that the resources of this country have scarcely been tapped. It is a matter of time and in the way they are tapped, the business process.

Recently—I will give you one example on the school issue, since you have raised it, that came to my attention several months ago—in the State of Tennessee, a school issue could be financed in one place at 4 percent.

Actually they were limited by law to $3\frac{1}{4}$ percent. I think that school issue would have done well to have taken the 4 percent money. And I think this has happened in hundreds of other places, if the demand for the school was there. Or they should have deferred it until a time when perhaps the cost of labor and materials may not be so rapidly rising.

Senator O'MAHONEY. Mr. Levitt, of New York State, testifying before our committee yesterday, said that there was a substantial amount of school building that had been postponed because of this high interest rate.

And in the New York Times of this morning on page 46, I find a story headed, "Employment Dips 900,000 in Month. Decrease is Almost Entirely in Agriculture. Number of Jobless up 550,000."

If it be true—and I think these are official statistics—that unemployment is beginning to appear, perhaps, it ought to be a signal to your Board that a change in policy is necessary.

Would you think so?

Mr. MARTIN. I certainly think we should be alert, Senator. And as I say, those are the forces in the economy that in my judgment are, in the long run, controlling.

I have a chart here which Mr. Young gave me on the cost of apartments and buildings, how they have been rising, which you might like to have for the record just as a matter—

Senator O'MAHONEY. Which Mr. Young?

Mr. MARTIN. Mr. Ralph Young, the head of our Department of Research.

Senator O'MAHONEY. Not Robert Young?

Mr. MARTIN. No, it was not. [Laughter.]

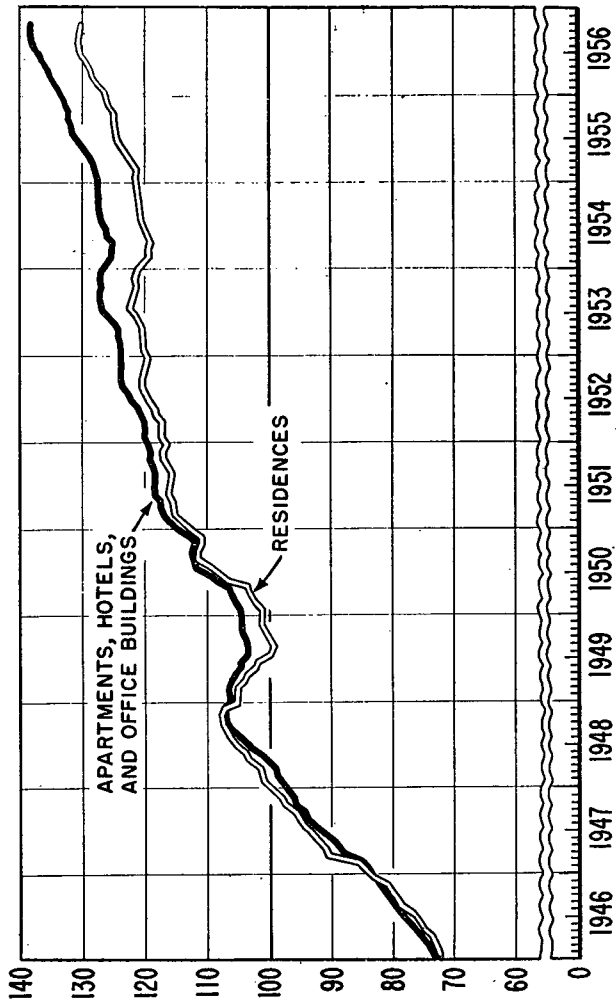
Senator O'MAHONEY. Now then, may we keep this?

Mr. MARTIN. Oh, certainly. Certainly.

(The chart is as follows:)

INDEX: 1947-1949=100

**BOECKH INDEXES OF CONSTRUCTION COSTS FOR: (1) RESIDENCES;
AND (2) APARTMENTS, HOTELS, AND OFFICE BUILDINGS**



Prepared by Housing and Home Finance Agency

SOURCE: U.S. Department of Commerce

Senator O'MAHONEY. I would like to look at it again.

On page 57 of the New York Times this morning I find this heading— I haven't had time to read the article—Three Savings Banks Actually Increase Interest From 3 to 3 $\frac{1}{4}$ Percent.

I think it has been pointed out by the chairman that the savings and loan associations are competing for savings with much higher rates of interest. And of course, I know that the savings and loan associations operate under different circumstances from the banks. But this indicates, does it not, that there is a shortage of money, that is, money is less than is demanded?

Mr. MARTIN. That is correct.

Senator O'MAHONEY. Your judgment is that the demands are so great that we cannot allow them to be supplied, because it would drive

up the cost of living, the cost of materials and other things. You have no doubt about that at all?

Mr. MARTIN. Well, unless all previous experience is wrong, if our analysis is correct, the economy is trying to buy more than there is in the aggregate at a given time and additions to the money supply will put prices up.

Senator O'MAHONEY. But you change your opinion every once in a while?

Mr. MARTIN. Oh, exactly. And these articles that you are reading us will be considered by the Open Market Committee. We just had a meeting yesterday

Senator O'MAHONEY. Perhaps you will have one tomorrow.

Mr. MARTIN. We will consider that item that you refer to.

Senator O'MAHONEY. Can I wire my banks in Wyoming—

Mr. MARTIN. I would not.

Senator O'MAHONEY. That there will be such a meeting?

Mr. MARTIN. I would not be too precipitate about it. But it will be a factor that will be considered.

Senator O'MAHONEY. My point, Mr. Martin, is, that you gentleman come to a judgment about this, and it is based upon the material that you gather through your staff. Is it not?

Mr. MARTIN. We come—

Senator O'MAHONEY. And necessarily, there is a time when you feel that interest could go too high. I understood you to say so in response to one of Mr. Patman's questions.

Mr. MARTIN. I do. I think—a modest rise in interest rates certainly tends to reduce this gap between saving and investment. And when that gap is eliminated why the pressures move in the opposite direction.

Senator O'MAHONEY. Well now, when we are unable to build schools enough to educate our increasing population, when it is known that Soviet Russia is concentrating upon the education of the youth and we find ourselves with less room than necessary to educate our children, do you think that that is a consideration which your Board ought to give considerable weight to in determining what the rate of interest shall be?

Mr. MARTIN. Well, again I return, Senator, to the fact that I do not think we make the interest rates. Mr. Patman and I have a slight disagreement on that, but I think that we do a lot of talking about administered prices.

Senator O'MAHONEY. You fix the discounts, don't you?

Mr. MARTIN. What?

Senator O'MAHONEY. You fix the discount rate?

Mr. MARTIN. We fix it in accord with supply and demand if the banks have no necessity to come to us to borrow funds then the discount rate does not mean anything.

Senator O'MAHONEY. Why don't we close up the Federal Reserve banks if you don't have any part in it? Why do we talk about tight money?

Mr. MARTIN. The Federal Reserve—

Senator O'MAHONEY. Let us get this straight. In your judgment do you or do you not have an influence upon the rate of interest?

Mr. MARTIN. We have an influence, but it is not in my judgment the controlling influence. If we make the controlling influence we are not performing our function, as I understand it.

Senator O'MAHONEY. Now then, let me ask you a question :

When this administration began, the Treasury Department issued the now 30-year bond, at $3\frac{1}{4}$ percent interest. In a short time it was selling at a big premium. Now it is selling below par.

The theory was that the Federal Government could increase the rate of interest upon long-term bonds in order to reduce the amount of short-term obligations that were outstanding.

But there has been a great change and the market for these 30-year bonds has fallen off.

I find in the New York Times this morning on page 61, that the $3\frac{1}{4}$ percent bond—that same long-term bond that I am talking about—is selling "demand 98.2."

When the bonds of the United States are selling below par, isn't that a danger signal?

Mr. MARTIN. Senator, I hope that the United States issue can always in the open market sell at par and above.

But you have the finest security in the world when you have the United States security today. You know now—wait a second—you know when the interest comes—

Senator O'MAHONEY. I am glad to know that your answer is on the record.

Mr. MARTIN. When the interest comes due it will be paid. You know that. When the principal comes due it will be paid. You have no worry about that.

The only worry you have is depreciation of the dollar. We have a responsibility to people. It is unfortunate if they have to liquidate early but we have a responsibility to see that they are paid off in their interest and in their principal in terms of the dollar they put into it.

We have not always been successful in that, but our purpose with a Government security—if it becomes interest-bearing money—if it is fixed by fiat of the Government and has no market adaptability and if you depreciate the dollar to maintain it at par—

Senator O'MAHONEY. I am not talking about fiat money. We are not going to get into that debate. Lincoln fought the Civil War with greenbacks and Lincoln did a good job, but it is irrelevant here.

I am prompted to ask this question because the First National City Bank of New York, in its monthly economic and business letter of September 1956, expressed concern over the gold position of this country. It pointed out that:

The continued growth of foreign dollar holdings of interest to Americans is that, while these dollars constitute assets to their foreign owners, they are liabilities in the monetary system of this country.

The letter goes on to refer to the expansion of foreign holdings of short-term obligations of the United States Treasury and then it continues to the effect that—

foreign short-term dollar assets, including deposits and United States Treasury obligations, total around $\$14\frac{1}{2}$ billion, equal to 66 percent of our gold stock, presently standing at $\$21.8$ billion, compared with 31 percent in 1949.

Mr. MARTIN. I was—

Senator O'MAHONEY. I am interested—and I think it is important in discussing the amount of American dollars held in foreign countries. Do you know what that quantity is?

Mr. MARTIN. I do not have the figure offhand. I could get what our estimate is. It is probably several billion dollars.

Senator O'MAHONEY. Several million?

Mr. MARTIN. Several billion.

Senator O'MAHONEY. Several billion?

Mr. MARTIN. Several billion. I do not have it exactly.

Senator O'MAHONEY. Will you please put the accurate figure in the record?

Mr. MARTIN. I do not think we can get the exact figure. I will try to get the best figure.

Senator O'MAHONEY. Get the approximate. And let it be inserted in the record here.

Mr. MARTIN. I will be very glad to.

(The following was subsequently received for the record:)

Foreign holdings of United States currency have been variously estimated at amounts ranging between \$0.8 billion and \$2 billion. The lower figure (actually \$839 million for the end of 1955) is the estimate of the Department of Commerce; it is based on the Department's computation of the international flow of payments to and from the United States. The higher figure is an estimate made 3 years ago by some members of the Federal Reserve staff; it was based on the total United States currency in circulation and the estimated holdings of United States individuals, corporations, and public agencies. Both figures should be considered as very rough guesses. Exact estimates are impossible because, even if all domestic holdings could be ascertained without error, there still would be no way to find out how much of the remainder was actually held abroad and how much was lost and destroyed abroad during the recent unsettled periods of war and revolution.

In addition to these holdings of United States currency, foreign residents and governments held, at the end of October 1956, \$7.3 billion in deposits with the Federal Reserve banks and United States commercial banks.

Senator O'MAHONEY. As to American dollars, the fact is that they are in foreign hands at the rate of at least \$2 billion?

Mr. MARTIN. I would think that was a conservative estimate.

Senator O'MAHONEY. Is it not a fact that those dollars in foreign hands can buy gold in Europe?

Mr. MARTIN. That is correct.

Senator O'MAHONEY. Is it a fact, or is it not, that these American dollars are now being invested by foreigners in the issues, bonds, notes and bills of the Treasury which are selling below par?

Mr. MARTIN. If they hold—yes; some of them are; yes.

Senator O'MAHONEY. Do you know how much?

Mr. MARTIN. No, I don't.

Senator O'MAHONEY. Don't you think it is a serious question? The Government is talking about asking Congress to increase expenditures for foreign aid and yet the same countries to which this aid will go are holders, according to your testimony, of American dollars which they invest in depreciated securities of the United States? Isn't that a situation which should give you and your Board and your regional presidents pause for serious thinking on this question?

Mr. MARTIN. Well, I don't see any reason to differentiate between a foreign holder of United States dollars and the domestic holder.

Senator O'MAHONEY. This is the fact that I see to differentiate. It is that the national debt of the United States now stands at about \$278 billion, if this new borrowing is floated; isn't that correct?

Mr. MARTIN. That is correct. That is correct.

Senator O'MAHONEY. The ceiling is \$275 billion except for certain gimmicks to excuse it, to let it go above on the belief that before the fiscal year is out receipts will be such as to bring it down.

Well, if we are going to expand the expenditures abroad, if we are going to increase the appropriation for defense, as Secretary Wilson said the other day, coming from a conference with the President—he didn't say how much, but he said there would be an increase—and we are already in debt above the limit, does it not mean a great deal to us whether or not those who are to be the beneficiaries of our foreign economic aid are getting over 3 percent interest on the short-term and depreciated issues of the Treasury of the United States?

Mr. MARTIN. Well, you raise a serious problem. I am not trying—
Senator O'MAHONEY. That is why I am worried about it.

Mr. MARTIN. Well, I am worried about the whole overall picture, also.

Senator O'MAHONEY. Has your Board given any considerations to that?

Mr. MARTIN. Our Board discusses this and all other aspects at every meeting, sir.

Senator O'MAHONEY. Then will you give us for the record the exact figures on these phases which we have just been discussing?

Mr. MARTIN. I will be very glad to do the best I can.

Senator O'MAHONEY. Let us have it all on the record, so the public may know, too, what the danger is.

Mr. MARTIN. I will be glad to get it. Our overall solvency is a matter of the greatest concern to all of us at all times.

Senator O'MAHONEY. Of course it is.

(The following was subsequently received for the record:)

At the end of October 1956, foreign residents and governments held \$4.7 billion in United States short-term Treasury paper (bills and certificates) and \$1.2 billion in United States long-term Government securities (notes and bonds).

Senator O'MAHONEY. And since we are engaged in an economic war with Soviet Russia, everybody, and particularly those of us who are in Government and those of us who are in the independent boards which think they are outside of Government sometimes, should pay a great deal of attention to what this situation is.

You will agree with that, won't you?

Mr. MARTIN. I certainly agree with that.

Senator O'MAHONEY. Perhaps now you will agree with me that there ought to be a meeting of the Board tomorrow?

Mr. MARTIN. Well, I may say, Senator, that the Board meets every day.

Senator O'MAHONEY. And will take this up.

Mr. MARTIN. This is not the Open Market Committee but the Board itself meets every day.

Senator O'MAHONEY. Let us get the Open Market Committee meeting at an early date.

Mr. MARTIN. We will try to keep them meeting.

Senator O'MAHONEY. Mr. Moore of our staff points out that in the Federal Reserve Bulletin for October 1956, there are the figures. Would you read those into the record?

Mr. MOORE. The significant ones are the purchases, the net purchases by foreigners of Government securities in bonds and notes in 1955, which were \$529 million.

Looking at the detail of that, it is largely accounted for by Switzerland, United Kingdom, and Canada.

During the current year there have been net sales in March of a substantial proportion, of \$236 million.

The last few months have been running net purchases of quite a small magnitude, 13, 16 and 27 million, respectively, in May, June, and July.

Senator O'MAHONEY. Switzerland and what other country?

Mr. MOORE. Switzerland, United Kingdom, and Canada: 1955 the Swiss bought 147.

Mr. MARTIN. We will try to bring it up to date for you.

(The following was subsequently received for the record:)

In August and September 1956, foreign residents and governments and international institutions made net purchases of \$81 million of United States Government notes and bonds; of this total, \$73 million was purchased by international institutions and 8 million by foreign residents and governments. In the same period, net purchases of United States corporate securities by foreign residents and governments and international institutions amounted to \$36 million, of which \$2 million was purchased by international institutions and \$34 million by foreign residents and governments.

Total net purchases of United States Government and corporate securities by foreign residents and governments (excluding international institutions) thus amounted to \$42 million; Switzerland accounted for net purchases of \$27 million, the United Kingdom for net purchases of \$21 million, and all other countries together for net sales of \$6 million.

Senator O'MAHONEY. It is my understanding that the banks of Switzerland give no information of any kind with respect to the actual beneficial holder of such trust accounts, so that this refusal to reveal the names and the identities of the holders of these dollar accounts, affords a cloak behind which those attempting to avoid public scrutiny can hide.

If you will, please, let me point this out: Earlier in the present year a writer for the Scripps-Howard Newspapers chain wrote an article which was based upon the assumption that there might be a danger that Soviet investments were being made in these securities of the United States.

If that be true, it is a matter of serious concern underlying that everybody who has any interest or power over our financial system should know exactly all of the time the course of foreign investments in our depreciated securities.

The United States today has the greatest debt that was ever undertaken by any Government in all history. There is no question about that, is there? And the debt is not decreasing.

The world crisis is so great that we do not know how much more the President will ask Congress to authorize to be borrowed in order to defend ourselves in this crisis.

So that it is not a matter of what speculators in Wall Street think about it, nor those who wish to sell real estates, nor corporate executives who want to expand plant facilities, nor financiers who want to get a larger income from their loans than they are now getting.

You will not demur to the statement, will you—

Mr. MARTIN. The questions you raise are very pertinent.

Senator O'MAHONEY. Let me add this further statement. You will not demur to the statement that the banks have profited upon tight money.

Mr. MARTIN. To the extent that they have made loans at higher interest rates, yes. To the extent they have had to sell Government securities at a loss that has been diminished somewhat.

Senator O'MAHONEY. You will let me ask you to answer this question. Do you think that the fiscal policy of the Government of the United States should be carried on exclusively for the interest of the banks?

Mr. MARTIN. Certainly not, sir.

Senator O'MAHONEY. I knew your answer would be "certainly not." But throughout the history of this Government and every other Government, there always has been a struggle between the money power and the people.

And the question is where to determine to draw the line. The Federal Reserve Board was set up to try to do that. It is your authority and it is your responsibility.

But the record is here clear that a substantial part of the American people are suffering because of high interest rates and all of my questions have been in the attempt to determine what factors enter into your judgment in the rules and in the decisions that you make.

Will you be good enough to comment upon that now?

Mr. MARTIN. Well, the factors that we consider outside of the statistical indices of business at every meeting have to do with the basic requirement of Government finance. We have to consider the needs of the Treasury.

We are not authorized by the Congress to ignore the appropriating authority of the United States Government. We are here to help the Treasury without giving the Treasury an automatic rate adjustment to the market.

Senator O'MAHONEY. The questions which I have asked you have come to the peak of the most importance one with which you agree.

I have a lot of other minor questions which I could ask you but I do not want to take that time.

I thank you for your very frank responses to the queries I have made. And I hope that the other members of the Board who may feel moved to make any comment now will do so.

Mr. MARTIN. May I make a concluding comment on what you said, Senator?

Senator O'MAHONEY. There is an invitation to all of you to speak, gentlemen.

Mr. MILLS. Mr. Chairman, Senator, you have posed—

Senator O'MAHONEY. This on the record?

Mr. MILLS. A very—yes, sir—a very important question and raised concern about the problem of international investment. You have focused your discussion on investment within the United States by foreign nationals, a type of investment which in the opinion of many people is to be welcomed in that it represents a compliment to the security of and faith in the obligations of the United States Government.

But against the investment of foreigners in securities of the United States, I am sure you have in mind that there are offsetting investments of a considerably greater magnitude on the part of United States citizens and United States businesses in foreign lands that are contributing to the development and the benefit of those nations to the same degree that investment by foreigners in the United States has in the past and continues to be beneficial to the economy of the United States.

In other words, the concern that you express, in my humble opinion, has two facets. And I do not share it, frankly, in the way that you do that we should not welcome and may not have benefited from the investment that you refer to.

Senator O'MAHONEY. I hope I haven't given you the impression that I am against foreign investment in the United States. I certainly am not.

I am merely pointing out to you the condition that admittedly exists at a time when communism is waging an economic war against us and when the leaders of communism are leaving no device unused to weaken our economy.

And I am urging you gentlemen to beware and to give it more consideration than apparently it has had.

Mr. MILLS. Senator, I must apologize for not getting the intent of your discussion, but it might be inferred that foreign investment in the United States was a tool of communism to undermine our economy. Rather—

Senator O'MAHONEY. I said that the Scripps-Howard chain of newspapers published during the past few months a serious article by one of its staff writers who was assumed to be an expert, at least, who made an examination into the question and who intimated that the Communists were doing precisely that. It is not my statement. I am just looking at the facts which are presented to me in the daily press and the facts which I gather when I ask questions of gentlemen like yourself.

Mr. MILLS. If I might say so, when you have the advantage of the statistical records that can be presented to you, it is my belief that you will reach the conclusion that foreign investment in the United States is a small factor in the overall magnitude of our economy.

Senator O'MAHONEY. May I interrupt you to say, Mr. Mills, that I hope that you will keep an open mind until you yourself have looked over these statistics again. I am only asking for information.

Mr. MILLS. Indeed I will, sir.

Senator O'MAHONEY. I am not arguing with you as to whether you are right or the Scripps-Howard writer was right, but if there is any basis for what he placed in that article it is a very serious matter.

Mr. BALDERSTON. Senator, may I express appreciation of the point that you have made that the soundness of our economy is our first bulwark in the cold war you have mentioned and that the integrity of the dollar is an essential part of maintaining that soundness.

(Question posed to Mr. Martin by Senator O'Mahoney, by telephone, December 17:)

Senator O'MAHONEY. The First National City Bank of New York in its economic letter of September 19, 1956, expressed concern because of the gold position of this country. It pointed out that "The continued growth of foreign dollar holdings of interest to Americans is that, while these dollars constitute assets to their foreign owners they are a liability in the monetary system of this country.

The bank letter goes on to refer to expansion of foreign holdings of short-term Government obligations of the United States Treasury; then refers to statements "that foreign short-term dollar assets, including deposits and United States Treasury obligations, total around \$14½ billion or 66 percent of our gold stock presently outstanding at 21.8 billion, compared with 31 percent in 1939." This can be found on page 104 of the bank's September letter. It would be helpful in furnishing the material that I requested if you would deal with this also. There is a lot of rumor that should be corrected. I am concerned about the general aspect of this business.

(The material requested follows:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Washington, December 19, 1956.

HON. JOSEPH C. O'MAHONEY,
United States Senate, Washington, D. C.

DEAR SENATOR O'MAHONEY: This refers to your telephone call to me the other day raising a further question with respect to the relation between United States gold reserves and foreign dollar holdings.

Attached is a brief memorandum, prepared by the Board's staff, which I think will answer the question you have in mind. A copy of this memorandum has been sent to Mr. Lehman, clerk of the Joint Economic Committee, for inclusion in the record of the hearings last week.

Sincerely yours,

WM. MCC. MARTIN, Jr.

As to the problem of the relation between United States gold reserves and foreign holdings, the following facts may be noted.

First, it is not quite correct to compare all foreign dollar holdings directly with our gold reserves, since only foreign governments and monetary authorities are permitted to purchase gold from the United States; private foreign dollar holdings cannot be converted directly into gold. On September 30, 1956, foreign dollar holdings (including not only deposits with United States banks but also holdings of short-term Treasury paper, bankers' acceptances, and other short-term assets) amounted to \$13.2 billion, of which \$7.9 billion were held by governments and monetary authorities, and \$4.3 billion by private individuals and corporations.

Second, it is true that foreign dollar holdings have increased considerably since the end of the forties, while our gold reserves have slightly decreased. Table I shows the development of our gold reserves and foreign dollar holdings between 1919 and 1956. It will be observed, from the table, that our gold reserves have not changed much since the end of 1953 and that the ratio between our gold reserves and foreign dollar holdings, although it is now smaller than it was during the thirties and forties, is about the same as during the last twenties.

Third, the increase in foreign dollar holdings and in foreign gold reserves is in line with expansion in the volume of international trade, the restoration of more normal international financial and commercial relations, and the growing importance of the United States as a world banker. Table II shows the imports and the gold and dollar reserves of foreign countries (excluding the Soviet bloc) in 1928, 1938, 1948, and 1955. It will be observed, from this table, that the ratio between foreign reserves and imports in 1955 was not much larger than in 1928 or 1948, and much smaller than in 1938.

We are watching these developments continually. In my judgment our international gold position will not prove embarrassing so long as we pursue effective monetary policies. Confidence in our currency and in the stability of its purchasing power is crucial abroad no less than at home.

TABLE I.—United States gold stock and foreign dollar holdings

End of year	United States gold stock (millions of dollars)	Foreign dollar holdings (millions of dollars)	Ratio (2) : (1) (percent)	End of year	United States gold stock (millions of dollars)	Foreign dollar holdings (millions of dollars)	Ratio (2) : (1) (percent)
	(1)	(2)			(1)	(2)	
1919.....	2,707	1,214	45	1939.....	17,644	3,221	18
1925.....	4,112	1,281	31	1945.....	20,083	6,880	34
1927.....	4,092	2,889	71	1946.....	20,706	6,010	29
1928.....	3,854	2,756	72	1947.....	22,868	4,850	21
1929.....	3,997	2,673	67	1948.....	24,399	5,850	24
1930.....	4,306	2,335	54	1949.....	24,563	5,960	24
1931.....	4,173	1,304	31	1950.....	22,820	7,120	31
1932.....	4,226	734	17	1951.....	22,873	7,660	33
1933.....	4,036	388	10	1952.....	23,252	8,960	39
1934.....	8,238	670	8	1953.....	22,091	10,020	45
1935.....	10,125	1,301	13	1954.....	21,793	11,150	51
1936.....	11,258	1,623	14	1955.....	21,753	11,700	54
1937.....	12,760	1,893	15	1956 (September).....	22,032	13,227	60
1938.....	14,612	2,158	15				

TABLE II.—Imports and reserves of foreign countries (excluding the Soviet bloc)

Year	Imports (c. i. f.) (billions of dollars) (1)	Gold and dollar reserves at end of year (billions of dollars) (2)	Ratio (2) : (1) (percent)
1928.....	29.39	8.53	29
1938.....	21.07	13.40	64
1948.....	52.06	14.55	28
1955.....	75.98	25.84	34

Senator O'MAHONEY. Thank you very much, Mr. Balderston. Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, Senator O'Mahoney.

You mentioned a while ago, Mr. Martin, in answer to Senator O'Mahoney, when he asked you if the banks did not profit more than any other group by reason of higher interest rates, that the banks also suffer harm or losses.

And you mentioned specifically that they were compelled to sell Government bonds at a loss in order to provide reserves.

I think you should point out, Mr. Martin, that the banks are pretty well protected on Government bonds. If they buy them at par they can always keep them on their books 100 cents on the dollar for all examinations. That is correct, isn't it?

Mr. MARTIN. That is correct.

Chairman PATMAN. If they go down to 75 they can still carry them for 100. Therefore, it does not jeopardize the capital stock of the bank.

But that is not the important part. You failed to mention the fact that our tax laws are so written that if the banks are compelled to sell a bond at a loss, the net of capital losses over capital gains fully offset against the banks taxable income.

In other words, the losses on the sale of their bonds can offset the profits the banks make from higher interest rates. This reduces their current year's tax liability.

Furthermore, the bank has this advantage. When the bonds go down and they sell, they can immediately buy another issue. They do not have to wait 30 days like people have to wait on stocks. They can immediately buy another issue right close to it. And as that bond goes up in value, and goes back to par, and they sell it, their profit is taxed at the 25 percent rate. Losses are offset against income taxable at 52 percent. Gains are taxed at 25 percent.

So they are not hurt so much.

Furthermore, another point which you did not point out, was that they obtain these powerful dollars when they sell the bonds which are used as reserves. Upon each dollar of reserve they can extend \$6 in loans.

So that the banks are not crippled too much in this operation.

You did not intent to leave the impression that they were greatly harmed, did you, Mr. Martin?

Mr. MARTIN. No, I merely made the comment, Mr. Patman, that while they were getting more interest on loans, if they made the conscious choice of selling a security in order to make a loan because they didn't have adequate reserves, and if those securities had declined that would to some extent offset their return.

Chairman PATMAN. But don't you think you have an unusual advantage there when they can use that loss that they have on that bond to offset any gains that they have in the way of profits?

Mr. MARTIN. Individuals can do that also.

Chairman PATMAN. On short term?

Mr. MARTIN. Yes.

Chairman PATMAN. They cannot do it on long term, can they?

Mr. MARTIN. I would make—

Chairman PATMAN. But the bank is not restricted either way, long or short, makes no difference.

Mr. MARTIN. Well, I am really not competent to testify on the tax aspect.

Mr. HAYES. Could I say something?

Chairman PATMAN. Yes, sir.

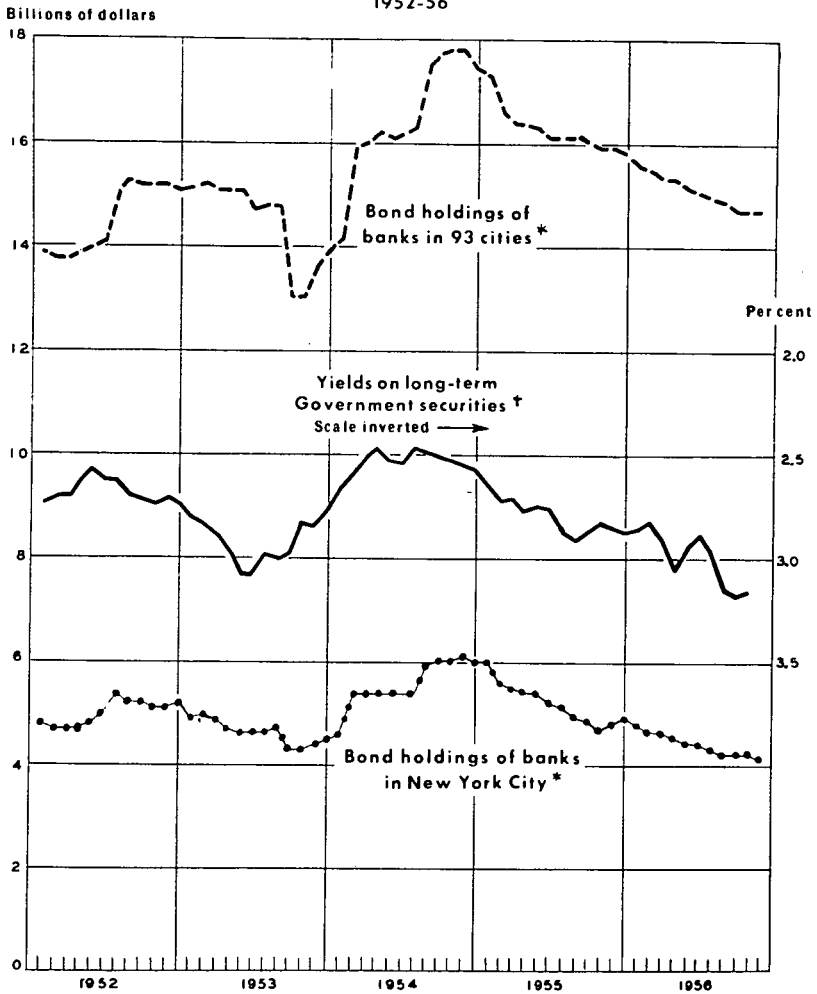
Mr. HAYES. If I may at this juncture, because you raise the question of the banks profiting from it, I should like to point out the effect on the banks of the sales of Government securities.

I am impressed by the fact that the banks have bought most of their Government bonds during the periods of relative ease, when interest rates were relatively low and prices have gone relatively high, and have had to sell them when prices were declining in order to raise funds for loans.

And I have here some interesting charts that show that very graphically, if you are interested in them.

Chairman PATMAN. What does it show, if you don't mind summarizing it for us? And we will insert it in the record at this point. (The charts are as follows:)

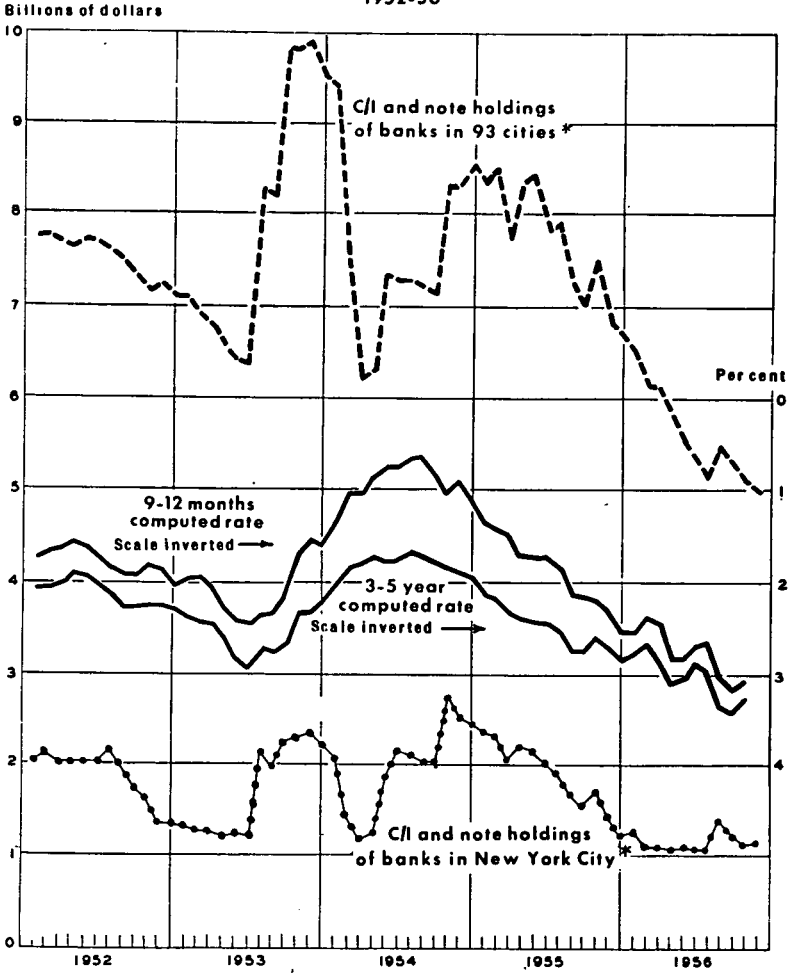
U.S. GOVERNMENT BOND HOLDINGS OF WEEKLY REPORTING BANKS
AND AVERAGE YIELDS ON LONG-TERM GOVERNMENTS
1952-56



* Last Wednesday of each month.

† Average of daily figures. Old series. (new series, including 3 1/4's of 1978-83 and 3's of 1995, shows similar pattern with somewhat higher rates, for period from May 1953 onward).

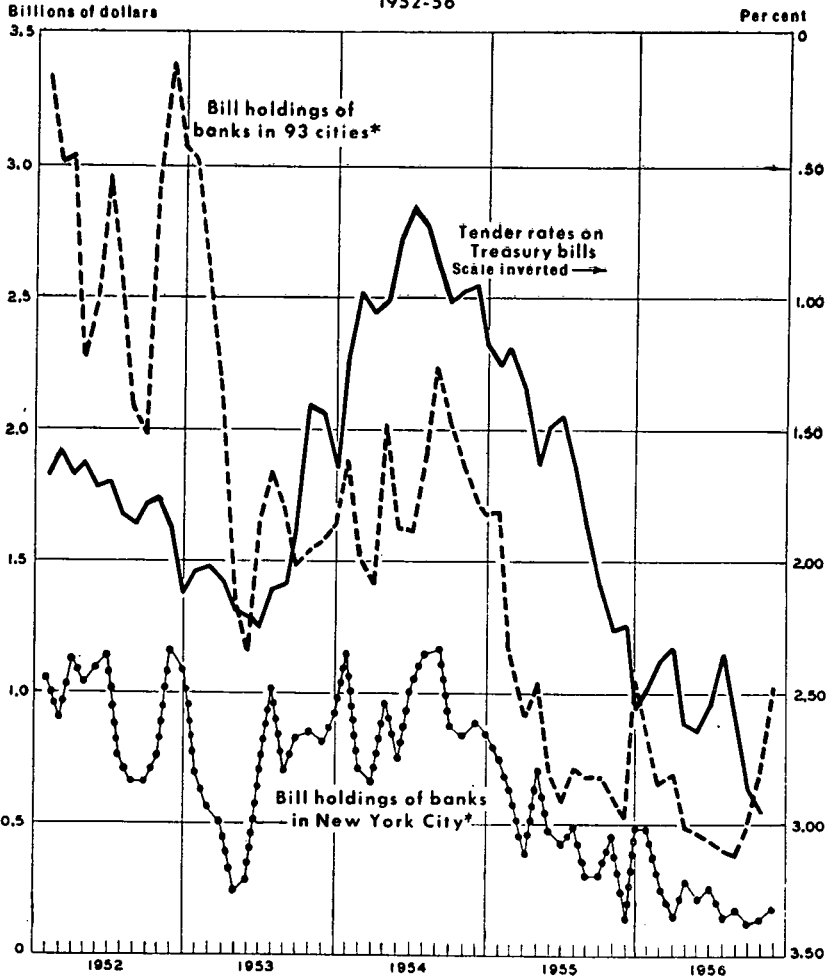
HOLDINGS OF U.S. GOVERNMENT CERTIFICATES AND NOTES BY WEEKLY REPORTING BANKS AND AVERAGE YIELD ON COMPUTED GOVERNMENT OBLIGATIONS 1952-56



* Last Wednesday of each month.

TREASURY BILL HOLDINGS OF WEEKLY REPORTING BANKS
AND AVERAGE YIELDS ON TREASURY BILLS

1952-56



* Last Wednesday of each month.

Mr. HAYES. It shows that the Government bond holdings of banks in 93 leading cities rose from a low point of \$13 billion in 1953 to nearly \$18 billion in 1954 and then their holdings declined.

Chairman PATMAN. Didn't they buy in 1953 when they were low?

Mr. HAYES. No; the price of the bonds was quite high all through 1954 and that is when most of this increase in holdings occurred. The peak occurred at the end of 1954. And then those bond holdings dropped off steadily during 1955 and 1956, and at that time prices were dropping steadily.

The charts on notes and certificates show about the same thing, although it is not as smooth a curve.

Chairman PATMAN. But, Mr. Hayes, you are acquainted with the facts and they are to the effect that the banks bought these bonds when

they were low in 1953, and they sold them when they were high in 1954.

And the banks dealing in those bonds made a profit in 1954 in excess of what they had made the year before of 966 percent.

My authority for that statement is the Federal Deposit Insurance Corporation report.

So they really made lots of money buying when bonds were low and selling them when prices were high. And, of course, they could get the benefit of capital gains, too.

Mr. HAYES. If I may comment on that.

Chairman PATMAN. Yes, sir.

Mr. HAYES. I have some figures here showing earnings of the banks, member banks—

Chairman PATMAN. Yes, sir.

Mr. HAYES. During the years 1946, 1949, 1952, and 1955.

During that period the interest earnings on Government securities, over the period as a whole, hardly changed at all.

Chairman PATMAN. Which years—you do not have them all.

Mr. HAYES. From 1946 through 1955. I am just taking those 2 years.

And if you will compare those 2 years the interest earnings from Government securities differ very little.

Chairman PATMAN. What were their earnings on Government securities in 1953?

Mr. HAYES. I do not have 1953.

Chairman PATMAN. I know, but it is necessary to have that because that is the point.

Mr. HAYES. But 1952 was 929 million.

Chairman PATMAN. How much was it in 1954?

Mr. HAYES. I don't have 1954.

Chairman PATMAN. They are the important years. Can you get that for us?

Mr. HAYES. I can give you the overall earnings figures for 1953 and 1954, and the net profits—

Chairman PATMAN. I am talking about profits on Government securities.

Mr. HAYES. I can get that for you.

Chairman PATMAN. You can get that for me. Will you put it in the record at this point?

Mr. HAYES. Yes.

(The data on member bank earnings, expenses, and profits are shown in the following table. Net profits or losses on securities are shown in the footnote; data on profits or losses on Government securities only are not available, but they account for the bulk of the figures.)

TABLE I.—Member bank earnings and expenses, 1946-55

[Millions of dollars]

Item	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Total earnings.....	\$2,402.5	\$2,578.6	\$2,828.3	\$2,985.6	\$3,264.7	\$3,698.7	\$4,119.6	\$4,590.2	\$4,826.1	\$5,312.6
United States Government's.....	1,053.5	920.8	854.8	859.2	865.1	831.9	929.3	1,011.0	1,066.4	1,118.1
Loans.....	772.3	1,043.7	1,307.8	1,427.1	1,634.0	2,003.0	2,305.9	2,632.0	2,711.2	3,083.2
All other.....	576.7	614.1	665.7	609.3	765.6	833.8	884.4	947.2	1,048.5	1,141.3
Total expenses.....	1,468.6	1,650.0	1,795.2	1,888.9	2,019.7	2,231.9	2,501.1	2,781.5	2,998.5	3,265.1
Salaries and wages.....	699.4	797.0	875.8	926.1	999.9	1,125.3	1,243.6	1,371.5	1,462.7	1,571.4
Interest on time deposits.....	211.6	235.9	250.5	261.1	271.0	305.5	364.5	424.7	493.6	543.1
All other.....	557.6	617.1	668.9	701.7	748.8	801.1	893.0	985.3	1,042.2	1,150.6
Net current earnings before income taxes.....	934.0	928.6	1,033.1	1,096.7	1,244.9	1,436.8	1,618.6	1,808.7	1,827.6	2,077.5
Net additions or deductions, total ¹	+108.8	-19.1	-178.7	-135.4	-95.1	-190.2	-181.4	-251.2	+72.7	-401.5
Net profits before income taxes.....	1,042.8	909.5	854.5	961.3	1,149.9	1,246.5	1,437.2	1,557.5	1,900.3	1,676.0
Taxes on net income.....	285.0	256.5	233.6	275.1	369.1	490.9	607.9	692.3	804.2	690.8
Net profits.....	757.8	653.0	620.9	686.3	780.8	755.6	829.3	865.3	1,096.1	985.2
Total capital accounts.....	7,868.0	8,291.3	8,629.8	8,999.0	9,455.0	9,947.0	10,480.0	11,043.0	11,724.0	12,499.0

¹ Included above in net additions or deductions to earnings are security net profits or losses, net recoveries or chargeoffs on securities, and net transfers from or to reserves for securities, as follows:

Item	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Net additions or deductions.....	+121.1	+28.7	+0.9	+40.7	+48.2	-24.2	-52.3	-117.9	+252.0	-152.1

When security net profits, losses, recoveries and chargeoffs, and transfers from or to reserves are adjusted for actual recoveries credited and losses charged to valuation reserves each year, the actual net profits or losses on securities are as follows:

Item	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
Net additions or deductions.....	(*)	(*)	+2.9	+43.7	+59.5	-20.5	-65.2	-128.6	+315.5	-189.3

* Not available.

Source: Federal Reserve bulletins.

Chairman PATMAN. Won't you admit for the record they were enormous?

Mr. HAYES. I would have to look at those figures.

Chairman PATMAN. Don't you have any recollection on it?

Mr. HAYES. I do not have on this particular figure. I would like to put in this table on the overall profit of the members banks.

Chairman PATMAN. That is not important in this particular question.

Mr. HAYES. I think it is, Mr. Patman.

Chairman PATMAN. Go ahead.

Mr. HAYES. The net profit was a product of both the interest earnings net and of expenses and profit or loss on sales of securities and other adjustments or recoveries and so on.

And that net figure for all member banks shows a figure—well, in percent of capital funds, it shows these following figures:

For 1952, 7.9 percent; for 1953, 7.8 percent; for 1954, 9.3 percent; for 1955, 7.9 percent.

(The table referred to follows:)

TABLE II.—Ratio of net profits to total capital, member banks and leading corporations, 1946-55

	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955
All member banks:										
Net profits (in millions).....	\$757.8	\$653.0	\$620.9	\$686.3	\$780.8	\$755.6	\$829.3	\$865.3	\$1,096.1	\$985.2
Capital (in millions).....	\$7,868.0	\$8,291.3	\$8,629.8	\$8,999.0	\$9,455.0	\$9,947.0	\$10,480.0	\$11,043.0	\$11,724.0	\$12,499.0
Ratio (percent).....	9.6	7.9	7.2	7.6	8.3	7.6	7.9	7.8	9.3	7.9
Central Reserve New York City banks:										
Net profits (in millions).....	\$158.2	\$132.9	\$138.7	\$111.3	\$145.4	\$141.9	\$174.6	\$161.1	\$213.2	\$186.5
Capital (in millions).....	\$2,167.0	\$2,232.6	\$2,275.7	\$2,323.0	\$2,336.0	\$2,387.0	\$2,458.0	\$2,541.0	\$2,651.0	\$2,744.0
Ratio (percent).....	7.3	6.0	6.1	4.8	6.2	5.9	7.1	6.3	8.0	6.8
Leading corporations—Percent return on net assets:¹										
Total manufacturing.....	12.1	17.1	18.2	13.9	17.1	14.4	12.3	12.7	12.3	15.0
Total mining.....	9.4	16.0	20.5	12.0	13.2	13.0	10.1	7.9	8.2	11.9
Total trade.....	21.9	18.4	18.2	13.4	15.0	11.5	10.1	9.9	9.9	11.1
Total transportation.....	7.6	3.9	5.2	3.4	5.8	5.2	6.0	6.1	4.6	6.1
Total public utilities.....	8.2	8.0	8.6	8.8	9.9	9.0	9.0	9.2	9.3	9.7
Total amusements, services, etc.....	19.4	14.2	10.1	9.9	10.4	10.4	11.1	10.5	11.4	12.3
Total finance.....	6.4	6.7	8.1	9.1	9.0	7.9	8.2	8.1	8.8	7.7
Grand total.....	9.5	12.3	13.6	11.0	13.4	11.4	10.4	10.6	10.3	12.0

¹ As reported by the First National City Bank's monthly letter. Book net assets at the beginning of each year are based upon the excess of total balance-sheet assets over liabilities.

Source: Bank data from Federal Reserve Bulletin.

And you can see, in 1954 it was somewhat higher than it had been, but at no time was it a very high figure, particularly if we compare it with returns in other businesses which are also shown here.

The point of that, I think, is that in 1955, when interest earnings were very good, the net profit went off sharply from 1954 because of the losses taken on the sales of Governments in 1955.

Chairman PATMAN. The Government bonds for some reason went down, took a nosedive in 1953; the banks bought the bonds low. They sold them high in 1954 and made a profit of \$417 million securities sales in that year.

In 1955 they started another nosedive; didn't they?

Mr. HAYES. Mr. Patman, the point of this chart that I mentioned—

Chairman PATMAN. What we are trying to find out is when they are going back.

Mr. HAYES. The point of this chart I mentioned, first, was to show that most of their purchases were made in 1954 when prices were relatively high. And most of the sales were made in 1955 and 1956 when they were low.

Chairman PATMAN. I have the latest annual report of the Federal Deposit Insurance Corporation for 1955, and it shows the following information on the insured commercial banks: Their net profits after taxes averaged \$1,163 million for the 3 years 1953, 1954, and 1955, compared to an annual average of \$865 million in the preceding 6-year period 1947-52. On the ratio of net profits to capital accounts the average for the 1953-55 period was 8.4 percent as compared to 8 percent for the 1947-52 period. It might be noted that in the 1947-52 period profits were rising faster than capital accounts, while in the recent period capital accounts have risen faster than the increase in profits, so that the increase in the current rate of profit on capital account over that for the 1947-52 period actually tends to understate the increased profitability of banks.

The ratio of dividends to capital accounts for the 1953-55 period has risen from 3.7 to 3.9 percent, for an average of 3.8 percent. In the 1947-52 period the ratio of dividends to capital accounts averaged 3.5 percent.

Rates of income for insured commercial banks on their holdings of United States Government obligations rose from 1.80 percent on each \$100 in 1952 to 2.09 percent in 1955. This increase was greater than that for the 6-year period 1927-52, when average rates of income of insured commercial banks on United States Government obligations rose from 1.54 percent per \$100 to 1.80 percent. In 1955, the average rate of income received by commercial banks on their holdings of United States Government obligations was more than a third higher than in 1947. In contrast, their average rates of income on other securities in 1955, 2.15 percent per \$100, was lower than the 2.16 percent for 1947.

Mr. Martin, will you please supply us with a memorandum on the Federal income taxation of commercial banks? We want you to do that. We would like the memorandum to describe the general provisions under which those banks are taxed, as well as any provision of the code which have special application to commercial banks.

We are particularly interested in the code's provision with respect to determination of income and tax consequences when premiums or dis-

counts on bonds including tax-exempt bonds, are involved, and the treatment provided when gains or losses are realized upon the disposition of bonds.

Do those provisions of special applicability involve significant revenue losses for the Government? Are these provisions, in your opinion, likely to affect the decisions of portfolio managers in such a way that the Government bond market as a whole is influenced for tax consideration as such?

Do the standards applied by the examining agencies in respect to the handling of discounts, premiums, losses, and recoveries conform to the requirements of the Internal Revenue Service?

Those are the questions, generally, we would like to have answered. But we would like to have a complete study. And I think it is appropriate to ask you that now, in view of the fact that you do not seem to be clear on what the tax situation is concerning the commercial banks.

Are you willing to furnish us that information, Mr. Martin?

MR. MARTIN. I will do the best I can. I will consult the Treasury on it, because it is primarily a tax problem.

Chairman PATMAN. I know, but you people have the information over there.

MR. MARTIN. I will try to get the best memorandum that I can for you on that, but it will take a little time to prepare it. I want to point out that taxation is not our field.

(The requested memorandum on Federal Income Taxation of Commercial Banks appears just below at the conclusion of the record of the morning session.)

Chairman PATMAN. I understand. There seems to be—I do not claim that you are dodging it; I am not making that charge at all—but you are pretty quick to point that out. And you do have a lot of power of which you do not say much about. That is where I argue with you.

I want to read you a communication I have just received from a place in California:

In connection with your current probe of tight-money situation, let me urge legislators to investigate unfairness of FHA law.

While buyers of houses are protected by law, through law stating they can pay no more than 1 percent premium to lending agencies, sellers have no such protection. Result is, in present emergency sellers are in vulnerable position and easy prey for mortgage companies who charge sellers exorbitant discount rates for providing money.

This is manifestly unfair and highly inflationary. Why should sellers have to pay 8 percent to procure money for sale of property which is security enough through intrinsic worth.

Further, let me suggest that someone in Washington is leaking advance news of rate hikes, thus encouraging lenders to stall in negotiations.

Now, of course, you can say that that is FHA, that you have not control over it; which is correct. But you have control of the tight money that is causing these people to charge the sellers even 8 percent in order to sell their property.

In addition to getting the mortgage, selling at a discount, sometimes as low as 10 and 12 percent—in some cases 14 percent discount; I have heard of those—they are making the sellers pay a discount, too.

The law protects the veteran buyer. He cannot pay more than 1 percent.

But since the law is protecting the veteran, they go over and make the seller to the veteran pay.

That looks to me like against conscience. Something ought to be done about that. I don't know whether you can do anything except to maybe loosen up on this money a little bit, because we have had an awful drought in this country, down through the Middle West. And it is a terrible thing.

And we don't have, and we haven't had, much rainfall. We have not had much water there. And we are suffering.

But other sections of the country are not suffering from the drought. That is the way it is with this money. We have a drought of money in certain sections only.

In New York they have plenty of money. The big business fellows can get all of the money they want for plant expansion. But the little fellows out over the Nation, they are in a drought, a very severe drought, a money drought.

I just hope tomorrow, instead of raising the discount rate again, I hope that you will do something about relaxing it, I mean, relaxing the tension and let us have a little easier money.

It is about 12 o'clock. Do you have the Manager of the System open market account here? Maybe I should ask Mr. Hayes that?

Mr. HAYES. He is here, Robert G. Rouse.

Chairman PATMAN. He will be here this afternoon?

Mr. HAYES. Yes, he will.

Chairman PATMAN. We want to ask him some questions.

Without objection, we will stand in recess until 12 o'clock this afternoon.

(Thereupon, at noon, the committee stood in recess, to reconvene at 2 p. m., this day.)

SUPPLEMENTARY QUESTION ON FEDERAL INCOME TAXATION OF COMMERCIAL BANKS

Question: Will you please supply us with a memorandum on the Federal income taxation of commercial banks? We would like the memorandum to describe the general provisions under which those banks are taxed, as well as any provisions of the code which have special application to commercial banks. We are particularly interested in the code's provision with respect to determination of income and tax consequences when premiums or discounts on bonds, including tax-exempt bonds, are involved, and the treatment provided when gains or losses are realized upon the disposition of bonds. Do those provisions of special applicability involve significant revenue losses for the Government? Are these provisions, in your opinion, likely to affect the decisions of portfolio managers in such a way that the Government bond market as a whole is influenced by tax considerations as such? Do the standards applied by the examining agencies in respect to the handling of discounts, premiums, losses, and recoveries conform to the requirements of the Internal Revenue Service?

Answer: Federal income taxation of commercial banks and the problems arising from such taxation form a highly technical area of Federal tax policy. This particular segment of Federal economic policy is not, of course, the primary responsibility of the Federal Reserve System but rather is the province of the United States Treasury and of Congress. These provisions of the Internal Revenue Code, however, do have some bearing on Federal Reserve actions. Our comments regarding the extent to which these tax provisions have an impact on problems faced by the Federal Reserve were set forth to you in my letter of November 4, 1955, in response to your query of October 17, 1955. At that time we also furnished you a memorandum giving some background information regarding the tax treatment of commercial bank capital gains and losses in Government securities. A supplementary memorandum prepared by the Treasury Department is attached which describes the technical features and answers some of the questions you pose.

The tax treatment accorded bank capital gains and losses, as mentioned in the accompanying memorandum, does have some effect on the decisions of portfolio managers and at times these decisions do have some effect on the action of the Government bond market. As we stated to you in our letter of November 4, 1955, the present provisions of the Internal Revenue Code no doubt make some banks less reluctant than they otherwise would be to sell securities on which they have capital losses and shift into other assets. The possibility of using net capital losses to offset fully ordinary operating income and of simultaneously establishing a new low potential capital gains base encourages switching activity in the Government securities market and thus increases the volume of trading. This is especially the case in periods, such as the present, when low bond prices (relative to recent years) coincide with the end of the year and many commercial banks act to establish a loss position in their bond portfolios. When a bank engages in this type of operation its total holdings of securities are unchanged. However, commercial banks may also be encouraged by these tax provisions to undertake the sale of United States Government securities without an offsetting purchase of some other issue. They then are able to acquire some other asset such as a higher yielding commercial loan, the securities sold by the banks being purchased in large part by other investors. This kind of activity has also been characteristic during the current business upswing and has permitted the banks to be quite responsive to cyclical credit needs in channeling funds from savers to those seeking funds.

It should be pointed out, as mentioned in our letter of November 4, that the sale of Government securities by banks does not add to the total reserve base or credit-extending capacity of the banking system, except when the securities sold are purchased by the Federal Reserve. Sales to other banks or to nonbank investors result in the shifting of reserves among banks, although sales to nonbank investors may reduce deposits and required reserves, thus making possible new extensions of credit in an amount corresponding to the securities sold.

With respect to the handling of discounts, premiums, losses, and recoveries on securities, the Internal Revenue Service and examining agencies follow substantially the same standards, for example, with respect to bonds bought at a discount, neither permits a writeup above cost. It should be noted, however, that with respect to bonds purchased at a premium, examining agencies insist that the premium be charged off or amortized on a consistent and reasonable basis to maturity or to date of sale. For tax purposes, Internal Revenue Service permits the taxpayer to report the difference between cost and the maturity or sales price of wholly taxable bonds as a loss or gain, or to amortize the premium over the period to maturity or earlier call date. For tax-exempt securities an adjustment must be made in the basis of the bond as described in the Treasury memorandum.

SUPPLEMENTARY MEMORANDUM

FEDERAL INCOME TAXATION OF BANKS

I. INTRODUCTION

Banks, as corporations, are taxed on their income under the provisions of the 1954 Internal Revenue Code applicable to corporations generally. For the most part, banks are treated in the same manner as other corporations in regard to the major aspects of corporate income taxation, such as tax rates, the kinds of income reported, the type of deductions permitted, and the treatment of gains and losses on capital assets other than bonds and other evidences of indebtedness.

There are only a few sections of the law that are specifically directed to banks. In subchapter H, chapter 1 of the 1954 code, relating to banking institutions, sections 581-584 set forth rules of general application to banks, including the definition of a bank, the treatment of losses on securities held by a bank, the deduction by banks of amounts paid to the Federal Government on certain preferred stock owned by the Government, and the treatment of common trust funds.

Sections 591-594 of subchapter H establish special rules for mutual savings banks, cooperative banks, and domestic building and loan associations with respect to deductions for dividends paid on deposits (similar to the deduction for interest paid on savings deposits by commercial banks), deductions for repayment of certain loans made by the Federal Government before 1952, the

treatment of bad debt reserves, and the provision of an alternative tax for mutual savings banks conducting life-insurance business.

The remaining specific bank rule, section 601, relates to a special deduction for bank affiliates.

In addition to the specific provisions of subchapter H, there are several sections of the law which apply to corporations generally but which have special importance for banks as a result of their particular economic function. These sections relate to the treatment of bad debts in the case of commercial banks (sec. 166 and the regulations), the amortization of bond premiums (sec. 171), the nonrecognition of gain or loss on exchange of property (sec. 1031), and the treatment of bonds bought at discount (sec. 1232).

II. TAX PROVISIONS OF SPECIAL IMPORTANCE TO BANKS

A. Reserve for bad debts

On the basis of section 166, banks and other taxpayers may deduct from gross income wholly or partially worthless bad debts in the year the losses are sustained. As an alternative, the taxpayer may establish a reserve for bad debts and take a current deduction for reasonable additions to such a reserve.

The principal use of the reserve method by banks is in connection with accounting for losses on loans. The regulations supporting section 166 prescribe two methods of determining the annual additions to bad-debt loan reserves. One method is based on a 20-year moving average (including the taxable year) of the ratio of actual losses on loans to total loans. The alternative method, which involves a similar set of computations, is based on a bad-debt ratio derived from the loss experience of any 20 consecutive years since 1927. Under both methods the current addition to the reserve is determined by multiplying the bad-debt ratio (average of losses to loans over the given period) by the loans outstanding at the end of the taxable year to obtain the maximum tentative reserve addition. The actual addition is either this amount or any smaller amount which will make the reserve at the end of the taxable year equal to three times the maximum tentative reserve addition. Thus the current additions to bad-debt reserves are directly limited and the reserve itself is limited indirectly.

The moving-average reserve method was first provided in 1947 and the alternative fixed-period method was authorized in 1954. The latter method, insofar as it allows the banks to use a larger bad-debt ratio than the moving-average method, results in larger current additions to reserves and total reserves. A bank on the moving-average method is allowed to switch to the fixed-period method without obtaining the Commissioner's permission. If a bank is on the fixed-period method, it may elect to use any 20 consecutive years and, consequently, may change from one set of years to another at any time without permission.

In addition to bad-debt reserves against loans, banks—as distinct from other corporations—may elect as a result of section 582 (a) to treat bonds and other evidences of indebtedness with interest coupons or in registered form as bad debts if they become wholly or partially worthless. This allows the banks ordinary loss treatment on such securities either as a current deduction or as a reasonable addition to bad-debt reserves for bonds. Specific reserve methods are not prescribed in this case but any reserve for losses on bonds may not merely reflect market fluctuations in bond prices.

B. Worthless stock in affiliated banks

Under section 582 (b) a bank is allowed to treat worthless stock in an affiliated bank as ordinary loss, provided the bank owns directly at least 80 percent of each class of stock of the other bank. This provision represents a change made in 1954 from prior law. According to the report of the Senate Finance Committee:

“Under present law (1939 code), losses on completely worthless stock or securities owned in an affiliated corporation are allowed as an ordinary loss if 90 percent of the aggregate gross income of the affiliated company for all taxable years was derived from sources other than investment income. In the past banks have not qualified for this tax treatment because most of their income is derived from investment sources.

“Both versions of the bill (H. R. 8300) remove this restriction in the case of banks by treating stock held in an affiliated bank as a noncapital asset. This provision places banks on a parity with other business corporations. Although the principal qualification of other types of business affiliates entitled to such

tax treatment is noninvestment income, this rule was adopted to limit the tax benefits to companies whose affiliates were engaged in the same general type of business as the parent, rather than those used as a dumping ground for undesirable investments. Since loans and investments are the stock in trade of banks, it appears discriminatory not to allow banks a similar opportunity to take an ordinary loss on worthless stock in an affiliated company."

C. Gains and losses on bonds and other evidences of indebtedness

Banks, unlike other corporations, are allowed by section 582 (c) ordinary loss treatment on the sale or exchange of bonds, debentures, notes, or certificates, or other evidences of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, if such losses exceed the gains of the taxable year from sales or exchanges of such securities. On the other hand, if in the taxable year gains on sales of bonds exceed losses on such sales, the net gain is subject to tax as a capital gain at a 25 percent rate.

This treatment is substantially the same as that permitted under section 117 (i) of the 1939 code, which came into being with the Revenue Act of 1942. The justification for section 117 (i) advanced at the time was that bonds were a necessary type of investment for banks. Moreover, section 117 (i) parallels the treatment under section 117 (j), which was enacted at the same time, and relates to depreciable and other real property used in a taxpayer's trade or business and held for more than 6 months, except for property includible in inventory or held primarily for sale to customers.

Section 1031 (a) also relates to gains and losses and provides, generally, that on exchanges of property held for productive use or for investment no gain or loss shall be recognized, but an exception is made for exchanges of stock in trade, bonds and other evidences of indebtedness, and equities. It is this exception which is of interest to banks since it means that on any exchanges of bonds at a gain or loss, the gain or loss will be recognized. Gain on exchange of bonds would be taken into account as capital gain. Losses, on the other hand, would be treated as ordinary losses provided the conditions of section 582 (c) were met, i. e., total losses exceeded total gains.

It should be recognized, however, that insofar as losses on exchanges of bonds are concerned the key provision is section 582 (c). In other words, as long as section 582 (c) allows banks ordinary loss treatment on the sale or exchange of bonds, provided losses exceed gains, it is immaterial that section 1031 (a) states in a negative manner that gains or losses on such exchanges will be recognized.

Estimates of the revenue effects of allowing banks full deductions as ordinary loss for net losses on sales of bonds, debentures, etc., will vary with the assumptions made. The latest available data from the corporate Statistics of Income for 1953 show the item "Net Loss, Sales Other Than Capital Assets" as reported by banks and trust companies to be \$212 million, of which \$197 million was reported by those with net incomes. The bulk of this item is assumed to be losses on sales or exchanges of bonds. In the absence of the provision for deduction as ordinary loss, it may be assumed that this amount of capital loss could be offset against capital gains currently or through a loss carryover to other years. The net effect of the ordinary loss treatment is thus to allow a deduction effective against income at a rate of generally 52 percent rather than 25 percent, or a differential of 27 percent. Thus, for 1953, there would have been a maximum revenue effect of \$53 million, on the assumption that the same volume of sales and exchanges would have been transacted in the absence of ordinary loss treatment. If, however, it were assumed that without this tax treatment, the volume of loss on sales and exchanges would have been substantially contracted, as is probable, the revenue loss would, of course, be commensurately smaller.

D. Amortization of bond premiums

In purchasing bonds for investment purposes, banks at times buy bonds at a premium, equal to the excess of a bond's purchase price over its redemption price. Under section 171, banks and other taxpayers are allowed to amortize the bond premium to maturity or earlier call date and to deduct from income in each taxable year the portion of the premium amortized in that year. By this procedure the premium is gradually recovered over the remaining life of the bond. In effect, this provision provides an appropriate current adjustment of the interest to its approximate real amount.

The bond premium amortization rule applies, however, only to bonds the interest on which is wholly or partially taxable. Tax-exempt bonds, as is the

case with municipal bonds, are specifically excluded from the provisions of section 171.

A distinction is also made between callable and noncallable bonds in connection with the period over which the premium may be amortized. As noted above, the premium may be amortized to maturity or earlier call date, except that in the case of wholly taxable bonds issued after January 22, 1951, and acquired after January 22, 1954, the premium may be amortized to the nearest call date only if that date is more than 3 years from the date of original issue. Therefore, bonds with a very short call feature, such as 30-day callable bonds, may not now be used as vehicles of tax abuse as was the case under prior law.

When a bank or other taxpayer amortizes bond premiums, a compensating adjustment of the basis of the bond must be made to insure that a double deduction of the premium does not occur; that is, to insure that there is not a loss on sale or redemption of the bond attributable to the amortized portion of the premium in addition to the deduction for the amortization of premium. Even though tax deductions for amortization of premiums on tax-exempt bonds are not allowed, the adjusted basis of such bonds must be reduced over time as if the premium were being amortized. The reason is, of course, that if reduction of basis of tax-exempt bonds bought at a premium were not required, losses would arise on sale or redemption of the bonds (attributable to the premiums), a result inconsistent with the rule that premiums on tax-exempt bonds cannot be amortized and deducted currently.

The general rules relating to premiums on tax-exempt bonds applicable to investors are also applied to banks and others who are dealers in tax-exempt securities, except where a dealer buys short-term municipal bonds at a premium which are disposed of within 30 days of purchase or the bonds' earliest maturity or call date is more than 5 years from the purchase date. The effect of these exceptions is to allow the dealer to realize an ordinary loss upon sale or redemption of such bonds. Recently the staffs of the Joint Committee on Internal Revenue Taxation and the Treasury Department recommended to the Subcommittee on Internal Revenue Taxation of the Committee on Ways and Means that the 30-day and 5-year rules be removed so as to treat dealers and investors in tax-exempt bonds in the same manner.

E. Bonds bought at discount

Section 1232, relating to bonds and other evidences of indebtedness, is another general provision of the code in which banks as substantial purchasers of bonds have an interest. Specifically, this section states, in part, that a portion of any gain realized on taxable bonds bought at a discount and which were originally issued at a discount will be taxed as ordinary income.

To summarize briefly, when a bond is issued at a discount, the difference between the bond's issue price to the public and its redemption price at maturity is called the original issue discount. Any gain on sale of the bond which represents recovery of this discount is taxable as ordinary income and gain in excess of the discount is treated as capital gain. Where a bond is sold before maturity the original issue discount is spread pro rata over the entire life of the bond. This procedure reduces the amount of the total discount which is recovered as ordinary income at the time of sale. In connection with the computation of original issue discount, it should be noted that where the discount is less than one-fourth of 1 percent of the redemption price multiplied by the number of complete years to maturity, the original issue discount is deemed to be zero. Thus, any gain realized by the bondholder would be a capital gain. This rule serves to eliminate cases in which the ordinary income part of any gain is likely to be very small.

F. Deduction of dividends paid on certain preferred stock

According to section 583, which conforms substantially to section 121 of the 1939 code, the dividends a bank pays on its preferred stock owned by the United States or any instrumentality thereof which is exempt from Federal income tax are deductible from gross income. This provision reflects the fact that at times certain Federal agencies advance funds to banks in financial difficulties in exchange for preferred stock in order to sustain the banks and to protect the depositors.

G. The treatment of common trust funds

Banks often establish common trust funds for the collective investment and reinvestment of funds placed in their care as trustees, executors, administrators, or guardians. Section 584, which relates to the tax treatment of such trust funds, provides, essentially, that a common trust fund shall not be considered

a corporation and that the income of the trust fund shall be taxable in the hands of the individual participants. In other words, the common trust fund is viewed as a conduit and is treated more or less like a partnership.

H. Special deduction for bank affiliates

A holding company affiliate of a bank is allowed by section 601 a special deduction in connection with the computation of accumulated taxable income and undistributed personal holding company income. The deduction is allowed in the amount of earnings or profits of the affiliate which, in compliance with the law, has been devoted during the taxable year to the acquisition of readily marketable assets other than bank stock. To obtain this deduction, the Board of Governors of the Federal Reserve System must certify that such an amount of the earnings or profits of the holding company has been devoted to the prescribed use.

This section of the 1954 code corresponds substantially to section 26 (d) of the 1939 code.

AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order.

Is the manager of the open market account available now?

Mr. ROUSE. Yes, sir.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY ALFRED HAYES, C. CANBY BALDERSTON, J. A. ERICKSON, W. D. FULTON, DELOS C. JOHNS, A. L. MILLS, JR., OLIVER S. POWELL, J. L. ROBERTSON, CHARLES N. SHEPARDSON, AND M. S. SZYMCAK, MEMBERS OF THE FEDERAL OPEN MARKET COMMITTEE; AND ROBERT G. ROUSE, MANAGER, SYSTEM OPEN MARKET ACCOUNT—Resumed

Chairman PATMAN. Give your name to the reporter, if you please.

Mr. ROUSE. Robert G. Rouse.

Chairman PATMAN. Is Mr. Robert V. Roosa in your office?

Mr. ROUSE. He is a vice president of the Federal Reserve Bank of New York, and presently in charge of research and statistics. He was associated with me in the open market function until comparatively recently.

Chairman PATMAN. You are acquainted with his book?

Mr. ROUSE. Yes.

Chairman PATMAN. I think it was written on Federal Reserve Operations in the Money and Government Securities Markets. He was with the Open Market Committee quite a long time, was he not?

Mr. ROUSE. Yes, he was with the function for approximately 3 years. He is still interested in it, of course, as an economist.

Chairman PATMAN. You have complete charge of what you call the open market account for the New York Federal Reserve Bank?

Mr. ROUSE. Yes, sir; I am manager of the account.

Chairman PATMAN. And you were selected by Mr. Hayes of the New York Federal Reserve Bank, or by the Board of Directors?

Mr. ROUSE. I was selected originally by Governor Harrison and Allan Sproul in November 1939, approved by the directors of the bank, and approved by the Federal Open Market Committee.

That was an annual process thereafter, and it has been carried out through March of this year, when I was last selected and approved by the Committee.

Chairman PATMAN. You are employed by the bank?

Mr. ROUSE. I am a vice president of the bank.

Chairman PATMAN. And approved by the Open Market Committee?

Mr. ROUSE. Correct, sir.

Chairman PATMAN. Including the Federal Reserve Board?

Mr. ROUSE. Yes, sir.

Chairman PATMAN. Where do you get your pay?

Mr. ROUSE. From the Federal Reserve Bank of New York.

Chairman PATMAN. From the Federal Reserve Bank of New York. You are hired and paid by the Federal Reserve Bank of New York?

Mr. ROUSE. That is right, sir.

Chairman PATMAN. In your operations in connection with the open market, you buy and sell Government securities for all the 12 Federal Reserve banks?

Mr. ROUSE. That is correct.

Chairman PATMAN. Under the 1935 act, no other bank has any right to buy or sell securities, but each bank is obligated to carry out instructions from you?

Mr. ROUSE. They are obliged to sell or buy as the account sells or buys.

Chairman PATMAN. When you buy, say, a million dollars worth of Government securities, you give a check on some bank, do you not?

Mr. ROUSE. We give our own check.

Chairman PATMAN. You give a check on the Federal Reserve Bank of New York?

Mr. ROUSE. Yes, sir.

Chairman PATMAN. How do you allocate that million dollars among the 12 Federal Reserve banks?

Mr. ROUSE. It is in accordance with the daily averages of the total resources of each bank, pro rata.

Chairman PATMAN. In other words, you will determine the daily average of the resources, value of the resources, of each bank, and then that million dollars will be allocated to each bank in proportion?

Mr. ROUSE. That formula was adopted by the Federal Open Market Committee. This is done annually. As of February 28, or some such date, we each year allocate the securities if, by reason of the application of that formula each day, or each day that a transaction takes place, some variance has developed during the year; and the Committee has the opportunity to reassess the propriety of that formula at any time that it sees fit.

Chairman PATMAN. If there is any—in other words, if it is not properly balanced, you make the adjustment at the end of the year?

Mr. ROUSE. The Committee authorizes an adjustment in the formula.

Chairman PATMAN. If it is necessary for New York banks to transfer bonds to, say, Dallas, Tex., Dallas, Tex., will send you Federal Reserve notes to pay you for them?

Mr. ROUSE. It is done through the interdistrict settlement fund.

Chairman PATMAN. Now then, suppose you should buy a million dollars worth of bonds from the Dallas bank, and the Dallas bank said, "I want Federal Reserve notes in payment of these bonds, a million dollars," how would you go about getting those notes delivered to the Dallas bank?

Mr. ROUSE. We have never had that question come up, Mr. Patman.

Chairman PATMAN. I beg your pardon?

Mr. ROUSE. That is a new—I don't think I understand your question.

Chairman PATMAN. Well, you see, these Federal Reserve notes, of course, are printed by the Bureau of Engraving and Printing here in Washington. In some way you get that million dollars worth of Federal Reserve notes to pay that Dallas bank. How would you get those notes? How would you get them away from the Bureau of Engraving and Printing?

How would you get them delivered to the New York Federal Reserve Bank for that purpose?

Mr. ROUSE. It is a bookkeeping transaction through the interdistrict settlement fund, I believe, which is carried out at the Board of Governors' office.

Chairman PATMAN. In practice, it is a bookkeeping operation. But the truth is, all the bonds that you have—and you have about \$25 billion worth of bonds, do you not?

Mr. ROUSE. Something less than that; yes, sir.

Chairman PATMAN. About 24 or 25?

Mr. ROUSE. About 24.

Chairman PATMAN. Every one of those bonds have been bought, not on the resources of the Federal Reserve banks, but on the credit of the Nation by exchanging Federal Reserve notes for them, have they not?

Mr. ROUSE. Yes; they are bought by the—out of Federal Reserve funds.

Chairman PATMAN. No; you are mistaken there, are you not? You do not say that they are bought with Federal Reserve funds. The money is created by those bonds. Do you not understand that?

Mr. ROUSE. It is created—yes, indirectly.

Chairman PATMAN. Well, directly.

In other words, if you buy bonds, you must pay for them, and those \$24 billion worth of bonds were paid for, but not by Federal Reserve bank funds; they were paid for by Federal Reserve notes.

Now, I will not insist on your answering that. I will ask Mr. Martin to answer that.

Is that not correct, Mr. Martin?

Mr. MARTIN. It would be the same thing, sir.

Chairman PATMAN. In other words, that is where the power to create money comes in through the Federal Reserve.

Mr. MARTIN. Yes.

Chairman PATMAN. You create the money. In other words, the money is printed, it is paid for the bonds, the \$24 billion worth of bonds.

Mr. MARTIN. We have the power to create money.

Chairman PATMAN. And you did do it to buy these bonds?

Mr. MARTIN. In the purchase of bonds, we ease the money market; in sales of bonds—

Chairman PATMAN. I am not talking about the reasons or arguments. I am just asking.

Mr. MARTIN. I was just talking about the process. The purchase of bonds would ease the money market, and the sale of bonds would contract it.

Chairman PATMAN. Let's divorce it from any argument about any market, easy or hard, and confine it to the bonds that you already have.

You have \$24 billion worth of bonds. Now, those bonds were bought by giving of Federal Reserve notes in exchange for the bonds, were they not?

Mr. MARTIN. Well, Federal Reserve credit.

Chairman PATMAN. What is that?

Mr. MARTIN. Federal Reserve credit. They were not specific—

Chairman PATMAN. That is what I mean. But every one of them is an obligation of the United States Government, is it not?

Mr. MARTIN. That is correct.

Chairman PATMAN. And every one of those notes that you trade for those bonds of the Government says on its face that it is an obligation of the United States Government?

Mr. MARTIN. That is correct.

Chairman PATMAN. And that is what makes it good.

Mr. MARTIN. That is right.

Chairman PATMAN. Now then, whenever you take that Government obligation from the Bureau of Engraving and Printing and you trade it for \$24 billion worth of bonds which you have, and you have those bonds now, you draw interest on those bonds, do you not?

Mr. MARTIN. We do.

Chairman PATMAN. About \$600 million a year; and, although you traded one Government obligation for it, you keep the bonds and you do not cancel them. They pay interest, and you use that \$600 million in any way that is allowed by law, for administrative purposes in the operation of the Reserve banks. And then, of course, after all the deductions have been made, why, you pay 90 percent of the remainder into the Treasury of the United States?

Mr. MARTIN. That is correct.

Chairman PATMAN. The point I am trying to make, Mr. Martin, is, I am trying to answer a fallacious argument that is going over the country: No. 1, that these reserves that the member banks have in their Federal Reserve Banks are used to buy these bonds. That is a fallacy, is it not?

Mr. MARTIN. That is a fallacy.

Chairman PATMAN. That is a fallacy; it is not true.

Mr. MARTIN. That is right.

Chairman PATMAN. All right.

No. 2 is that the banks own the Federal Reserve Banking System, and it is run by the banks, it is operated for their benefit.

That is a fallacy, is it not?

Mr. MARTIN. That is a fallacy.

Chairman PATMAN. Now, the reason it is a fallacy is because the stock in the bank does not mean anything to the operation of that bank, does it? In other words, it is not used.

Mr. MARTIN. The stock in the bank is not proprietorship.

Chairman PATMAN. It is not used at all, is it? There is no use that that stock is put to?

Mr. MARTIN. Well, the—

Chairman PATMAN. The member banks.

Mr. MARTIN. There is a use put to it in the sense that it provides participation in the vote.

Chairman PATMAN. That is kind of psychological, to make them feel they are part of the System.

Mr. MARTIN. No. It creates the power to vote.

Chairman PATMAN. The what?

Mr. MARTIN. It creates the power to vote.

Chairman PATMAN. The power to vote for—

Mr. MARTIN. It is not proprietorship.

Chairman PATMAN. The power to vote for directors to run the bank.

Mr. MARTIN. Yes.

Chairman PATMAN. Well, that is easy. That is nice. [Laughter.]
I was wondering what they did.

But they paid in about \$300 million?

Mr. MARTIN. That is right.

Chairman PATMAN. In stock. And that stock now is there, but it is really useless to the banking system except make them believe, "Now you have got an interest in this thing, and that determines your participation in electing directors."

But do they vote according to the amount of stock they have?

Mr. MARTIN. No; not precisely.

Chairman PATMAN. Well, you see, that is knocked in the head, too, is it not? What I mean is, it is not used for that purpose.

All right.

So it is used to give the bankers a feeling that they have an interest in the Federal Reserve System when they don't have any interest except they get 6 percent interest on that stock, 6 percent dividend; is it not?

Now, is it not a fact, and we have gone over this before, that the Federal Reserve System and the Federal Reserve banks are Government institutions operated for the Government?

Mr. MARTIN. The Federal Reserve Board is clearly Government. The Federal Reserve banks, under our setup, are quasi-Government.

Chairman PATMAN. Are quasi-what?

Mr. MARTIN. Quasi-Government; they have an independent board of directors.

Chairman PATMAN. All right, let's examine that.

That stock, or that word "stock" is a misnomer, is it not?

Mr. MARTIN. If you are talking about stock in terms of proprietorship—ownership—yes.

Chairman PATMAN. Well, of course that is what stock is; yes. Normally that is what stock is; when you say "stock," you mean a proprietary interest of some kind, do you not?

Mr. MARTIN. In the ordinary sense, yes.

Chairman PATMAN. That is right, in the ordinary sense.

Mr. MARTIN. You and I are in agreement that it is not proprietary interest.

Chairman PATMAN. Yes.

Therefore, this does not convey any proprietary interest at all, and the word "stock" is a misnomer. It is not a correct word at all. It is just an involuntary assessment that has been made on the banks as long as they are members.

Now, they go out, the money is refunded to them. But as long as they are members, they get 6 percent annually on that.

And as evidence of the fact that they do not have any proprietary interest, which you admit, is the fact that this so-called stock cannot be sold, it cannot be hypothecated, and as a convincing and unanswerable argument that the banks have no interest in the Federal Reserve System as such, financial or proprietary interest, the law specifically

provides that in the event of the liquidation of a Federal Reserve bank, that after they get their \$300 million stock back, the Government gets everything else. That is right; is it not?

Mr. MARTIN. That is right.

Chairman PATMAN. Now, if the banks had any proprietary interest in that, they would get what was left after liquidation, would they not?

Mr. MARTIN. Well, you and I are in agreement it is not proprietary interest.

Chairman PATMAN. Yes.

Therefore, the statement that the banks own the Federal Reserve System is not a correct statement, is it?

Mr. MARTIN. The banks do not own the Federal Reserve System.

Chairman PATMAN. That is right.

Mr. MARTIN. But the banks do participate in the management.

Chairman PATMAN. It is an agency operated in the Government's interest by public members, seven members of the Federal Reserve Board, each one selected for a term of 14 years, and he cannot succeed himself after he fills out the whole term.

Of course, he can fill out two or three part-terms and make it 25 years. That would be all right. And they are selected by the President and confirmed by the Senate.

Mr. MARTIN. That is correct.

Chairman PATMAN. Now, you state—I am about to get off of this gentleman over here, and I will go back and ask him another question.

Senator O'MAHONEY. You are going to let him up? [Laughter.]

Chairman PATMAN. I think I had better ask Mr. Martin this instead of this gentleman:

I believe you have stated repeatedly, Mr. Martin, that the Treasury, in sizing up what kind of interest rate should be charged—and Mr. Humphrey has testified a number of times before this committee, I know, to that effect—that the Treasury will call in people who are dealers and people who have something to do with the sale of Government securities, and that they talk to the Treasury, and then they talk to you.

Almost invariably they go from the Treasury to your shop, do they not?

Mr. MARTIN. They frequently do; yes, sir.

Chairman PATMAN. They frequently do, and they are the ones that are consulted for the purpose of determining the interest rate that should be paid on Government bonds; I mean they are the ones that the Treasury uses. And you, of course, either say "yes" or "no."

Mr. MARTIN. We consult with the Treasury. We don't say "yes" or "no" on their interest rate. We are glad to give them the best advice that we have about what we think the market is.

Chairman PATMAN. Do you really believe we have a free market in Government bonds, Mr. Martin?

Mr. MARTIN. Well, all freedom is relative, but I say there are forces in the market place, as I have repeatedly said to you, that are stronger than both the Federal Reserve and the Treasury together. Some people question that, but I think that is where the law of supply and demand comes in.

Chairman PATMAN. You would not positively and without reservation say that there is a free market at all times in Government bonds?

Mr. MARTIN. I would say that there is some intervention, as was provided in the Federal Reserve Act, in the market, but that generally speaking, the market forces are permitted to operate.

And since the Treasury-Federal Reserve accord in 1951, the market forces, the market has been relatively free.

Now, that does not mean that we step completely aside and let the market become the law of the jungle. We are there as a guardian. We are trying to develop a climate and a general situation in which the players on the field have the best conditions to operate in.

But we do not make the market.

Chairman PATMAN. I am not going to pursue that accord further, but you have dug up a real snake that I want to help you kill on that.

Senator O'MAHONEY. Mr. Chairman, may I ask a question on that point?

Chairman PATMAN. Yes, sir.

Senator O'MAHONEY. Your answer is a qualified one, is it not, Mr. Martin?

Mr. MARTIN. Yes; it is qualified.

Senator O'MAHONEY. You do not want this committee or anybody who reads or hears this testimony to believe that you are saying that there is a free market in Government securities. There is not, is there? Am I not right?

Mr. MARTIN. There is not a completely free market in Government securities. We are watching over it from time to time.

Senator O'MAHONEY. It is as free as you will allow it to be.

Mr. MARTIN. It—there are—

Senator O'MAHONEY. You do not want a free market in Government bonds, do you?

Mr. MARTIN. Yes, indeed, I want the forces of the market to be permitted to play, but I don't want—

Senator O'MAHONEY. Let's follow this through.

You cannot get any answers to any questions, particularly to a complex question involving money, unless you are clear about your definitions.

Now, a free market, in the question which I am directing to you, is a market in which the law of supply and demand alone operates. It will go up or it will go down according to the forces which operate in the market, without Government intervention which will affect it. That is a free market.

Mr. MARTIN. Well, we have some Government intervention in this market.

Senator O'MAHONEY. That is the whole point.

Now, the whole issue here is to what extent and how should Government intervene? The Federal Reserve Board does intervene. Some people who come to us tell us that your intervention is bad for them, and for the economy of certain regions.

Others tell us that your intervention is good.

Your explanation of the intervention is that you want to prevent inflation. But you cure inflation or prevent inflation by providing a certain amount of inflation in the cost of money. When you raise the interest rate, all in the world you are doing is raising the price of money; is that not right?

Mr. MARTIN. No, Senator. The cost of money, it is the demand for money which creates the inflation. We could—

Senator O'MAHONEY. But you can control the interest.

Mr. MARTIN. We could control the interest at a price which would be depreciation of the dollar. Now, if you want us to control it in that way, it can be done.

Senator O'MAHONEY. Don't you see, you are changing the subject.

Mr. MARTIN. I don't think so. I don't think you can cover this subject except by looking at it as a process.

Senator O'MAHONEY. No matter—accepting your answer just as you made it, it nevertheless is true, is it not, that you have intervened, that you have raised the cost of money, and that you have done so for the express purpose of preventing the price of other commodities from rising?

Mr. MARTIN. Let's put it this way: We have not supplied all the money that is required to prevent a rise in interest rates.

Senator O'MAHONEY. Will you repeat that, please?

Mr. MARTIN. We have not supplied all of the credit which is necessary to prevent a rise in interest rates.

Senator O'MAHONEY. That is precisely true. You have not supplied all the money which the free market demands; you assert, and I think with propriety, that the object of your doing this is to prevent inflation.

But the sad fact is that it does not prevent inflation, because all you have got to do is look at the prices in the Economic Indicators to know that the prices of all goods except farm commodities have been going up, and particularly have the prices of dividends been going up, the value of securities going up, but the income of the farmer has been going down. And if you will pardon me while Mr. Moore hands me this document, prepared by the Council of Economic Advisers and printed under the authority of this committee, the figures I am going to read to you now will explain why so much complaint about this matter comes from rural areas.

Sometimes it is hard to find the exact page where these figures appear. Let's get it piece by piece.

Here it is—page 7, entitled "Farm Income," shows that the farm operators' net income, excluding adjustment for inventory change, which in 1951 was \$14.8 billion, has fallen every year since then until in 1955 it had fallen to \$11.3 billion.

Now, while that was going on, the returns from dividends were increasing: Dividends in 1950 amounted to \$9.2 billion. In 1952 they were \$9 billion flat, in 1953, \$9.3 billion, in 1954, \$10 billion, and in 1955, \$11.2 billion.

At the same time, personal interest income was increasing from \$10.6 billion to \$16.1 billion. In other words, while the farm economy was going down, the income of those who have dividends, who receive dividends for income and who receive personal interest, collect the interest.

So not only is the home builder paying more money, more interest for the money that he borrows, not only is the small-business man paying more interest for the money that he borrows, but the Government itself is paying more money, more interest for the money that it borrows.

Under your policy, the cost of money to the Government of the United States and to a vast segment of the people of the United States has increased, and some have complained about it.

Now, it is your policy that does it. I will admit there are other factors—of course, there are other factors—but you have spoken very frankly against pegging bonds; have you not?

Mr. MARTIN. I have, indeed.

Senator O'MAHONEY. You do not believe that bonds should be pegged. You could peg them; could you not?

Mr. MARTIN. We could.

Senator O'MAHONEY. But the reason you do not believe in pegging them is because you believe that that would cause inflation?

Mr. MARTIN. Because the price of that would be too great.

Senator O'MAHONEY. The price would have to be too great.

I am not arguing whether you are right or wrong. I am just trying to get the facts right out here on the table where we can all look at them and see them, without a misunderstanding of what we mean.

So here, somewhere along the line, because of this judgment which you have just repeated, you intervened as a Government board, and you changed the rate of interest.

Now, it injures some people; it certainly helps the banks. It helps those who collect interest, who loan money, but it does not help those communities which want to build schools, the communities which want to build roads, the people who want to build homes, the businesses which want to expand.

Now, am I wrong in that statement of fact?

Mr. MARTIN. Well, I think there are two sides to it, Senator. The demand for credit is what is creating the increase in interest rates. The Federal—

Senator O'MAHONEY. Why do we have an increased demand for credit?

Mr. MARTIN. Because the people are trying to do too many things too fast.

Senator O'MAHONEY. That is your judgment.

Mr. MARTIN. Well, that seems to be borne out, I think, by the facts in terms of prices. We could supply all the money that everybody is requesting today.

Senator O'MAHONEY. Do you think that the people who want to build more schools for their children want to do it too fast?

Mr. MARTIN. I am not passing a judgment on whether they are doing it too fast or not; I don't know. But I am saying that they have to face up to what I was discussing with you this morning, whether they would rather pay \$3½ million for that school instead of \$3 million for that school.

Senator O'MAHONEY. What I want to point out to you, sir, is the conflict between two different branches of the Government. You do not want to take the steps that would make the cost of money less to the communities which want to build schools; but we understand from the announcements that come from Augusta that the President is going to ask the Congress to appropriate money to build schools, to aid the States in building schools.

Now, will that not be inflationary, too, by increasing the expenditure? Would it not be better, by a lower interest rate, to get that money from investors, particularly when the investors might be in the very school districts?

Mr. MARTIN. If the people of the United States wish, through their Congress, to depreciate their dollar in order to build schools, that is certainly within the purview of Congress.

Senator O'MAHONEY. Well, now, Mr. Martin, I have never been very much impressed by this talk about depreciating the dollar, because I know that the purchasing power of the dollar has been steadily decreased since this Government was founded.

You will agree with me on that, will you not?

Mr. MARTIN. I think it has been depreciated often far too much. But I don't think we are asked to —

Senator O'MAHONEY. The falling price of the dollar has accompanied steadily the increasing prosperity of the Nation.

Mr. MARTIN. Well, that I don't agree with you on, Senator.

Senator O'MAHONEY. I will show you a chart produced by one of these Cleveland banks which was presented to us several years ago, which shows the fluctuations of the dollar. And the better we have grown, the prouder we have grown, the more productive we have grown, the less we have been able to get for the dollar, because we have so many of them. The dollar is merely an instrument of doing these things.

Mr. MARTIN. Here are wholesale prices which have been given to me by Mr. Young, which shows the fluctuations. Now, you can always handle a situation of this sort by outright depreciation of the dollar, but there are many factors that go into each one of these situations, and I do not think that the inflation has improved at any time the prosperity of the country.

Senator O'MAHONEY. Here is a chart on wholesale prices, too, and this comes from the Council of Economic Advisers.

Mr. MARTIN. I am quite sure it will agree substantially with this.

Senator O'MAHONEY. Very likely, but what does it show? It shows that the prices, the industrial prices, have been rising, in 1952, 1953, 1954, 1955, and 1956, the same period during which you have been raising the interest rates; that all commodities have risen from index 110 in 1952 to an index of about 116 in 1956; whereas the prices of farm commodities have fallen from an index of 100 in 1952 to an index of about 89 in 1956.

So what has your increase in interest rates been doing?

Mr. MARTIN. Are you suggesting that our policy has not been progressively severe enough?

Senator O'MAHONEY. I am suggesting, sir, that your policy has not been effective, that one segment of our economy is suffering and another segment of the economy is profiting from the policy that you followed.

Mr. MARTIN. Well, I don't agree with you on that.

Senator O'MAHONEY. You do not deny that dividends have increased?

Mr. MARTIN. Well, is that bad?

Senator O'MAHONEY. What?

Mr. MARTIN. Is that bad?

Senator O'MAHONEY. But farm prices have fallen.

Mr. MARTIN. Well—

Senator O'MAHONEY. That is bad.

Mr. MARTIN. There are two different sets of premises that you are dealing with.

Senator O'MAHONEY. No; I am making them all out of one chart.

Mr. MARTIN. Oh, no. The supply and demand in securities and the supply and demand for farm products are two different sets of factors, and that is what we cannot get away from.

Senator O'MAHONEY. Let me put it this way, Mr. Martin. You are too nice a man to argue with, although I would enjoy it, but I just want to say to you that I would like to have you write another paper to submit to this committee, in which you will undertake to show that the policy has actually been successful and could not be varied one way, one jot or tittle either way, for the benefit of the country.

Mr. MARTIN. Well, for the sake of the record, let me say that we have never claimed that our policy has been a hundred percent perfect, and we never will. It is not the nature of this problem that you can have a hundred percent perfection.

But I will say that so far as making the blanket charge that because there have been increases in prices the policy has failed, let us never forget that there are budgetary and fiscal problems, also; but the real test is how much higher would those prices have risen if the law of supply and demand in the money market had not been permitted to operate to dampen down somewhat the rate of spending and proceed to move in the direction of increasing savings.

That gap between savings and investment has to be met by some process.

Senator O'MAHONEY. Well, you are buying bonds right now in order to supply more money for the Christmas trade; are you not?

Mr. MARTIN. That is correct.

Senator O'MAHONEY. That is a justifiable purpose, in your mind?

Mr. MARTIN. That is right.

Senator O'MAHONEY. But it would not be a justifiable purpose, in your mind, to buy bonds to stabilize the Federal bond market and prevent a further decline in those bonds?

Mr. MARTIN. Except in the instance of a disorderly market, we would think that buying bonds just for that purpose, under present conditions—

Senator O'MAHONEY. How about for building of schools? Do you not think you might as well help the building of schools as help the retail merchants to supply the Christmas trade?

Mr. MARTIN. Well, now you are in a different field.

Senator O'MAHONEY. I have to jump around to different fields to keep up with you.

Mr. MARTIN. On the building of schools, I make no observation as to its desirability or undesirability, but I want those schools to be built with the price of labor and materials which will give the users of those schools the maximum value, and minimize their expenses in creating those schools.

Now, if it requires them to delay a little bit from time to time, I personally would think it would be preferable to delay than for everybody to rush in for a limited supply of steel and building materials and bid the prices up.

That is where I come back to this demand factor.

Senator O'MAHONEY. But when you delay the building of schools, you are delaying the education of children; and nature seems to have provided a limit to the life of man. It has been extended a little bit

by the decrease in infant mortality, but the old rule of three score and ten seems still to apply, if the obituary notices in the newspapers are indicators, and I think you can well make a selective exception from your rule in the case of building schools.

Mr. MARTIN. Well now, how many exceptions do we make?

Senator O'MAHONEY. That would be up to you. You make some exceptions, you have made six different changes, the chairman tells us.

Mr. MARTIN. Well, those have been impersonal. They have not been directed toward helping schools or houses or automobiles.

Senator O'MAHONEY. I led off with the one which was specific, and that was the Christmas trade. I asked you that question.

Mr. MARTIN. Well, we have a definite responsibility to supply the seasonal needs of all business, not just the Christmas trade.

Senator O'MAHONEY. Now you see why I have to jump from field to field with you. [Laughter.] You cannot defer the need of education or training.

Mr. MARTIN. I would like to associate the Board a hundred percent with the desire for education [laughter], and we are all united in our belief that education is of paramount importance.

Senator O'MAHONEY. Let me ask you to go one step further, and announce that the Board is united in its determination to do what it can to help the school districts and States of the United States to build the schools they need.

Mr. MARTIN. Without depreciating the American dollar. [Laughter.]

Senator O'MAHONEY. How are you going to deal with the social demands of the country?

May I say this? And then I am going to close my questioning. Of course, Mr. Martin, this is a people's country, not in the sense that the Soviet use that phrase, but in the sense that was stated in the preamble to the Constitution of the United States. This Government was founded to improve the general welfare.

All of the founders of our Government agreed upon that, and all through our history we have had battles between the Congress and the banks to prevent the banks from running the Government in a way that would be injurious to the social progress of the people.

I do not mean to tell you the story of William Henry Harrison and John Tyler. Tyler was a Democrat. He was nominated for Vice President on the Whig ticket because the Whigs thought they could win that way, and only in that way; and one of the purposes of the Whig Party was to reestablish the United States Bank which Jackson had destroyed because he felt that it was taking too much control over the trend of Government.

Tyler tried his best to agree on a charter for the new bank, and made 3 or 4 changes. He vetoed the bill.

Then it was changed, and he couldn't take it. He vetoed it again.

So his inherent support of the right of the people to have these social improvements through the Government overcame his desire to cooperate with the ultraconservative Whigs, who thought that money was more important than people.

That is the same issue that we have now, but it is made much more acute by reason of the facts which we have developed this morning.

The conservative and customary methods of fiscal policy which

could be justified when the national debt of the United States in 1939 was less than \$50 billion cannot be justified now when the national debt of the United States is \$278 billion, and at a period when we must remember that so much of that debt, practically all of it, is money that was spent for destruction, not for productive enterprise at all.

There has been many a wise word said with respect to interest, that it should be paid only on productive loans. That is to say, for projects that create new wealth or earn a legitimate profit, as distinguished from destructive loans or loans that were made to recover from disaster or to wage wars or things of that kind.

We cannot govern this interest problem by shutting off the desire of people in some enterprises to expand and progress, while we grant to others the privilege to expand and progress.

Mr. MARTIN. Well, Senator, I would just like to say that this money power that you have been discussing has been with us as a problem, as you state, from the early days of the Republic.

Senator O'MAHONEY. Right.

Mr. MARTIN. And we have evolved a means of handling it whereby Congress placed a trusteeship over it and wrote a trust indenture in the Federal Reserve Act.

Senator O'MAHONEY. Let me say that the Federal Reserve Board is doing much better than was done before the Federal Reserve Board was created, but you are working under very much more difficult conditions.

Mr. MARTIN. Well, I want to reemphasize what I said this morning, that we welcome this inquiry.

Senator O'MAHONEY. Fine.

Mr. MARTIN. We appreciate the opportunity to review this problem. Our responsibility is an impersonal one with respect to the allocation of resources. Now, it is up to us to present, under the Federal Reserve Act, to you what the price is if you are going to create money in excess of the requirements at a given time, which will go into increases in prices.

Senator O'MAHONEY. What I have been trying to find out, unfortunately without success, all day long is: What is the yardstick by which you measure the amount of money that ought to be created?

Mr. MARTIN. Well, the yardstick—there is no firm yardstick, but we have looked on the normal growth of the country in terms of perhaps 2, 3, 4 percent, no fixed formula, and we have added to the money supply generally for that purpose. But we have to gage things in terms of the demand and supply of credit and business activity.

Now we have increased the money supply $1\frac{1}{2}$ percent over this past year, but the velocity of money has been considerably higher than that, so that a 3- or 4-percent increase during the recession of 1953-54, in terms of the actual use of money, probably contributed less than the $1\frac{1}{2}$ percent that we have been adding today.

But, generally speaking, we have tried to make money available at all times, and although many people say that it hasn't been available, we question it. We have studied it very carefully. It has been available, but the cost of it has been rising because of the demand factors, where the root of inflation comes; the demand factors, not the cost factors, have been the ones that have overpowered the money supply in such a way that interest rates rise; and the saver, under these circumstances, should receive a higher return. And we think this bene-

fits the little man, the pension holder, the small savings account, because let me point out that stable prices are one of the greatest blessings, in my judgment, that the little-business man can have.

The big-business man can defend himself against increases in prices of a jagged sort, but the little-business man is pretty helpless when it comes to a price level that goes haywire.

Chairman PATMAN. What about the price level of interest?

Mr. MARTIN. We are trying to pull all these things together.

I am sorry, Mr. Patman.

Chairman PATMAN. I say, you talk about how injurious a price level is, an erratic price mechanism, on the little man. What about the price level on interest; isn't that destructive to the little man where it goes up—

Mr. MARTIN. Again, I say I would like to have, and you would, too, as low interest rates as we can have.

Chairman PATMAN. Yes, sir.

Mr. MARTIN. But something has to give at given points, and I think that using the credit mechanism as one of the governors on the flywheel of the economy, as I frequently express it, is about the most satisfactory way consonant with free institutions that we have so far devised to handle this money problem, that is a very real one, which Senator O'Mahoney so appropriately raises.

Chairman PATMAN. The way it looks like, the people that you are asking to give are the small-business people, the schools, the municipalities, the home builders and you state here that there is only so much—in effect you say that—so much labor available and so much of materials available, and if you make credit easier, it will not cause any more housing; it will just take away from somebody who is now getting it.

Now, this morning you said something about administered prices and you did not conclude. I wonder if you would mind finishing your statement on that.

Mr. MARTIN. I do not really recall what I said this morning.

Chairman PATMAN. All right, let me ask you anew: Do you recognize administered prices?

Mr. MARTIN. Well, I recognize the fact that in certain industries—

Chairman PATMAN. Prices are fixed?

Mr. MARTIN. (continuing). Prices are fixed.

Chairman PATMAN. Administered?

Mr. MARTIN. You have to determine prices.

Chairman PATMAN. All right.

Now, what percent of the prices are administered prices?

Mr. MARTIN. That I don't know.

Chairman PATMAN. Well, they are in the big industries, are they not?

Mr. MARTIN. Well, they tend to be there, because the demand and supply factors can be gaged a little bit better there.

Chairman PATMAN. Well, they are, as a matter of fact, they are in the big industries.

All right. Now, the big people are getting these loans, so the same people who are benefited under the high interest rate, because they can get loans and other people cannot, they already have charge of the pricing, the administered prices.

Mr. MARTIN. Let me make—

Chairman PATMAN. What evidence have you—you state that if you made it possible for all the little people to scramble for it, it would just mean that they would have to pay more to build a schoolhouse and more to build houses, and you wouldn't get any more done, but what proof do you have that they are not going to raise these administered prices anyway? They have a right to do that anyway, I mean they have that power.

Mr. MARTIN. Let me make a comment about this little man that is being denied the credit. I don't know whether he is being discriminated against. I don't honestly know. There may be some of it because this is a free society, and some people tend to take the easier course.

But we have tried in our administration of credit—we don't control the free enterprise system, but we have tried to point out that we want credits judged on as sound a basis as possible, and there are many banks that tell us they actually favor the little man as distinct from the big man.

But one of the important things about a big man is financial, one of the reasons you try to get bigger is that you have financial status that the little man doesn't have.

I frequently pointed out that between two prize fighters, a good big man will usually beat a good little man, because that is just muscle, and most little men are trying to get bigger.

Chairman PATMAN. How do you compare that with the big fellows getting the money?

Mr. MARTIN. I don't know whether the big fellows do and the little fellows don't.

The point I am making is, we are trying to gather data on that, but right now the assumption is made that I am not absolutely sure is correct, that all the big men are getting the money.

Now, this is borrowed money, mind you.

Chairman PATMAN. I know, but they are on the board of directors.

Mr. MARTIN. It doesn't help a man to borrow money and get into trouble.

Chairman PATMAN. They can lend it to themselves, in effect.

Chairman PATMAN. I want to ask you a few questions. I hope it will not take too much time.

You mentioned about the wholesale prices there a while ago. I wish you would get that chart again.

It has been my argument, Mr. Martin, that the darkest day for the farmers in the history of this Nation was March 4, 1951, when the Federal Reserve Board seceded from the executive, declared their independence, and said they were going to go their own way and let interest rates go up.

That is, in effect, what was said. And from that day on, interest rates commenced going up. Look at that chart, and I will venture to say on farm prices that you will find from March 4, 1951, every year since that time the line is consistently downward. Is that not right? From March 4, 1951—I know it is right, because I have seen many of your charts.

You see, the farmer pays both ways. You know, there are people who can protect themselves on interest rates as it goes up—say there

are 10 middlemen between the farmer and consumer, each one of these middlemen will take into account increased interest, and they will take it out of the price of the farmer's product. This accounts in part for the fall in the farmer's share of the consumer's dollar spent on farm products.

Moreover, higher interest rates are reflected in the price of farm machinery, from the cost of the ore, the barges on the Great Lakes, and in the steel mills and fabricating plants, in transportation. It all comes right down to the farmer, every one of them have added the higher cost of interest on every transaction.

Therefore, the farmer has paid it both ways, because he is the only unprotected person.

Mr. MARTIN. Let me just introduce into the record here that in the last year, farm prices have gone up 4 percent. During this period, the demand for money has exceeded the supply, and interest rates have been rising.

Now, the farm problem is not one that I am an expert on, but it is essentially a matter of supply and demand.

I might ask, if you would permit it, to have Governor Shepardson, who has had experience in farming, to make some comments on the farm problem.

Chairman PATMAN. I don't want to get it off on that angle right now [laughter], not that I wouldn't be interested, but I know what your story is. We have some good fox dogs down South, and when we have a good fox dog and we are on a trail and that fox dog takes out after a cottontail rabbit, why, we don't consider him a good fox dog any more. He is a cottontail rabbit dog. So I do not want to go off at an angle, and the main thing is about high interest rates, and I do not want to get off on the farm program, not that I am not interested in it, but because it does not dovetail in with what we are doing here now, and we have a lot of things to cover.

If we have time, I will be very glad to do it. If he wants to file a statement, we will be delighted to have it in the record, Mr. Martin.

I want to get back to Mr. Rouse over here, the manager of that greatest account on earth.

What is normally the aggregate of business done by your office in the course of a month, Mr. Rouse?

Mr. ROUSE. I haven't those figures in mind, Mr. Patman, I am sorry.

Chairman PATMAN. Well, would you say a hundred million dollars?

Mr. ROUSE. Probably in excess of that.

Chairman PATMAN. Two billion dollars?

Mr. ROUSE. I wouldn't know.

Chairman PATMAN. In the course of a year, what would it run?

Mr. ROUSE. I can't give you a figure, I am sorry.

Chairman PATMAN. You couldn't even estimate?

Mr. ROUSE. It is a large figure.

Chairman PATMAN. You couldn't even estimate?

Mr. ROUSE. No; I would rather not, because in some years it has been very little, and some years it has been a lot.

Chairman PATMAN. Well, last year, for instance?

Mr. ROUSE. You have this matter of purchases and sales, in some cases the purchases might run 2 to 1 to sales because of redemptions of securities at maturity.

Chairman PATMAN. I know, Mr. Rouse. I did not expect any involved answer on this. I did not think it demanded any. But you ought to have an idea within \$5 billion of how much business you did last year.

Mr. ROUSE. Perhaps—well, just say it was noticeably less than \$5 billion.

Chairman PATMAN. Less than \$5 billion.

How much was it this year?

Mr. ROUSE. I haven't a figure in mind at all.

Chairman PATMAN. You do not know. But everything is done in the open market; in other words—

Mr. ROUSE. I will say this: that between runoffs sales and purchases, the amount of securities in the account now is almost the same as it was the first of the year.

Chairman PATMAN. About the same as it was the first of the year. All right.

Now then, in your selection, you were selected by the Federal Reserve Bank of New York, as you stated.

Now, these directors that run the Federal Reserve bank in New York are just like all of the other 11 banks, are exactly alike for the New York bank, except the New York bank has the account, the open market account, and you run it for that bank.

All right. These 9 directors who have charge of that bank, they are selected, are they not, 3 class A, they are selected by the big banks, 1 of them; 1 of them by the medium-sized bank; 1 of them by the small bank, is that right?

Mr. ROUSE. Three bankers, that is correct.

Chairman PATMAN. Three banks. That is, three of them, that is class A.

Class B, they are, of course, bankers?

Mr. ROUSE. No. Class A are bankers. Class B are—

Chairman PATMAN. They are bankers.

Mr. ROUSE. Class B are not bankers.

Chairman PATMAN. What is that?

Mr. ROUSE. Class B are not bankers.

Chairman PATMAN. Not bankers?

Mr. ROUSE. No.

Chairman PATMAN. They hold an interest in banks. You mean to say they cannot own an interest in banks?

Mr. ROUSE. They may.

Chairman PATMAN. Why, of course they can.

Mr. HAYES. May I inject a word?

Chairman PATMAN. And the majority of them do have an interest in banks.

Mr. HAYES. I would like to answer, in the New York bank it just happens that no one of our B directors owns any bank stock.

Chairman PATMAN. The banks selected them, did they not?

Mr. HAYES. The banks selected them.

Chairman PATMAN. The banks selected every one of the class B's, that is, three of them. All right.

And the bankers evidently thought they were sympathetic, or they would not have selected them.

Now then, the class C, that is the Chairman of the Board, used to be—and I guess he is—a Federal Reserve agent, and two more.

Do you ever bring them in to your conferences here in Washington, Mr. Martin?

Mr. MARTIN. Yes; we just finished a conference.

Chairman PATMAN. About the class C directors.

Mr. MARTIN. With the Chairman and Deputy Chairman, two of the class C directors. We did not have all three of the class C.

Chairman PATMAN. But you recognize the class C directors?

Mr. MARTIN. Yes; we do. We do; indeed, we had a very—

Chairman PATMAN. And this bank is set up just like the other banks. The six selected by the banks have two-thirds of the directors who run that bank, don't they, Mr. Rouse?

Mr. ROUSE. Yes, sir; two-thirds of the directors are elected by the banks.

Chairman PATMAN. They select them?

Mr. ROUSE. Selected by the banks.

Chairman PATMAN. Therefore, the private bankers select the officers and agents of the bank, including yourself who run this biggest business on earth, using the Government's credit from the Bureau of Engraving and Printing, and trading it for United States Government bonds.

Mr. Martin, don't you think that the Federal Reserve System should be divorced—while you are talking about divorcing yourself from the executive—don't you think you should divorce yourself from the private banks?

Mr. MARTIN. Well, do you think that the Department of Agriculture ought to be divorced from the farmers?

Chairman PATMAN. Well, that is not exactly the same question.

Mr. MARTIN. Well, I think—

Chairman PATMAN. You see, no—

Mr. MARTIN. Same elements in it.

Chairman PATMAN. They don't use cotton and wheat as a medium of exchange.

Mr. MARTIN. Well—

Chairman PATMAN. If they used the cotton and wheat and pork as a medium of exchange, why your question would be a valid one.

But here we are talking about the creation, issuance, and distribution of money, that affects everybody. It does not take a banker—

Mr. MARTIN. We have special supervisory laws with respect to banks that we do not have for a business—all businesses. And I think they should be carefully supervised, but to say that the bankers of the United States control and dominate the System is not, in my judgment, correct, but that we need the bankers of the United States who are dealing every day in money and credit—if we are going to deal in money and credit at all, it seems to me obvious on the face of it.

Chairman PATMAN. Well, it is all right to get their views and suggestions and judgment, but it would be just as reasonable to me, like Woodrow Wilson said, to have the railroad owners run the Interstate Commerce Commission, and fix freight rates, as to let the bankers be on these policymaking boards and fix interest rates.

Now, I do not impugn the motive of a single banker—not a one—they are good, patriotic American citizens. I do not have any grievance against any of them. I do not distrust them. I do not question their honor or their integrity.

But I am talking about from a self-interest standpoint.

Here is the Federal Reserve Board, composed of 7 members—you are surrounded by 24 bankers to do your job. You have 12 on the Advisory Committee, selected by the private bankers who have the power of going in there and seeing what you are doing, ask you questions, and why you want to do it this way or that way, representing the private bankers.

Then you have 12 presidents of Federal Reserve banks selected by the banks.

So this Board of 7 is surrounded by 24 bankers, to do their job.

And I am just hoping in divorcing yourself from the Executive, you would also make a recommendation to Congress about divorcing yourself from the private banks.

Mr. HAYES. Could I make one observation?

Chairman PATMAN. Yes, Mr. Hayes.

Mr. HAYES. I would like to take exception to the statement that the presidents are selected by the private bankers. You have traced this chain of authority through the directors.

Chairman PATMAN. Wait just a minute. Maybe I made a misstatement. Selected by—representatives selected by the private banks.

Mr. HAYES. I misunderstood you then.

Chairman PATMAN. That is the only statement I intended to make and did make.

Mr. HAYES. I did want to point out, too, that the presidents, after being initially selected by the 9 directors, who include 3 directors chosen by the Board of Governors, must still be approved by the Board of Governors; that is, the appointment both of the president and of the first vice president cannot become effective until approval by the Board of Governors.

Chairman PATMAN. That is right.

Well, of course, they would pick out somebody like yourself, a good man, that they could not turn down. I am not questioning the motives or impugning their motives, of anybody in connection with this.

Mr. MARTIN, interest rates have gone up; discount rates 200 percent since 1947. Did you know that in discount rates—

Mr. MARTIN. Well—

Chairman PATMAN. The private acceptance, 90 days, have gone up 266.7 percent. The prime commercial paper for 6 months has gone up 252.4 percent since 1947. And the 3 months' bills have gone up 434.3 percent.

The 9 to 12 months' bills have gone up 267 percent, in 3 to 5 years, issued, I assume in notes, 172.7 percent.

I do not know of anything in the commercial or business world that has gone up any more than that, do you?

Mr. MARTIN. Disposable personal income has also had a spectacular rise.

Chairman PATMAN. Not that much.

Mr. MARTIN. These are comparative figures. But disposable personal income, as I pointed out in the statement this morning, is up, I think, \$21 billion over a year ago.

And tight money in the sense we are talking about it today, in one sense it is almost loose money because money has been flowing so freely, in so many directions, it has not seemed to have had any retarding

effect on disposable personal income and we have had a relatively stable price level.

I have been sorry that it has gotten out of hand recently.

Chairman PATMAN. Relative, but how, Mr. Martin, did you get that price level? How did you get it? Industrial prices, as you know, have gone up. They have consistently gone up.

Now then, that price level has gone up. If the farm prices had gone up, too—but farm prices were depressed, just enough to make the average an even price level—if it had not been taken out of the hide of the farmer, this price level would have gone way up.

You will have to admit that if farm prices had not gone down as much as they have, this price level would not have remained stable, would it?

Mr. MARTIN. That is true. Mr. Patman, from about the middle of 1955, up to that time, we had overall reasonably stable prices.

Now, I have regretted—and that is one of the reasons we have been so alarmed about the current trend and have wanted to do what little we can through money and credit policy to alert the country to the danger of price increases which have been showing a persistent tendency to move upwards over the last 6 or 7 months.

Chairman PATMAN. How about the increase in interest rates? Interest is part of the cost of doing business. It is a price increase.

Mr. MARTIN. The role of interest in the economy is that it is one of the prices, but, as I have pointed out, to satisfy all of the demands for money, at a time of intensive utilization of resources, can do nothing but add to the price of money.

And one of the restraining influences of interest rates is that interest rates tend to reduce spending and to give an incentive to savings.

That has been one of the few equilibrating forces that we have ever developed on a strictly impersonal basis in the economy.

Chairman PATMAN. All right. Now then, you have known Professor Bogan, don't you, you know of him?

Mr. MARTIN. I have high regard for Professor Bogan.

Chairman PATMAN. I have before me a statement he made about the financial situation, about the savings lag, in the face of high interest rates, in which he says, right on that point—I am quoting:

As has often been the case, the volume of personal savings is not proving responsive to higher interest rates. The volume of savings, of individual savings, is determined in the main by established habit patterns, rather than the rate of return.

In other words, savers do not act quickly that way. It is some sort of a pattern. And I do not see how anybody can safely contract or provide for the future at all when they do not know how low these bonds are going to get. They do not know, but what they are going as low as the British bonds that are now below 60—31½ percent bonds. They do not know how high this interest rate is going.

Is there any limit beyond which you will not permit these bonds to sink, Mr. Martin?

As a representative of the Open Market Committee, charged by Congress—and I am glad you brought that up—every statement you issued could properly be worded, "The Federal Reserve Board has taken the following action for Congress," because every action you take you take it for Congress, don't you?

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

Chairman PATMAN. That is right. You are the agent of the Congress. And every action you take, you take it for Congress. And whether Members of Congress recognize it or not, each and every one is responsible for your action. Each and every one of them.

Mr. MARTIN. Exactly, and on this matter of contract there is nothing more destructive of contractual relationships than a dollar that people do not have confidence in.

Chairman PATMAN. How can they have confidence in the bonds and the interest rate like it is—how low will you let these bonds go?

In other words, is there a limit beyond which you will not permit these bonds to descend?

Mr. MARTIN. I have not place, no limits of any sort on this matter. But I think we have to recognize that there is an equilibrating force at work.

I have here a table which shows that net personal saving is tending to increase, and when the gap between savings and investment is gradually filled, as it will be in due course, this equilibrating force will come into play again. And the business process as we have known it, has made it possible for us on a general basis to attain a definitely higher standard of living.

Now, the future of this country is unlimited. Our greatest economic problem is this: if we travel too fast we are going to get into a lot of trouble.

Chairman PATMAN. You do not depend on savings entirely, do you, Mr. Martin—don't you depend on created money?

Mr. MARTIN. If we create money—when the demand for money—when people are trying not only to spend more money than they have, but to buy more goods in the aggregate than there are—if we create money at that juncture in the economy, then all we do is add upward pressures on prices.

Chairman PATMAN. Now, about helping savers, all of which I am for—I want to help the savers—but do you believe that it is in the interest of the country to have an interest rate so high for savers that they will be satisfied with the return they get in the form of interest from their savings or is it in the interest of the country to have the interest rate low so that they will be looking around, let their minds be feeding around and finding opportunities to invest money and go into private enterprise, and let it become a part of venture capital and make more money.

Which is better for the people, to have an interest rate that will induce people just to be complacent and say, "I am satisfied"—

Mr. MARTIN. I want to restate—

Chairman PATMAN. Or is it best to have a rate that they will want to improve on by investment into the private enterprise system.

Mr. MARTIN. I want to restate my position on interest rates. I do not favor high interest rates. I want interest rates as low as we can have them without producing inflationary consequences because I believe you will have a greater formation of capital that way.

But if the alternative is to have inflationary pressures, I believe you do a great deal more damage to this little man that we are talking about than by any other single thing in the society.

Chairman PATMAN. You still are fighting inflation, but you cannot tell us where it is.

Mr. MARTIN. I always do everything within my power to resist inflation.

Chairman PATMAN. I don't blame you at all. But remember this, that you have plenty of ways to resist inflation, but you have not one way to resist deflation.

Mr. MARTIN. Let me just make—

Chairman PATMAN. That is a correct statement, isn't it?

Mr. MARTIN. A statement that I made this morning. I do not believe that a money and credit policy can make business, in itself. It produces a climate in which business can perhaps thrive and flourish.

But when we talk about this business of inducing or producing a depression or a recession, when money is available, I say that those people have more faith in the power of money policy than I have, and less faith in the strength and vitality of the economy than I have.

I have complete confidence that over a long period of time the American economy is strong enough to survive even a few mistakes of the money powers, because it is the ingenuity and the workmanship and the skill and the resources and the vitality of America that we are discussing now that cannot be destroyed by modest adjustments from time to time.

Mr. PATMAN. Mr. Martin, talking about this school situation, and the housing situation, I want to ask you about two things. Under the law the Federal Reserve Open Market Committee can buy Government bonds. And the Federal Reserve Open Market Committee can buy any bonds that are guaranteed by the United States Government, whether housing bonds, school bonds, or anything else; can't they?

Mr. MARTIN. Well, we can. We haven't as a rule.

Chairman PATMAN. You have the power, but you have not done it; have you?

Mr. MARTIN. We have not done it; that is right.

Chairman PATMAN. Why don't you arrange to do it? Now these schools are suffering. Mr. Levitt up here at New York gave an illustration where one school district is paying an increased rate of interest that amounts to as much money—the increase now—that would build an additional schoolhouse that would house 900 students, just in 1 school district.

That is an awful penalty for those people to pay on these long-time bonds that are tax exempt.

And you have the power to stabilize that market. If it takes a congressional act, you can get it, if you will ask for it.

The same way on housing. And a lot of these mortgages are guaranteed. I don't know whether they come within the regulations, exactly, or not, but if they do not, if you would ask for the power you would get it from Congress.

You would not have the least trouble getting it and you could solve both the housing problem and the school problem through the Federal Reserve banks.

So I suggest to you, you start working on that, Mr. Martin, and give a little consideration to it. Will you do that?

Mr. MARTIN. Well, I want to associate the entire Board again with an interest in education and—

Chairman PATMAN. All right, act.

Mr. MARTIN. The welfare of the country.

Chairman PATMAN. And the school system in particular.

Mr. MARTIN. And the school system in particular.

Chairman PATMAN. Actions speak louder than words. And I have shown you how to do it.

Mr. MARTIN. Let me also say as to the people that are educated in those schools, the boys and girls of tomorrow—that if the savings, the saving and investment fabric which has made this country strong, are destroyed by the process of building school buildings for them at rates that have been forced upon an unwilling market by an unending stream of fiat-created money—that they will be very sorry that something has gone out of American life.

Chairman PATMAN. You are in effect saying, Mr. Martin, whether you intend to or not—and again I am not impugning your motives or questioning your motives at all, but you are in effect saying that it is better for the economy that this school district in New York State pay a million and a half dollars more in interest than it would have had to pay 2 years ago—it is better for them to do that—than to spend that money to house, to have a place to educate 922 additional students.

And that thing can be multiplied by thousands of school districts all over the land.

In other words, what you are doing is in opposition to our educational program, Mr. Martin. You are stifling education in this country.

Mr. MARTIN. Not in the slightest. You and I are in complete agreement on our objectives. We differ on the methods we use to get there.

Chairman PATMAN. Now then, let us take industrial loans. You have a right under the law to make small-business loans, don't you?

Mr. MARTIN. That is right, sir.

Chairman PATMAN. How many have you made the last year?

Mr. MARTIN. I defer to Mr. Erickson. I do not know that we have made any.

Mr. ERICKSON. We have made some.

Chairman PATMAN. Ten million or one million?

Mr. ERICKSON. \$300,000.

Chairman PATMAN. How much money do you have for that purpose?

Mr. ERICKSON. There is no special amount.

Chairman PATMAN. Isn't it \$134 million?

Mr. MARTIN. About \$134 million.

Chairman PATMAN. Why do you say there is no specified amount?

Mr. MARTIN. We have not allocated any specific amount.

Chairman PATMAN. You do not have to allocate it. It is there.

Mr. MARTIN. That is correct.

Chairman PATMAN. Congress put it there, specified, earmarked it.

Mr. MARTIN. That is correct.

Chairman PATMAN. Isn't it a fact that you refused to use it, because you said the RFC was making those loans, and the RFC could do a better job? The RFC has terminated. There is no more RFC. There is no satisfactory agency making Small Business Administration loans.

Why don't you get back in there and help these small-business people? That \$300,000 is just a drop in the bucket. It does not mean anything, \$300,000 a year. I know you are not bragging about it.

Mr. ERICKSON. That is the only request we have had.

Chairman PATMAN. It is?

Mr. ERICKSON. Yes, sir; the only request.

Chairman PATMAN. Your Public Relations Department has not been working.

Mr. ERICKSON. In answer to that we had floods in Connecticut and Massachusetts, last year, and we sent around to all of the banks notice of 13-B and did not get a single request.

Chairman PATMAN. That goes to the public relations ability of the people that you have. You have unlimited funds, because if you need more money, take more greenbacks out of the Bureau of Engraving and Printing, buy more bonds and keep the interest and spend it for that purpose. That is the way you can do it. That is the system. All right.

So you can have plenty of public relations men to spread the word. And I hope you get busy. If you need more money, I believe Congress would give it to you out of your funds because you have plenty of funds down there to be used for that purpose.

Senator O'MAHONEY. I want to call your attention, Mr. Martin, to this. I know you are familiar with this publication, the Economic Indicator.

On the first page there appears at the bottom of the page a table or graph, indicating the variations in Government spending, Federal, State, and local.

There is, also, a table showing business spending, and consumer spending. This is all intended to show up the Nation's income, expenditure and savings.

In this latter—in the table I first spoke of, at the bottom of the page—it appears that Government spending in 1950 was slightly below \$50 billion. It increased to a peak of about, oh, maybe \$60 billion, in 1951. It leveled off, though gradually increasing, until in 1953 it would figure about \$75 billion. And then it began to fall off again, until 1955, when it rose above \$75 billion, where it stayed during 1956.

And now with pronouncements that we are receiving because of the increased burdens that the Government will have to face for national defense, and for economic aid to foreign countries, the lowest estimate of increased spending for the next budget year that I have heard is about \$3 billion.

There is very little possibility, apparently, of cutting down domestic expenditures.

Don't you agree with me that this tremendous amount of Government spending makes an altogether new problem from that which existed at the time the Federal Reserve Board was created?

Mr. MARTIN. I think in degrees it is different; yes, sir.

Senator O'MAHONEY. Well, isn't it actually utterly different in substance as well as in degree? Government expenditures, so far as defense is concerned, is something vastly greater than it ever was before. Until we became involved in World War II, why, we didn't know what the cost of defense would be.

I was chairman of the Defense Subcommittee on Expenditures, and I remember when the cost of an improved airplane, toward the end of the war, would be about a million and a half dollars.

Now, these new jet airplanes that are being built for civilian traffic cost about \$8 million apiece.

The expenditures that we have to make for the Army, for the Navy, and for the Air Force, are incomparably greater than ever before imagined and they are increasing steadily, particularly in the field of guided missiles, and the supernuclear weapons.

This utterly changes our situation. Don't you agree?

Mr. MARTIN. Well, I don't think that it changes it in the sense of the desirability of a stable dollar. I think that it certainly is a very complex and difficult problem; but if you compare all of these relationships, the gross national product, the growth of the country, the size of the debt, you still have—

Senator O'MAHONEY. When Government expenditures increase, do they not have a necessary effect upon the dollar?

Mr. MARTIN. Well, unless they are—

Senator O'MAHONEY. You cannot avoid it, can you?

Mr. MARTIN. Unless they are properly financed. We have a financing problem and we also have a problem of—

Senator O'MAHONEY. To me it seems like putting on a new tire, when I was a boy. When you got it on the rim on one side it was bulging out on the other, and it was a day's job sometimes to get that tire on.

You gentlemen are old enough to have experienced that, are you not?

Mr. MARTIN. Yes.

Senator O'MAHONEY. That is what we are dealing with now when we are trying to fit this Government finance to the demands put upon it, is it not?

Mr. MARTIN. We have a very difficult problem that—

Senator O'MAHONEY. And when the national debt exceeds the debt limit that Congress has placed upon it, does it not throw out of balance completely the desire of Government leaders to talk about a balanced budget? They have to change their course of action almost every 6 months and they have done it, have they not?

Mr. MARTIN. They have a very difficult problem, indeed, sir.

Senator O'MAHONEY. Well now, I will just say this to you: I believe very definitely and fundamentally that if we are going to win the cold war with Russia we had better concentrate all of your fiscal policies to see that the social and human goals of the masses of the people are protected from depression of any kind.

We would much rather go out of balance somewhere else than out of balance in improving the standard of living and the culture of the masses of the people who make up this Nation of ours. They are the very foundation of it.

That is why I respectfully will urge upon the Federal Reserve Board to forget the theories and the sound principles, even, which may have been sound when we did not have this great international problem, and place first of all in our consideration the maintenance of a sound people rather than a sound dollar.

Mr. MARTIN. Let me say, Senator, that I agree with you completely. And I frequently say the dollar should be our servant and not our master.

Senator O'MAHONEY. Right.

Mr. MARTIN. But we should have—and we will have this strength to stand up in the free world only as we are strong industrially and

economically, and as our standard of living is growing on a sound basis, and we have sustainable jobs, which is our problem today.

The actions which the Federal Reserve Board have been taking in accord with the forces in the money market have been designed to prevent deflation, with the understanding that preceding inflation will lead to a more drastic deflation than perhaps we could afford to have.

And therefore, an ounce of prevention is worth a pound of cure.

There are many, many facets to that, and it is a very complex problem. And no one on this Board thinks that we have all of the answers.

Senator O'MAHONEY. Mr. Chairman, I want to say, because I must go, that I feel that the Federal Reserve Board should be complimented for the frankness it has employed in answering the questions which we have propounded to its members here.

I feel that they have come here with a completely sincere desire to reveal all of the factors that can be revealed, and by that I mean can be revealed only because of the complexity in revealing these things.

You are telling whatever we want to know. And if we were smarter men maybe we could ask smarter questions. But I think maybe you would have some smarter answers, too. I feel that you are doing the best you can. And I thank you for what you have presented here today so far as I am concerned.

I still feel, however, that the problem is not settled, and that members of the Board must keep an open ear to all factors of the economy, before they reach a sound solution in the next Congress, which I hope we shall, as to what shall be done.

Of course, I thank the chairman for the magnificent way in which he has been handling this matter.

I beg to be excused now. I have some constituents here.

Chairman PATMAN. Thank you, sir. You have made a great contribution to our hearing.

Senator O'MAHONEY. I have some of my constituents here—young students—to see the Federal Reserve Board.

Chairman PATMAN. The Open Market Committee.

Senator O'MAHONEY. Thank you very much.

Chairman PATMAN. Mr. Shepardson, I feel like I ought to ask if you want to reply to what was said here about the farm situation in view of Chairman Martin's statement. If you would like to comment on anything that has been said, you have the opportunity now to do so.

Mr. SHEPARDSON. I might say this just briefly.

It is true that the farm prices declined from 1951, until the recent upturn this year. And that all too slight, I admit.

But that was not a result of availability of money or cost of money. The farmers of this country expanded facilities tremendously to meet the war and postwar demands when other countries were out of production.

Chairman PATMAN. Mr. Shepardson, would you take that chart there and look at it, and answer this question: if it is a fact that what the farmers received was going up, until March 4, 1951, and every year since that time it has gone down.

Mr. SHEPARDSON. I think it hit a peak in 1947, if I remember right; then it dropped.

Chairman PATMAN. I want to go to March 4, 1951.

Mr. SHEPARDSON. It dropped from 1947 to 1951, came back up in 1951 on account of Korea, not on account of money—on account of another demand for food, and agricultural products.

And as that demand fell off, agriculture is suffering today primarily from the burdens of surpluses that are hanging over the market.

The one thing that has been a partial offset, that has saved us from the decline that we had back in the thirties, was the fact that the rest of the economy has been moving at a high level.

There has been a high consumer purchasing power that has softened what might have been a much worse drop in prices than there has been.

But the decline in farm prices is strictly a relationship of supply against a declining demand—the war and the immediate postwar and Korean demand that we had for farm commodities both here and abroad.

Mr. PATMAN. Thank you very kindly, sir.

Now, Mr. Martin, in furtherance of that suggestion I made that the Federal Reserve could support these bonds, may I suggest to you that since the RFC has gone, and you have the authority, and if you need any more authority I am sure that Congress would grant it to you—that the Federal Reserve banks could do what the RFC used to do, buy up all of these school bonds and road bonds and city bonds, and State bonds where they could not get a market for them, and where they could not get a reasonable price.

The RFC made millions of dollars out of it, didn't lose a penny, and sold them out to the market evenly and everybody profited by it.

Now, the gentlemen in these Reserve banks, they do not have too much to do now since the central bank was organized.

You took most of their powers away from them. And you could give them something to do on that, on these municipal bonds and school bonds, in particular, and these small business loans, these industrial loans.

And I can remind you, too, that the first investment that was made as an open market transaction was the Federal Reserve Bank of New York buying \$5 million worth of securities from New York City. Do you remember that?

Mr. ROUSE. No.

Chairman PATMAN. Or reading about it?

Mr. ROUSE. No.

Chairman PATMAN. You see, the bankers, they were almost having running fits because they were going in the hole all of the time on the Federal Reserve, and they could not get the money from the member banks, and it looked like they were going to have to go to Congress and ask for an appropriation.

The bankers are pretty smart fellows. They began to think about it, "Now, what can we do?"

And some banker said, "Well now, we have the power to create money. Let's create money and buy some bonds. And use the interest on the bonds."

And that is exactly what they did on that first purchase of \$5 million of securities from the city of New York, not Government securities.

And so I humbly suggest that to you, Mr. Martin.

And I join Senator O'Mahoney in thanking all of you members—members of the Open Market Committee, which includes, of course,

the Federal Reserve Board—for your frankness and for being so forthright in answering all of the questions.

Mr. Martin always answered all of the questions, as all of the rest of you always do the same thing. Every question that is asked you try to give us an honest answer and we appreciate that.

I know it is nearly the time that some of you wanted to go. We do not want to hold you too long.

But, Mr. Martin, if we submit to you any questions before we close this record, I assume you would be willing to answer those questions and let it appear in the record as part of the hearings.

Mr. MARTIN. Be very glad to.

Chairman PATMAN. And the other members would do the same thing.

Mr. MARTIN. To the best of our ability.

Chairman PATMAN. Mr. Hayes, the hour is getting late; I wonder if you could run rapidly through your statement. We expect to have some more hearings, later. You know we have just scratched the surface of this thing and can go into questioning at that time.

Mr. HAYES. I would like to direct my comments today principally to the method of operation of the Federal Open Market Committee and the role of the Federal Reserve Bank of New York in executing the Committee's instructions. As a practicing central banker of less than 5 months' standing, I certainly make no claim to expertness in these matters, but it occurs to me that your committee might like to have the views of a newcomer like myself, taking my first look at the way in which this very vital function of national monetary and credit control is handled.

It goes without saying that the Federal Reserve Bank of New York, of which I have the privilege of being the chief executive officer, undertakes a great variety of important activities, most of which are related in some degree to the operations of the Federal Open Market Committee. I am thinking of such things as handling the reserve and borrowing accounts of the member banks, the provision of currency, the processing and crediting of checks received for collection, the expediting of wire transfers of deposit balances among banks and of Government securities among investors, the calling and disbursement of funds for the United States Treasury, the handling of transactions for foreign central bank and government accounts representing settlement of the United States balance of payments with other countries, and the supervision of member banks. These activities, most of which we undertake in common with the 11 other Federal Reserve Banks, have a great deal to do with the System's major responsibility of contributing to an efficient and adequate money and credit mechanism for the Nation. But they are sometimes referred to as "defensive" or "passive" operations, in contrast with the three "dynamic" or "active" instruments—reserve requirements, discount rates, and open market operations—which are employed in our efforts to minimize both inflation and deflation and to facilitate sturdy economic growth.

To discuss the Federal Open Market Committee's activities without referring to all three of these instruments would be quite misleading. For while it is true that the Board of Governors alone has the responsibility for determining reserve requirements, and while discount rates are established by the individual Reserve banks—subject to review and determination by the Board of Governors—in practice the Fed-

eral Open Market Committee has become the principal forum in which these two instruments, as well as that of open market operations, are discussed and weighed by representatives of the entire System in arriving at a systemwide consensus as to what should be done at any given time in the field of general credit control. The emergence of the Federal Open Market Committee as the meeting place where representatives of all parts of the System's complex structure can be brought together, for joint discussion of interrelated responsibilities, is one of the most interesting, and also probably one of the most constructive developments in Federal Reserve history.

Meetings of the Federal Open Market Committee are generally held every 2 or 3 weeks in Washington, so that I have been privileged to attend some 6 or 7 times since I became associated with the New York Reserve Bank. As you know, the Committee consists of 12 members, including the 7 members of the Board of Governors and 5 of the Reserve bank presidents. The president of the New York Reserve Bank is continuously a member, while the other four presidents are appointed in rotation. The 12 members of the Committee, which was established by statute, sit and reach decisions as responsible individuals, not as representatives of any constituency. Each must find the answer, in the light of all the facts and his own conscience, to the question: "What policy of credit control would be the best policy under present conditions for the economy of the United States?" Naturally each member brings to the Committee the full benefit of any special information available to him, including—in the case of the Reserve bank presidents—information concerning economic conditions in the various districts and the views concerning them held by businessmen and others; but each member also gives careful consideration to nationwide conditions and makes his final judgment on that basis.

The 7 presidents who are not, at the time, members of the Federal Open Market Committee nevertheless attend these meetings regularly by invitation and participate in the discussions on the same basis as the 12 Committee members, with the sole exception that they have no vote on matters requiring a vote. Thus the Committee obtains a firsthand report on conditions in each of the 12 Federal Reserve districts. During the periods between meetings, the 7 Governors and the 12 Presidents are of course pursuing their various other duties, but they are also preparing for the coming deliberations of the Federal Open Market Committee by observing the results of policies established at previous meetings, gathering new economic data, and continually reviewing their judgments of past decisions and current events. In New York, for example, our senior officers gather at least once each week to review important developments, and we have another special meeting of officers a few days in advance of each Federal Open Market Committee meeting for the special purpose of discussing the current state of business and credit conditions, Treasury finance, and related matters, and what type of credit policy seems best suited to this state of affairs.

At each Federal Open Market Committee meeting the procedure is to have the Manager of the System Account, who is also vice president in charge of the securities function at the New York Reserve Bank, lead off with any observations he may wish to make on what has actually happened in the Account and in financial markets in

general since the last meeting. He will already have furnished each member of the Board of Governors and each president with special written reports that are complete through the close of business on the preceding day. Thereafter two of the senior staff members of the Board of Governors present a comprehensive and detailed summary of current business and credit conditions in the country as a whole. After this the Chairman, following such introductory remarks as he considers appropriate on domestic or foreign developments, calls on each president and each governor, in turn, to give his appraisal of the current situation and to state his views concerning appropriate policy in the circumstances. Customarily the president of the New York Reserve Bank is called on first, and, because of the location of the bank in the country's money center, I usually talk of business and credit developments and expectations in national terms, and of the open market and other Federal Reserve policies I would consider appropriate in the light of those developments. The other presidents usually start off with comments on conditions in their particular districts and they, too, give their views as to credit policy. Likewise each member of the Board of Governors states his opinion concerning the appropriate policy after discussing any particular developments in the country's economy which appear to him pertinent. Generally the last man to comment is the Chairman of the Federal Open Market Committee, who is of course also Chairman of the Board of Governors. He summarizes his own appraisal of the situation and then undertakes the difficult task of pulling together the threads of all the preceding discussion and expressing the consensus of the meeting in terms of, first, how the directive to the New York Reserve Bank should be worded and, second, what specific actions are called for in the way of open market purchases or sales or other credit control measures—perhaps mentioning, for example, the possibility that consideration may be given to discount rate changes by the various Reserve banks, or to changes in reserve requirements by the Board of Governors. The Chairman then gives all present a chance to state whether they agree with his understanding of the consensus. The Manager of the System Account is asked whether the instructions are sufficiently explicit to enable him to carry out the Committee's wishes effectively, and at this point the Committee has an opportunity to convey to the Manager any nuances of policy which they think should be kept in mind.

I have been greatly impressed by the effectiveness of this whole procedure in bringing together a variety of disinterested and objective views on our country's economic conditions and problems, and then in deriving from these a reasoned consensus as to monetary and credit policy. Often the opinion of any one member is not yet crystallized when he arrives at the meeting, and it may well be modified during the meeting by this process of give-and-take. On the other hand, I think it is pretty clear that with 19 well-informed people having a full opportunity to present their views, on the basis of data assembled by able staffs throughout the System, it would be quite impossible for any one man holding an extreme position to dominate the Committee and dictate the Committee's conclusions. Indeed, the thinking of any one man may not be fully in accord with the consensus; the consensus is acceptable because it is a fusing of all the views, and it provides a workable basis for operations. Over time, such a consensus is bound to

be far more reliable than the occasional flash of insight that a single individual might produce.

I have been struck by the degree of harmony which has been achieved in this whole procedure. It has almost always been possible, without even the formality of a vote, to reach a consensus through the give-and-take of reasoned discussions.

As I have already indicated, the general conclusions of the Committee as to credit policy are set forth in the directive issued to the Federal Reserve Bank of New York. The directive is amplified by the statement of the consensus and by the full discussion, all of which are of course noted in the Committee's minutes. From this point on, and until the next Federal Open Market Committee meeting, the primary responsibility for conducting open market operations is in the hands of the Federal Reserve Bank of New York, acting in accordance with the instructions of the Committee. With the country's money market and securities markets centered in New York, most open market operations must necessarily be executed there, but I would like to stress that the New York bank is acting at all times for the System as a whole on the instructions of the Committee and is at all times responsive to the Committee's wishes. In my capacity as a member and Vice Chairman of the Federal Open Market Committee, I am in a position to help interpret the Committee's wishes to the Manager, and he himself has of course been present at the last meeting when he was specifically instructed on the varied detailed considerations which the Committee wishes him to keep in mind. He knows, for example, approximately what member bank reserve position the Committee believes appropriate, or he may have been told to give only secondary consideration to this factor and for a time to be guided primarily by such factors as the tightness of the banking structure in the money centers, the degree of market pressure suggested by United States Treasury bill rates and other money market rates, the impact of a large Treasury borrowing operation, and even more broadly by that on-the-spot appraisal of current attitudes and actions which is described as the "feel" of the market.

A comprehensive procedure has been worked out for keeping the Board of Governors and the other members of the Federal Open Market Committee promptly and fully informed on market conditions and all actual transactions for the System account, as well as on contemplated transactions. One of the most effective tools to this end is the so-called daily conference call at 11 a. m., each business day, when the manager of the account or his assistant talks by telephone with the economic adviser and a senior economist of the Board of Governors. The presidents of those Federal Reserve banks outside of New York who are currently serving on the Committee also participate by long-distance telephone in these discussions on a rotating basis, 1 President sharing in the call for a period of 2 or 3 weeks. At the New York Reserve Bank, the first vice president or I often "sit in" on the telephone call and many times both of us are present. (The first vice president is, in conformity with the statute, my alternate as a member of the Federal Open Market Committee.) The manager of the account summarizes conditions in the money and capital markets, the various reports or comments received from the dealers in United States Government securities, the reserve position of the principal New York banks, and the reserve position of the country's member banks as a

whole—together with the New York Reserve Bank's expectations as to changes in this national reserve position day by day for the next few weeks. The manager then indicates whether these available data and expected developments point to a need for open market operations in order to fulfill the Federal Open Market Committee's instructions, i. e., whether Treasury bills should be purchased or sold, whether repurchase agreements should be made with dealers, whether holdings of acceptances should be increased or run down, and in approximately what amount any or all of these might be considered. Participation in the call provides the economic adviser to the Board of Governors and the other president who is taking part in the call, the opportunity and responsibility of contributing their views as to existing conditions and the proposed course of action, particularly as these relate to the policy set at the most recent Federal Open Market Committee meeting. Usually there is immediate agreement, but suggestions may be made which result in some modification of the manager's program. Immediately following this conversation, a full summary is prepared at the Board and distributed to all of the Governors in Washington; the same summary is sent by wire to the various Reserve bank presidents.

The staff of the Board of Governors is advised periodically during the day by telephone on all details concerning actual operations and market developments. In addition, a written report is submitted daily to the Board of Governors by the New York Reserve Bank with copies to the interested officers of the other Federal Reserve banks and branches. At the end of each statement week a full written report is submitted by the manager to the members of the Federal Open Market Committee and to the other presidents. These reports not only provide a complete statement of all actions taken but they also give a full running record of conditions in the money and capital markets, with emphasis on interest rate changes and on the behavior of United States Government and other security prices. Prior to each Federal Open Market Committee meeting, as I have mentioned earlier, a detailed recapitulation of all major market developments and all transactions since the last previous meeting is prepared for submission to all Committee members and the other presidents.

Questions may occur to the account manager between Federal Open Market Committee meetings, perhaps as a result of some unforeseen development at home or abroad, which appear to call for an interpretation of some policy decision reached at the last meeting. If it is a minor matter, the question may be settled by discussion with the president or first vice president of the New York bank, but if it involves a major policy consideration, we may decide to consult by telephone with the Chairman, or, in his absence, with the Vice Chairman of the Board of Governors or some other member of the Committee. Or the initiative may come from Washington; i. e., Chairman Martin or Vice Chairman Balderston may telephone me and raise some question or make some suggestion having to do with interpretation of the current Federal Open Market Committee policy. If very urgent questions arise, it is possible to arrange on short notice for a telephone meeting of the Federal Open Market Committee to deal with whatever emergency may exist.

We in the New York Reserve Bank encourage the governors and the other Reserve bank presidents, as well as senior members of the staffs of the Board of Governors and of the other Reserve banks, to

spend as much time as they can spare visiting our trading desk, observing the manager and his assistants carry out open-market operations, and familiarizing themselves with the actual market atmosphere in which these operations are conducted. I am happy to say that we have had fine visits of this kind recently from the chairman and several of the governors and presidents.

The chief point which I would like to emphasize is the high degree of close contact and close cooperation existing between the Federal Open Market Committee as the originator of all open-market policy and the Federal Reserve Bank of New York as the executor of this policy. In my brief experience with the System I have felt that this whole mechanism works very effectively in the public interest.

I have already touched upon the importance of the New York money and capital markets, which is the basic reason for placing the responsibility for execution of the Federal Open Market Committee's policies on the Federal Reserve Bank of New York. Perhaps it would be useful at this point to explain briefly just what is meant by the Nation's "money market" and how the New York Reserve Bank's trading desk is organized to keep in intimate touch with that market.

The money market has been defined as the active market for money and close money substitutes which financial institutions and others rely upon to provide the liquidity needed in the usual course of their operations. Commercial banks, Government securities dealers, investment bankers, other financial institutions, nonfinancial corporations, State and municipal governments, and others turn to the money market to adjust their cash positions—supplying funds when they hold surplus cash, withdrawing or borrowing funds when they need cash. The instruments employed (in addition to bank borrowing at the Federal Reserve banks) might be short-term Government securities, marketable private short-term paper, demand loans, or Federal funds—money that is good at the Federal Reserve banks today, purchased with money that will not be collected funds until tomorrow. The money market through which all these day-to-day cash adjustments are made is national in scope, but the residual shortages or surpluses of funds come to focus in New York at the large New York banks. The extensive correspondent and customer relationships of these banks, and the purchase and sale of money market securities by the specialized dealer firms located in New York, provide facilities upon which all other regions depend to settle their shortages or use their excesses.

By providing a mechanism whereby interest earning investments may be converted readily into cash, and short-term money needs can be met through borrowing, the money market provides a degree of liquidity to debt instruments and a degree of flexibility to investment and borrowing practices that are essential to the functioning and the growth of a highly developed industrial and financial system. The participants in the money market are as varied as the economy itself. Business corporations are important and may come to the money market with temporary cash accruals to invest in short-term Treasury securities, bankers' acceptances, sales finance company paper, or other instruments. The corporations have to be confident of a market for their investments so that the latter can be liquidated readily when these funds are needed to pay dividends or taxes, or for operating purposes. Confidence in the liquidity of their investments has made it possible for them to make money available to others seeking money

rather than holding these funds in idle cash balances. State or local government may have funds from tax collections or from the sale of a bond issue that are not immediately needed and are temporarily available for investment. Foreign central banks accrue dollar reserves that may be invested in Treasury bills or bankers' acceptances. All of the financial intermediaries—life insurance companies, such Government agencies as the Federal intermediate credit banks or the Federal home loan banks, or any others—participate in the money market at least some of the time, either as borrowers or lenders of short-term funds.

Of course, the 14,000 commercial banks in the United States, or a considerable number among them, are the principal participants in the money market. The deposits held with them are check-book money and may be withdrawn without notice. It is particularly important, therefore, that commercial banks hold adequate secondary reserves in the form of liquid short-term investments to provide a potential source of cash to meet withdrawals. Moreover, commercial banks are required by law to keep minimum cash reserves against deposits; in the case of Federal Reserve member banks, these reserves must be kept with the Reserve banks. Since cash reserves earn no return, it is in a bank's interest to limit its cash reserves as nearly as possible to the amount required by law. In doing so, however, constant recourse to the money market is necessary, either to borrow money or to sell short-term investments when an excess of withdrawals over deposits pulls money away or to lend or invest short-term funds if an excess of deposits over withdrawals temporarily provides excess cash.

It is through the complex interrelations of this network of short-term financial transactions that the money system is kept working smoothly, from day to day, meeting the vast payments requirements of a vigorous, growing economy. The great bulk of the enormous movement of funds through the banking system each day works itself out through an offsetting of funds available against funds required on a local or regional basis, but a net residual of available funds or need for funds remains. It is in absorbing or supplying these residual funds that the central New York money market is of crucial importance. And it is here that the net dependence of the entire financial structure upon the Federal Reserve is brought most clearly into focus. That is why the operations of the arm of the System located in New York necessarily fill a central role in exerting the marginal degree of easing or restraining influence that is needed, if monetary policy is to exert a determining marginal force upon the availability of money and credit for the country as a whole.

These operations in New York include, of course, a host of varied functions that are also being performed by the System's 35 other arms—the 11 other Federal Reserve banks, and the 24 Federal Reserve bank branches, located throughout the country. They include, notably, the discount mechanism through which banks may borrow directly to meet short-run adverse swings in their reserve positions. That is a vast subject in itself. The only special significance of New York in this zone of System activity is that so much of the borrowing need that converges on the large New York City banks results from the residual of pressures exerted on these banks by their correspondents everywhere.

What is more or less unique in New York is the location there of the active center of the trading market in the United States Government securities. Because all banks and others may turn to the purchase or sale of Government securities, as the first line of defense for employing or obtaining money market funds, that market becomes a major zone for the exercise of System responsibility at its own initiative. By buying or selling short-term Government securities, or by advancing funds at times to the dealers who are continuously making markets in these securities for all classes of investors, the Federal Reserve can bring about the general degree of tightness or ease that is most likely to fulfill the broad dynamic aims of monetary and credit policy.

I will not try, here, to describe that market in any detail. What I do want to attempt, very briefly, is to outline the procedures followed by our own trading desk, in carrying through each day the instructions of the Federal Open Market Committee. Perhaps I should note parenthetically that our use of the term "trading desk" does not imply that we "trade" in the usual sense—with a view to making profits. Our desk, is, in reality, a listening post and a "transactions desk" where orders are executed.

This desk at the Federal Reserve Bank of New York has direct telephone lines with the principal dealer firms and with the commercial banks in New York and Chicago that have Government securities dealer departments. A group of specialists on the desk are in constant communication with these firms, which are in turn in touch with banks and other investors all over the country, and the composite picture that elolves hour by hour from these conversations and from direct reports from the principal New York banks will show the balance of forces that is taking shape in the money market. Price and yield quotations from various dealers for all Government securities and United States agency issues, the latest Federal funds rate, overall changes in stock prices, and other information are chalked up on a large quotation board to provide statistical background for the reports and comments that are constantly pouring in. In a real sense, the trading desk is the Federal Reserve System's listening post in the money market as well as its operating arm.

Discussions at meetings of the Open Market Committee with respect to its instructions to the Federal Reserve Bank of New York usually include among other things reference to the degree of pressure—ease or tightness—that the Committee wishes to maintain in the money market in pursuit of its broad policy objectives. The discussion may sometimes include mention of targets in terms of bank reserve positions or short-term interest rates that would be generally appropriate to the current phase of credit policy. But it is recognized that statistical measures are not always satisfactory guides to the condition of money and credit availability which the Committee wishes to maintain and that the "feel" of the market, as interpreted by specialists, must be the principal day-to-day guide—that is, the things that close observation can reveal are invaluable aids from the standpoint of the timing of operations.

However, I would not wish to leave the impression that the open market operations for the Federal Reserve System are guided largely by educated intuition. Back of the day-to-day decisions to buy or sell Government securities or to enter into repurchase agreements with dealers lies an intensive evaluation of the supply and distribution of

bank reserves and of the forces that are likely to influence the money market currently and in the near future. A group of money market specialists works constantly at forecasting the additions to or withdrawals of funds from the national money market which may be expected on the basis of patterns previously observed in changes occurring during a week, month, season, or year. Estimates are made of the daily flow of Treasury receipts and expenditures to determine if the Treasury will be supplying or withdrawing funds from the market. Other specialists keep records of scheduled security flotations by corporations and Government bodies, including the Federal Government, and the expected influence of these operations on interest rates and market conditions is included in the total picture. Detailed data are compiled on the positions of the New York banks, including their borrowing from the Reserve bank and in the Federal funds market. And many other statistics and reports—more than I could detail in this statement—are poured into the hopper each day to form part of the background against which operating decisions are made.

The piecing together and interpretation of the bits and pieces of statistical data, market reports, developments in psychology and news items that goes on constantly in the securities department of the Federal Reserve Bank of New York is directed toward a single purpose—the execution of the policy instructions of the Federal Open Market Committee. By 11 o'clock on most mornings enough of the overall picture will have been assembled to give a reasonably clear idea of the action, if any, that will be called for, and it is then that the conference telephone call—to which I referred earlier—is made. From that point on, subject to any questions that may come in from the members of the Committee or their staffs, the job becomes the highly specialized technical operation of choosing the right methods, and the right time, to effect the marginal degree of influence upon the volume of bank reserves, and the state of the money market, that will best carry through the general aims of System policy.

We have already had occasion this morning, particularly through Chairman Martin's testimony here, to discuss what has been done through recent weeks and months. If there are further questions, either as to techniques or as to objectives, perhaps the best way to give you the answers you require will be for me to attempt to respond directly to those questions.

Chairman PATMAN. You gentlemen are, I guess, the most important people in the United States now in our economy. You have more power than the Congress. You have more power than the Congress of the United States.

Mr. ROUSE. I have a complementary statement that I would like to put in the record, too. I covered part of it in response to your questions but the rest is my role.

Chairman PATMAN. Certainly, you may do so.

Mr. ROUSE. Thank you.

(The prepared paper by Mr. Rouse is as follows:)

STATEMENT OF MR. ROBERT G. ROUSE

This brief statement is intended to give your committee a thumbnail description of my role as manager of the Federal Reserve System's open market account. I was appointed System account manager in November 1939, succeeding Mr. Allan Sproul; Mr. Sproul, in turn, had succeeded Mr. W. Randolph Burgess. I was selected for the position by the board of directors of the Federal Reserve

Bank of New York, on the recommendation of President Harrison and Mr. Sproul, and my selection was approved by the Federal Open Market Committee. My official title at the Federal Reserve Bank of New York is vice president.

Under the operating procedures of the Federal Open Market Committee, the Federal Reserve Bank of New York has been chosen by the Committee to carry out all purchases and sale transactions in Government securities for the account of all 12 Federal Reserve banks. I have the responsibility of supervising the execution of those transactions in accordance with instructions of the Committee. The selection of the Federal Reserve Bank of New York is the logical consequence of the fact that it is physically located in the Nation's money market center, where the great bulk of all transactions in United States Government securities, and in other money market instruments, actually takes place.

Mr. Hayes has described the manner in which meetings of the Federal Open Market Committee are conducted and my participation in those meetings as manager of the System open market account. There are two reasons for my being in attendance at the meetings. First, it is my responsibility to report upon the manner in which instructions adopted at the last meeting have been executed in the market, and to answer any questions on the conduct of these operations that any member of the Committee might raise. After my report, the first order of Committee business is to approve the operations for the System account during the period since the last meeting. My second reason for attending the meetings is to learn firsthand the Committee's intentions as they are developed in the discussion of policy during the meeting. It is never possible to get into a written directive or into the minutes of the meeting the shadings and nuances that may be contained in the policy objectives the Committee establishes.

The instructions given to me by the Committee are of two kinds: First, the instructions on monetary and credit objectives that are to be achieved through operations during the period until the next meeting and, second, the continuing instructions that establish certain rules of procedure that are to be followed in the course of the System account's participation in the Government securities market.

The Committee discussions of immediate policy objectives at times include guideposts which my associates and I must keep before us in making day-to-day operating decisions. For example, the Committee sometimes establishes reserve targets. During a "restrictive" phase of credit policy it might be the Committee's intention that member bank excess reserves at the Federal Reserve banks should be prevented from rising above some particular range, or during a period of "easy money" policy, the Committee might direct that open market operations be conducted at least partly with a view to increasing excess reserves. At other times the Committee might be particularly interested in the developments in the capital markets and the direction and degree of change in interest rates. Reserve measurements are not always satisfactory measures of the true availability of credit and money, and movements of interest rates might give a better reflection of prevailing credit conditions. These guides might be among the 3 or 4 considered particularly important by the Committee at a given time. But the Committee will not expect to be able to blueprint the course of market developments, even for a few days ahead, and therefore would not set rigid targets for any of these guides, nor try to spell out in detail various alternative sets of possible developments and targets. Enough is said to make clear to my associates and me the degree of general pressure that the Committee wants maintained, and the relative importance of various guides in the circumstances then prevailing. Reliance must then be placed upon the judgment of the manager and his associates to interpret the meaning and implications of the stream of developments and of changing psychological attitudes occurring in the markets from day to day to achieve the proper timing in carrying out the instructions of the Committee.

Managing the System open market account to achieve the objectives established by the Committee calls for the assistance of many specialists. For many of these needs we call on the services of skilled technicians who also serve jointly some of the other operating or service functions of the bank. For example, it is necessary to have forecasts of changes in bank reserves that are likely to occur as a result of a great variety of developments that are quite independent of open market policy—our open market operations must take account of these influences. Such forecasts are, in fact, prepared each morning for our use. Back of their preparation lies a pyramid of statistical information and knowledge of past performance that is used by our money market specialists in drawing up their forecasts. Other specialists are constantly analyzing developments in all of the

securities markets so as to provide the account management with the necessary information required for interpretation of the hour-by-hour course of developments in these markets. Demands for bank credit are likewise important in appraising the pressure of credit demands in the market—and for some kinds of credit this is significant not just monthly, or weekly, but daily and even hourly. The economists at the bank help materially in keeping us informed on critical aspects of these developments.

All of us engaged in open market operations are thus constantly in touch with the money market and the Government securities market so that each new development, as it exerts its influence on credit conditions, can be included in the overall view of market conditions that we form from day to day. The most important part of my role as manager of the System open market account in carrying out the Committee's instructions is this never-ending appraisal of market influences. A decision to buy or sell Government securities results from the interpretation that my associates and I place upon the various conditions at work in the market and upon our judgment as to what would be required against this background to achieve the Committee's objectives. In passing, I might call your attention to one point which my comments have probably already made clear; managing the System open market account is not a one-man operation. While responsibility for final decisions is mine, I rely heavily upon the competent staff of market specialists, traders, statisticians, economists, and others at the Federal Reserve Bank of New York to assist me. In addition, I am able to discuss day-to-day problems of policy execution with the Vice Chairman of the Committee, Mr. Alfred Hayes, or his alternate, Mr. William Treiber, at the New York Reserve bank. And when more serious matters arise on which I wish guidance, I may contact Chairman Martin or request a telephone conference with the full Committee.

I mentioned earlier that the system account manager operates under two types of instructions from the Federal Open Market Committee. The first are the instructions for the execution of current policy that I have just briefly described. The second are more detailed operating instructions that establish certain procedures and methods of operation for the system account in the Government securities market. Among these there is the instruction that the manager should buy or sell at best prices in the execution of system account transactions. In the actual conduct of a system operation, dealers are asked to offer us securities if we are buying or, if we are selling, to bid for securities offered by the system account. The dealers quoting the lowest prices when we are buying or the highest prices when we are selling will get the system account business. Of course, the decision as to the total amount to be bought or sold for the system account at any time is made by the manager, within the framework of committee instructions and review. In this connection, the Open Market Committee establishes a limit on total purchases or sales for the system account between meetings of the committee. If market conditions appear to me to require that purchases or sales in excess of this authorized amount should be made, I must refer back to the committee for authorization to enter into these additional transactions.

It has always seemed clear to me that as manager of the system open market account, operating under the Federal Open Market Committee, I am answerable directly to the committee for the manner in which I discharge my responsibilities. My function is that of a specialist designated to carry out day-to-day operations under the direction of the policymaking Federal Open Market Committee. In this capacity it is part of my responsibility to keep the members of the committee fully informed on all operations for the account and the reasons which give rise to each operation. Mr. Hayes has outlined the conference telephone calls and the steady stream of reports originating in the securities department of the Federal Reserve Bank of New York. These calls and reports are intended to be as informative as it is possible to make them, and through the years we have attempted to improve this flow of communications between the manager of the account and the Open Market Committee.

Chairman PATMAN. And any of you can add anything that you think is material and germane, including you, Mr. Shepardson.

What is the status of the consumer study, Mr. Martin?

Mr. MARTIN. The consumer credit study will be completed and will be published early next year.

Chairman PATMAN. Early next year?

Mr. MARTIN. I won't set a specific date on it.

Chairman PATMAN. You had some staff papers on the 1953, 1954 recession. Have you finished those?

Mr. ENSLEY. If I may, Mr. Chairman, at the time of our hearings 2 years ago it was a little premature to make complete evaluation of the monetary experience during the 1953-54 period. I believe you indicated at that time that you had staff projects, looking into that experience.

It is my understanding that since then, staff papers have been prepared and circulated to academic and labor and business and banking economists.

Would you comment on your plans for the ultimate disposition of those papers.

Mr. MARTIN. Mr. Young informs me—Mr. Young, who is head of our Department of Research and Statistics—that these were just working papers and that they would require quite a bit of work.

Mr. ENSLEY. I appreciate that.

Mr. MARTIN. We are working on them and reviewing them in the light of these meetings we have been having with various groups that have been giving us some ideas and comments on them.

Mr. ENSLEY. I have heard some very favorable comments about them. And it seemed that their publication might have some merit.

Mr. MARTIN. It might be that the Board would take under consideration publishing them after we have had a chance to edit them suitably in the light of all of the comments we have received.

Chairman PATMAN. Just one other thing, Mr. Martin, about a request for a Federal Reserve survey that I will make of you, if it is reasonable.

There is a dispute about the effects of tight money on small business. In the absence of authoritative reports there have been private surveys which are contradictory.

For example, Standard Factors Corp. surveys show small business getting less loans, the ABA survey and the Mellon Bank study of its own lending, shows small business getting more.

I want to ask you, Mr. Martin, to make this survey.

A good way to do it would be to repeat a survey which the Board made as of October 5, 1955. This shows the amount of loans outstanding by size of borrowers, cross-classified by size of bank.

If the same survey were made as of October 5, 1956, we could by comparing to the report as of a year ago, tell, (1), what the effects of tight money have been on the small borrowers against big borrowers; and (2) what the effect have been on the small banks against big banks.

It previously covered business loans of all member banks, and appeared in the Federal Reserve Bulletin for April 1956. The tabulation shows 7 size classes of borrowers and 10 size classes of banks.

Would you have that survey conducted, Mr. Martin?

Mr. MARTIN. We will do our very best to get further data on this subject, Mr. Patman. We are deeply interested in it, you know.

Chairman PATMAN. Yes. I know you are.

Mr. MARTIN. And want to do everything we can.

Chairman PATMAN. And that \$134 million you have for small industrial loans will last too long at the rate of \$300,000 a year. We

hope you will find some way to pep it up, the opportunity for these little fellows to get these loans.

Mr. Frischknecht, do you have some questions?

Would you consider sending yours in like I am sending mine in?

Mr. FRISCHKNECHT. Mr. Martin, I am Dr. Frischknecht, legislative assistant to Senator Watkins. He could not be with us today. He is on his way back to Washington from Hawaii.

I just spoke with him by telephone from San Francisco. He asked me if I would convey to you and the members of the Board his sincere thanks for the good job which you have been doing the past 3 or 4 years.

I do have some questions I would have liked to have asked you. I think they might have added a little perspective to the discussion that has continued at quite great length here today, but I suspect, as the chairman indicated, that we may have another opportunity before too long to hear from you again.

And Senator Watkins will be here at that time. So with that little explanation I will forego any examination.

Mr. MARTIN. We will await receipt of those questions, or if you wish to submit them we will try to answer them now.

Chairman PATMAN. We can submit them in writing if it is all right.

Mr. MARTIN. That will be perfectly all right.

(Supplementary questions later submitted to Mr. Martin by letter and his answers to them are covered in the following.)

ANSWERS TO REPRESENTATIVE PATMAN'S QUESTIONS

1. Credit the lifeblood of our economy: An early economist to whom modern economists are greatly indebted was a French surgeon, Francois Quesnay. Quesnay's ideas about how the economy functioned were influenced by his knowledge of the circulation of blood in the human organism. Following along Quesnay's line and viewing credit as the lifeblood of our present-day economy, these questions occur to me. Our economy is a vital living organism. Will it be made healthier by curtailing its flow of lifeblood? Do we heal disease by general bleeding or do we treat specific infections?

Modern medicine puts great emphasis on the necessity of maintaining a general environment propitious to health. While analogies are imperfect, we would agree in general that credit may be likened to the lifeblood of our present-day economy. However, pursuing your analogy, we would diagnose the credit situation today as one of high blood pressure for which the remedy is neither bleeding nor pumping more blood into the system but a general therapy to alleviate the high pressure affecting the entire economic body.

2. Thirty years of penicillin for a minor infection: When you or I get an infection and come down with a fever we first try to build up our production of antibodies to bring that fever down. If the infection persists and the fever mounts, our physician may administer and prescribe penicillin for a week or 10 days, enough to curb the infection and bring the fever back to normal. You wouldn't think much of that doctor if he put you on penicillin for 30 years to take care of a 10-day infection? Yet in many cases the high interest rate cure for today's alleged inflation will have to be taken every day over the next 20 to 30 years.

Lower interest rates offer incentives for borrowers when resources are available and higher interest rates offer an incentive to defer borrowing when resources are unavailable. It is true that the borrowing costs on a 30-year obligation incurred 2 years ago would be less than the borrowing costs a borrower would incur in today's market. This illustrates the strong incentives interest rates, particularly on long-term loans, exert toward sustaining high-level employment and maintaining the value of the dollar in the economy. If 30-year money were available to borrowers at the same interest rate as 2 years ago, higher prices for resources and output generally would more than offset the lower borrowing costs.

3. Why should United States support a plan that drives its bonds down and makes it pay more? What would you say of the businessman who used his full power and influence to force down the market price of his company's obligations and gave enthusiastic support to a plan whereby he would have to pay more and more for the use of credit extended by lenders who had gotten it from him originally at no cost to themselves? No doubt you would find it difficult to find such a businessman—he either would be broke or in a mental hospital. Can you tell me why precisely the same pattern of conduct pursued by the United States Government is considered perfectly proper and sound?

Successful businessmen usually evaluate specific costs in terms of the total effects on their operations. It would be the height of folly for the United States to inflate the currency under the impression that this would lower the cost of running the Government. Actually, the country would pay for this folly many times over in the shape of higher prices for everything it buys.

4. Inflation and shortages: Inflation or sharply rising prices are usually associated with physical shortages. Would you say that inflation is more likely to be prolonged when employment, output, and incomes are rising and plant capacity is being expanded, or when credit is tightened with the inevitable rise in interest rates operating to restrict output, reduce the demand for workers and lowering incomes? Assuming that people in the United States desire not only to maintain past standards but to raise them, which policy would you say is more likely to result in permanent inflationary pressure?

We would not agree with this statement of the problem. Inflation arises when aggregate money demand is in excess of the capacity to make available the goods demanded. Attempts to increase money demand still further under conditions of intensive use of resources induces a competitive scramble for the available goods and thus increases prices. It should be noted that many industries are currently operating at capacity and the gross national product is the highest on record and still rising.

5. Safety factor versus speculative returns on governments: Assuming you want wide ownership of the Federal debt in the hands of permanent investors, which would you say is more likely to help you achieve such an objective—a policy that promotes confidence in the safety of the principal invested in a Government obligation, or one that creates opportunities for speculative gains, discounts and higher yields?

The record shows that the continued erosion in the purchasing power of the dollar that occurred prior to 1951, when United States Government prices were pegged at par, had serious adverse effects on the efforts of the Treasury to promote widespread ownership of savings bonds on the part of permanent investors. A policy designed to protect the value or purchasing power of the dollar is certainly most likely to encourage the "wide ownership of the Federal debt in the hands of permanent investors."

6. Would you say that since the accord the role of power of banks and investment houses in influencing the allocation of our resources have been considerably increased? From the standpoint of democratic government would you regard this as strengthening or weakening it?

The "role and power of the banks and investment houses in influencing the allocation of our resources" has been changed radically since the accord in that they are no longer shielded from fluctuations in interest rates and prices in the market. This exposure of the financial community to the sanctions of the market would seem to strengthen democratic processes. These institutions affect allocation of resources through investing the savings that are placed with them for administration. Total savings have been increased since the accord, but there has been no particular trend in the proportions of the total that have been invested or allocated through the medium of financial intermediaries as a group, on the one hand, and through the process of direct investment by individuals, on the other. Stability in the purchasing power of the dollar since the accord has increased the confidence of savers and the willingness of people to save in dollar form. This has financed the great growth of our productive capacity in recent years.

Do you think that the price of money allocates the supply of credit?

In our judgment, it helps. This influence is illustrated in the answer to question 9.

8. Could you have limited the growth of credit to the same extent without raising interest rates?

Interest rates rose in response to the basic supply-and-demand situation. When resources are being fully utilized, growth of credit cannot be limited without a rise in interest rates unless you have a credit-rationing system so

all embracing as to be administratively impractical and inimicable to our system of democratic government.

9. Do you think credit policy has effectively restrained the plant and equipment boom? If so, how?

The rate of construction of plant and equipment has surged 25 percent ahead of that of a year ago. This boom has accentuated the demand both for construction labor and for the materials used by the construction industry. As a result prices have risen. However, credit policy and fiscal policy have exerted a moderating influence. The recently released report of the McGraw-Hill Publishing Co. concerning business plans for capital spending in 1957 and 1958 states: "Difficulties in construction and in delivery of equipment have delayed some 1956 expenditures until 1957. And in some industries, a part of 1957 spending is being rescheduled for 1958. Cash shortages—resulting from lower profits and tight credit conditions—have been important in some cases. However, the main effect has been to stretch out plans for expenditures. Very few cancellations are reported." It may be noted that, "For 1957, business now plans to increase spending 11 percent compared with an increase of 21 percent in 1956. A considerable portion of the increase represents spending that was originally planned for 1956 and has been deferred until 1957."

At an earlier date we described for you the mechanism through which our credit policy operates to restrict inflationary expenditures. In our answers to the 1952 questionnaire submitted by the subcommittee of the Joint Economic Committee on Monetary Policy and Management of the Public Debt, of which you were chairman, we stated (question 31, pt. I, pp. 373-374):

"The sensitivity of borrowers to changes in the rate of interest varies widely. In certain fields of long-term investment, such as housing and public utilities (which are large and important fields), interest costs are particularly significant, and a comparatively small increase in interest rates can have a substantial effect in decreasing or postponing the demand for capital. Even in other fields where the rate of interest plays a less important role in costs, fringe borrowers may still be deterred from borrowing in case interest rates rise, while other borrowers may decide to get along with a smaller investment in inventory or in plant and equipment. The higher the long-term rate becomes, the more likely becomes the expectation that this condition is temporary and the more likely will be the tendency for long-term borrowers to postpone investment outlays in the expectation of borrowing later at a considerable saving in interest cost.

"The effect upon the borrower of the rate of interest considered as a cost of current investments, as described above, is far from being its only effect. An increase in the rate of interest has a further influence, and an important one, in that it reduces the money value of existing assets.⁵⁶

"Income earning assets are valued by capitalizing the expected income at the going rate of interest with due allowance for risk. When interest rates rise, the market value of such assets tends to decline, unless actual or expected earnings rise at the same time, since their earnings are capitalized at a higher rate of interest. This results in a basic change in the relationship between prices of existing assets and prices of new producible wealth which, together with changes in expectations as to profits and risks due to the changed credit and monetary situation, shifts the balance of entrepreneurial decisions toward holding or buying old assets, and adapting old assets to new uses, rather than buying new ones whose production would involve adding to the demand for materials and labor. Values of fixed-interest-bearing securities also decline as market interest rates rise, a development which reduces the liquidity positions of their holders and tends to discourage spending, both with borrowed funds and otherwise."

⁵⁶ In a highly developed economy such as the United States, the volume of accumulated capital assets is very great in relation to current income. Small percentage changes in the value of such assets involve large dollar amounts. In a recent study by Raymond W. Goldsmith, which is now in process of publication, it is estimated that for the 145-year period 1805-1950 the average yearly rate of growth reproducible tangible wealth in the United States was about 4½ percent, or about 2 percent on a per capita basis. At the end of 1948 reproducible tangible wealth owned by individuals, business, and farmers was valued at approximately \$600 billion. Although not all of this represents assets whose value is directly affected by changes in interest rates, the figure serves to give some idea of the magnitude of reproducible assets involved. In addition, values of income-producing lands are affected, as are values of negotiable claims not represented by real assets. The study is a part of a comprehensive inquiry into savings and investment in the American economy, financed by a grant of funds from the Insurance Companies Investment Research Committee, with the joint participation of the two associations of life-insurance companies.

10. Do you agree with Secretary Humphrey that savers and investors need to have even greater incentives in order to overcome this alleged shortage of capital? Do you feel that higher interest rates are part of the generally greater incentives they should be offered?

Yes, as long as savings are inadequate to meet investment demands. The record of 1956 shows that higher interest rates have encouraged individuals to increase their money savings.

11. Do you think that we face a capital shortage in the United States? Please explain how low interest rates from 1932 to 1952 contributed to this alleged capital shortage.

At present there are unsatisfied capital demands which cannot be met from existing resources at present levels of savings. During the period 1932-40, low interest rates offered an incentive for capital investment, but investment demands were small relative to savings. During the period of wartime inflation, savings were borrowed by the Government to help finance the war effort, and such investment as occurred was concentrated in war-supporting activities. Since the war, real capital formation has been high, partly because of the carry-over of accumulated backlogs and partly to provide for our current and prospective high rates of growth. The low interest rates, maintained artificially from 1946 to 1951, fed the inflation that took place in that period and seriously eroded the purchasing power of the dollar.

12. If people are induced to save more, won't this mean they will spend less on goods and services? If business is increasing its productive capacity and consumers are to buy less, what will happen to the business operating rate? How will this affect investment?

The problem of economic stabilization policies is to attain an appropriate balance between consumption, saving, and investment.

13. Is there a danger that high interest rates may become a permanent habit in the United States? Would this be a desirable development?

The level and structure of interest rates that prevails at any time must reflect the relationship between current borrowing demands and the volume of saving. Interest rates in this country today are not a habit; the great danger is that inflation may become a habit as it has become in several unhappy countries abroad. In this connection it should be borne in mind that the cheap money policies pursued in some countries have not brought about low interest rates. The countries which have allowed their money supply to expand without restraint generally have the highest rates of interest—and those which have exercised restraint have the lowest rates. In Switzerland the yield on government bonds is about 3¼ percent, a little below the level in the United States. In France it is about 5½ percent, and in Mexico, Brazil, and Chile it is over 10 percent.

14. If you had no alternative to choose from except a policy that led to mild inflation or one which led to outright deflation, which would you choose? Why?

Under our economic and political institutions, a mild inflation, deliberately accepted as a policy, would be certain to set the stage for an unhealthy boom and eventual collapse. A choice, therefore, is not open. The aim of monetary policy is to contribute, so far as it can, to steady economic progress.

15. What policies or institutional setups should we have, if any, to insure that certain social demands for schools, housing, highways, etc., do not get lost in the scramble for the relatively scarce credit resources?

This question relates to broad governmental policies, which go beyond the responsibilities of the Federal Reserve System for regulating overall monetary and credit conditions with a view to orderly growth in the economy as a whole and a stable value for the dollar. The worthwhile social demands referred to have, properly, the power of Government behind them—the power to tax and appropriate, the power to borrow, the power of eminent domain. The question is not one of inadequate power—but how much of the resources of the country should be preempted to these purposes at any point in time. Basically, public facilities are financed out of revenues and to this extent are not affected by conditions in the capital markets. When the decision is made to finance public facilities by borrowing, the funds sought must be bid away from other borrowers. There are various devices by which this money can be attracted for these special purposes—subsidies, tax exemptions, direct loans, etc. None of these provides a fundamental solution, however, to the problem of scarcity of physical resources. So long as demands for goods and services outrun productive capacities, any program to provide preferential treatment of one class of borrowers will add to the cost of borrowing by other groups and add to the cost of basic materials for all borrowers.

Chairman PATMAN. I did not finish out the question that I intended to finish a while ago about the statement that Mr. Roosa made in his book.

You know there has been quite a bit of discussion in here as to who is consulted when you are trying to arrive at just the exact rate that should be used on a bond issue like the 3¼ percent, or the others, and who is the go-between, between the Treasury and the Open Market Committee, and the people who buy, the dealers.

And this statement in here indicates something I think that is of interest. It says:

The senior managements which set the broad policy outlines for the various Government dealer firms, bank and nonbank, do so on the basis of tested experience in the rough and tumble of the whole range of financial markets.

In other words, it is the senior managements which set the broad policy outline for the various Government dealer firms, banks, and nonbanks.

They are the people that he says that you confer with in arriving at the interest rate, but, of course, I guess you say that you confer with a lot more people besides them.

Mr. MARTIN. Well, that is the Treasury's primary responsibility. And we give the Treasury all of the assistance we can in coming to a satisfactory decision. The number and the people that are conferred with are entirely in the Treasury's hands.

Chairman PATMAN. We want to leave this meeting on a good note. Is there any one of you members that would like to say anything before we conclude the hearings today and, really, for this year, because we will not have time to expand on it this year?

Would you, Mr. Martin?

Mr. MARTIN. No. I have probably talked too much, Mr. Patman.

Chairman PATMAN. We want to thank you very much for the forthright answers you have given. You are always giving us the information as you see it. And we appreciate all you gentlemen coming here. Without objection, I will insert at the conclusion of the record a series of tables containing data pertinent to today's discussions.

I said at the outset of these hearings that I did not anticipate that we would have time to work out and prepare a formal subcommittee report.

The course of the hearings has however raised a good many questions in my mind, and I should like to hold the record open long enough to place in it a statement of my personal views upon the implications of recent monetary and credit policies and practices.

Unless there is something else to come up, we will reserve the right to submit those questions and we will stand adjourned subject to call of the Chair.

(The statement just referred to, made available to the press on December 17, 1956, follows:)

HIGH INTEREST AND TIGHT MONEY POLICIES OF THE FEDERAL RESERVE SYSTEM

STATEMENT BY REPRESENTATIVE WRIGHT PATMAN (DEMOCRAT, TEXAS), CHAIRMAN OF SUBCOMMITTEE ON ECONOMIC STABILIZATION, JOINT ECONOMIC COMMITTEE, ON RECENT SUBCOMMITTEE HEARINGS ON MONETARY AND CREDIT PROBLEMS

The Subcommittee on Economic Stabilization has just concluded another of its periodic reviews designed to check on the adequacy and effectiveness of an important stabilization instrument—general monetary and credit controls.

At the opening of these hearings I stated that they were in no way intended to undermine or threaten the Federal Reserve System as it is presently consti-

tuted. Our objective rather was to gather information as to recent and current monetary and credit policy and its effects on various segments of our economy.

It was not originally intended to issue a report or recommendation after these hearings but rather to study the record and to consider it in connection with the annual report of the Joint Economic Committee due March 1.

However, in view of the unprecedented public interest that has been manifested in the brief 2-day hearing and the concern of many groups about the problems that were discussed before the subcommittee, I deem it appropriate to issue the following statement which incorporates some preliminary impressions.

First, the 2 days of hearings served to make me feel even more strongly than before that the time is past due for a thorough reexamination of our entire monetary system and particularly a reevaluation of the role and goals of monetary policy. Mr. Elliott Bell has made an important contribution by indicating some of the specific areas that need study. Without detailing his suggestions here I will say that I find myself in broad agreement with Mr. Bell as to the areas that need study. As to the vehicle for that study I differ with Mr. Bell. Suffice it to say that my reasons for differing with him are that I believe this is an area where the Congress has an inescapable constitutional responsibility. I believe we might well combine Mr. Bell's proposal with mine by having a joint congressional monetary committee assisted by outstanding qualified experts in the field of banking and public finance.

My second impression gained from these hearings is that there has been an exaggerated importance attributed to the monetary and credit powers of the Federal Reserve as instruments that can guarantee us stability and growth. Chairman Martin has made an important contribution to public enlightenment in once again warning that monetary policy is "only one factor" and that "it is not adequate to do an effective job if the budgetary and the fiscal policy of the Government runs completely counter to it."

In this connection there was apparent unanimity throughout the hearings that the main stimulus to the current inflationary pressures that the Federal Reserve is attempting to restrain through its restrictive monetary policy and higher interest rates and the greatest threat to instability have come from the capital goods area, and particularly from the plant and equipment expenditures boom. This points up a serious lack of coordination between the fiscal authorities and the monetary authority. For the expansion of plant and equipment expenditure was stated by the Secretary of the Treasury to be the primary objective of Administration tax policy. As he put it, "investment is the goose that lays the golden eggs."

Moreover, within the area of plant and equipment spending credit restraint has operated unevenly. As Chairman Martin pointed out, an important advantage big firms have is their financial status. The little man does not have it. That means that when the supply of bank credit is restricted and commercial banks and other lenders must resort to rationing, they will naturally extend credit to those whom they judge to be the soundest risks, the big firms with financial status. The small business is in effect being denied the right to scramble.

This leads to a third impression gained from these hearings. The Federal Reserve operates on the theory that by restraining generally the supply of credit and thereby denying credit to some would-be capital users, it is preventing a wild scramble for limited resources which could only raise prices without increasing the supply of resources. Ignoring for a moment the questionable assumption that resources are completely inelastic, it is pertinent to point out that the price increases that have been greatest occurred in metals and metal products, construction materials, and machinery.

These are the so-called administered price sectors. That is to say price decisions are not responsive to short-run interaction of supply and demand in the market. Instead they are fixed more with an eye on the probable effects of prices and profits on the attraction of new firms into the industry. Since in the administered price industries an important consideration is to limit the number of producers, it is likely that prices will not respond freely to unrestricted supply and demand forces. It is also true that prices will be raised on the basis of other factors which changes in the supply of credit and the interest rate will importantly affect. Thus the price will unquestionably be fixed to reflect a rate of return that takes into account the capitalization of invested funds at the going rate of interest. Therefore with respect to administered price sectors rises in interest rates, due to restriction of credit, play a more important role in raising prices than the restriction of credit does in

preventing prices from being pushed up by the pressure of market demand and supply forces.

Conversely it is true that in the areas characterized by sensitivity to market forces of supply and demand, rising interest rates are less likely to be passed on pricewise because of the sharp competitive situation that confronts each seller. The textile industry is a good example.

It would appear that the monetary authorities do not appreciate sufficiently the effects of credit restraint in areas characterized by administered prices.

A fourth impression created by these hearings is that under existing policies we have no way of assuring that certain social needs for schools, housing, highways, etc., do not get bypassed in the scramble for scarce resources. The machinery we rely on for rationing a curtailed supply of credit is not primarily influenced by social needs and priorities. The result is that many school districts have had to pay excessively high interest rates, in some cases enough to buy a school that could house an additional 900 pupils. In too many instances school districts have had to postpone bond issues because of the lack of investors. We cannot afford to postpone school facilities too long, especially in the light of the challenge that the Soviet Union is making to our technological leadership. And even if this challenge did not exist, education as a social need cannot be treated as impersonally in the allocation of resources as, say, the demand for racetracks or nightclubs.

It is evident that, assuming we want to continue to fight inflationary forces with some measure of restraint on credit, we must decide upon the type of machinery we want to ration the curtailed supply.

A final impression gained from these hearings is that not sufficient attention is being given by the monetary authorities on the harmful effects of higher interest rates on income distribution. The main concern seems to be with stimulating savings by offering higher interest rates as an inducement. It is well known that the man of moderate means does most of his savings through purchase of life insurance, payment of principal on home mortgages, etc. The really big savers are those with very large incomes. The effect of raising interest rates may well be to increase savings by increasing the income of the highest income receivers. This will tend to redistribute income and purchasing power in the same uneven way that led to the widening gap between consumption and productive capacity in the late 1920's. We do not want to stimulate savings at the expense of a widespread distribution of purchasing power which is the most potent incentive ever presented to a prospective investor.

We must at all times be equally vigilant to the dangers of deflation as we are concerned now about the dangers of inflation.

(By direction of Chairman Patman the following tables are made a part of the record:)

Farm wage rates, railroad freight rate index, and total transportation bill for farm food products, 1947, 1955, and 1956

	1947	1955	1956	Percentage increase to—	
				1955	1956
Transportation bill for farm food products (billions of dollars) ¹	\$2.05	\$3.59	(?)	Percent 75.1	Percent (?)
Railroad freight rate index (index No. 1947-49=100) ²	88	124	P 130	40.9	47.7
Farm wage rates, composite (dollars per hour) ⁴	\$0.571	-----	\$0.736	-----	28.9

¹ Estimates of total expenditures by shippers for transportation (except local hauling) of farm products for civilian consumption by rail and truck, including private trucks. Principal causes for increase are change in rates, volume shipped, and length of haul.

² Not available.

³ Combined index for railroad freight rates on livestock, meats, vegetables and fruits, wheat and cotton.

⁴ For October 1947 and October 1956.

Source: U. S. Department of Agriculture.

Bond yields and money market rates, 1947, and week ending Dec. 1, 1956

	Week ending Dec. 1, 1956 (percent)	1947	1947-56 percentage increase
U. S. Government securities (taxable):			
3-month bills ¹	3.174	0.594	434.3
9- to 12-month issues ²	3.23	.88	267.0
3- to 5-year issues ³	3.60	1.32	172.7
Bonds:			
Due or callable from 10 to 20 years.....	3.36	4.25	49.3
Due or callable at 20 years or after.....	3.33		
Local housing authority temporary notes (tax exempt) ⁴	2.355	.845	178.7
High-grade municipal bonds ⁵	3.45	2.01	71.6
Corporate bonds: ⁶			
Aaa.....	3.71	2.61	42.1
Baa.....	4.26	3.24	31.5
Prime commercial paper, 4 to 6 months.....	3.63	1.03	252.4
Prime bankers' acceptances, 90 days.....	3.19	.87	266.7
Federal Reserve discount rate ¹⁰	3.00	1.00	200.0

¹ Rate on new issues within period.

² Includes certificates of indebtedness and selected note and bond issues.

³ Includes selected note and bond issues.

⁴ 15 years or more.

⁵ Last sale of notes in 1947 and sale of Dec. 4, 1956.

⁶ Standard & Poor's Corp.

⁷ Week ending Nov. 28.

⁸ Moody's Investors Service.

⁹ Week ending Nov. 23.

¹⁰ Advances of member banks secured by Government obligations and discounts of and advances secured by eligible paper.

Source: Board of Governors, Federal Reserve system.

Average prices paid by farmers at independent stores Sept. 15, 1956, compared to Sept. 15, 1947

Commodity and unit	Sept. 15, 1956	Sept. 15, 1947	Percentage-increase (+) or decrease (-)
Food: Coffee..... pound.....	\$1.05	\$0.484	+116.9
Clothing:			
Men's overalls..... pair.....	3.58	3.29	+8.8
Women's shoes..... do.....	5.65	4.99	+13.2
Household operation:			
Soap flakes..... pound.....	.275	.291	-5.5
Detergent..... do.....			
Household furnishings: Living-room suites..... each.....	194.00	163.00	+19.0
Building materials: Framing lumber (2x4x16)..... thousand board-feet.....	143.00	115.00	+24.3
Motor supplies: Gasoline..... gallon.....	.306	.256	+19.5
Motor vehicles:			
Automobile: Ford, 6-cylinder, Mainline ¹ each.....	2,040.00	1,310.00	+55.7
Tractor: 20-29 belt horsepower..... do.....	2,090.00	1,490.00	+40.0
Farm machinery: Combine, 5- to 6-foot cut, power takeoff..... do.....	1,590.00	1,010.00	+57.4
Fertilizer: 3-12-6..... ton.....	40.80	38.10	+7.1
Livestock: Feeder cattle..... 100 pounds.....	16.70	20.10	-16.9
Feed: Mixed dairy, 16-percent protein..... do.....	3.65	4.23	-13.5
Iron and steel items:			
Milk can, 10-gallon..... each.....	12.60	7.43	+69.6
Nails, 8-penny, common..... pound.....	.154	.0966	+59.4
Barbed wire:			
2-point..... spool of 80 rods.....	9.39	6.47	+45.1
4-point..... do.....	10.50	6.95	+51.1
Poultry netting (5x150 feet)..... roll.....	10.10	6.55	+54.2
Fence posts, steel..... each.....	1.08	.729	+48.1
Gates, farm, galvanized, 14 feet..... do.....	26.60	18.50	+43.8
Iron pipe, galvanized, 1¼-inch diameter..... foot.....	.420	.249	+68.7

¹ For July 1947 and 1956. This model was a 2-door sedan in 1947 and a 4-door sedan in 1956.

Source: U. S. Department of Agriculture.

Average prices received by farmers for farm products in United States, Nov. 15, 1956, compared to Nov. 15, 1947

Commodity and unit	Nov. 15, 1956	Nov. 15, 1947	Percentage increase (+) or decrease (-)
Wheat..... bushel.....	\$2.05	\$2.74	-25.2
Corn..... do.....	1.21	2.19	-44.7
Cotton, American Upland..... pound.....	.3188	.3186	+0.1
Tobacco, all..... do.....	.10	.40	-75.0
Potatoes..... hundredweight.....	1.53	2.60	-41.2
Hogs..... do.....	14.20	24.30	-41.6
Beef cattle..... do.....	14.60	18.20	-19.8
All milk, wholesale..... do.....	4.59	5.02	-8.6
Eggs..... per dozen.....	.372	.534	-30.3

Source: U. S. Department of Agriculture.

(Thereupon, at 4 p. m., the hearing was adjourned, subject to call of the Chair.)

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