306

RECENT FEDERAL RESERVE ACTION AND ECONOMIC POLICY COORDINATION

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

EIGHTY-NINTH CONGRESS

FIRST SESSION

PART 1

December 13 and 14, 1965

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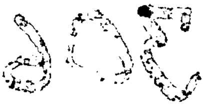

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RECENT FEDERAL RESERVE ACTION AND ECONOMIC POLICY COORDINATION

MONDAY, DECEMBER 13, 1965

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

The joint committee met at 10 a.m., pursuant to call, in room 318, Senate Office Building, Representative Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Reuss, Curtis, and Widnall; Senators Sparkman, Proxmire, Javits, and Miller.

Also present: James W. Knowles, executive director; John R. Stark, deputy director; Donald A. Webster, minority economist, and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

This hearing is called under section 5 of the Employment Act of 1946, which assigns to this committee the responsibility of studying means to coordinate programs to carry out the purposes of the act.

We have witnessed a most serious lack of coordination that runs to the very heart of that law. I refer to the recent action by the Federal Reserve Board to raise discount rates from 4 to 4½ percent, and to lift the ceiling on time deposits from 4½ to 5½ percent. This raises the discount rise by 12½ percent and the time deposit rate by 22.2 percent.

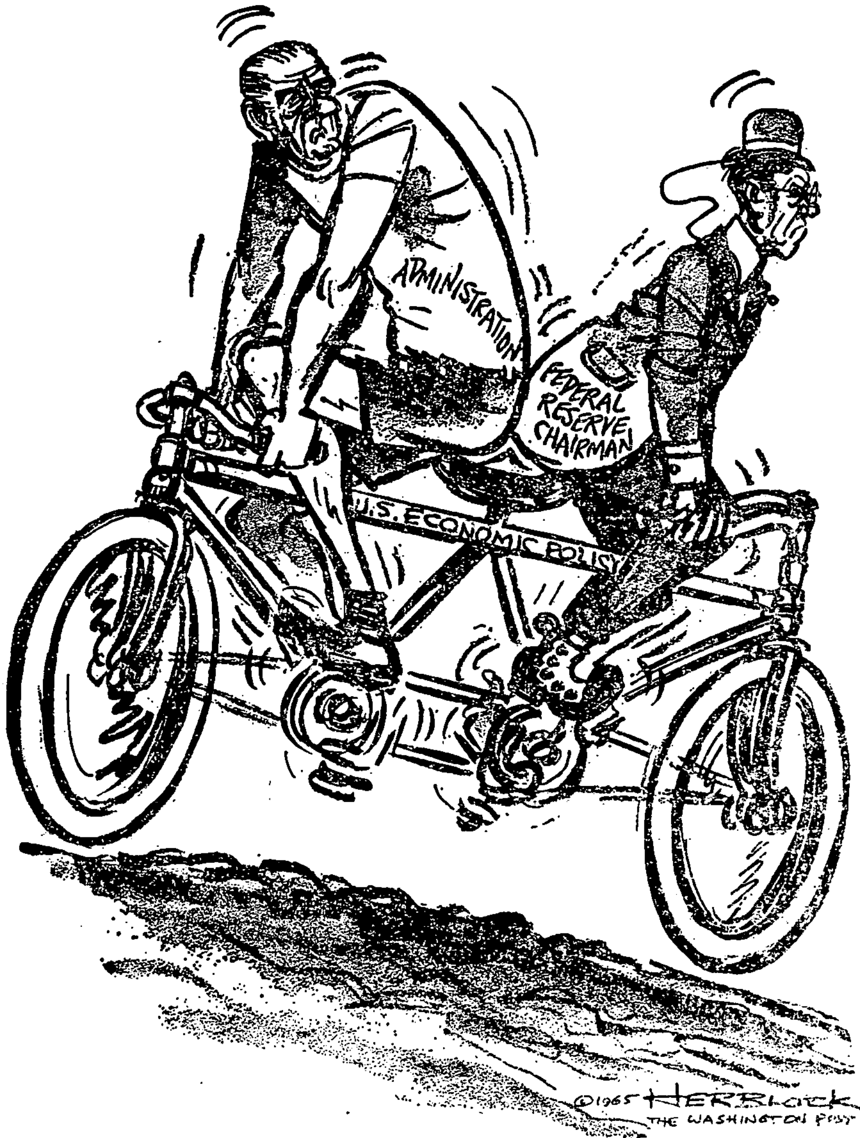
There is an old Navy saying that the quickest way to sink a ship is to have two captains. I believe this applies even more pronouncedly to our national economy. A cartoon from the Washington Post of December 8 showing the administration and the Federal Reserve trying to pedal one bicycle in opposite directions is a most expressive and accurate description of what is going on. I shall insert it at this point in the record.

The Employment Act specifically requires coordination when in section 2 it charges the Federal Government—

> * * * to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities including self-employment for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

Further, section 3 of the act requires that the President of the United States conduct "a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States * * * and the effect upon employment, production, and purchasing power" and to transmit his recom-

Bicycle Built For Two



mendations annually to the Congress. It also requires that he submit each year a program for carrying out the policies of the act.

The Employment Act is very clear and specific on the requirement that economic policies must be coordinated and it charges the President, the Congress, and all other officials with this duty. Although no agency was exempted, time and time again the Federal Reserve has chosen to ignore this public law and to go off on its own. It chooses to conduct the monetary policy machinery of this Nation as a completely

independent and separate operation—separate from the President, the Congress, the law, and the people.

Marriner Eccles, a former Board Chairman, had something to say about the role of a Federal Reserve Chairman. I would like to read his statement into the record at this time. It was made before the Joint Economic Committee on August 15, 1961:

> I think, as a practical matter, it is reasonable to allow the President to remove a Governor when he sees fit. An administration is charged with the economic and social problems of the Nation. It seems to me to be extremely difficult for an administration to deal with these problems, economic and social, of the entire country, without having these powers. There must be a liaison, a responsive relationship between the administration and the monetary system. This does not mean political control in the undesirable sense which it is often implied. I think that the Governor of the Federal Reserve Board is the channel through which the relationship with the Federal Reserve System should develop.

A brief review of events of recent weeks provides the needed background for this inquiry into the breakdown of economic policy coordination called for by the Employment Act.

On December 1, the President assured a group of business leaders in Washington that an outbreak of inflation was not anticipated in 1966 and that it would be a record year. He indicated that the 1.8-percent rise in consumer prices over the past 12 months had been due in large measure to rising food prices. He indicated that this situation had stabilized and was not expected to continue in 1966.

Shortly thereafter, the Secretary of Labor told the AFL-CIO convention that the level of unemployment was still high and that this economy is still not operating at a level necessary to make full use of available manpower. He said "The worst mistake today would be to put on some brakes."

(Article from Washington Post, Dec. 2, highlighting Secretary Wirtz' speech appears below, followed by news item appearing in same issue:)

[From the Washington Post, Dec. 2, 1965]

WIRTZ CRITICIZES CREDIT TIGHTENING—ATTACK STRONGEST YET

(By Frank C. Porter)

Labor Secretary W. Willard Wirtz let loose a salvo yesterday at administration critics who would relieve inflationary pressures by slowing down the Nation's booming economy.

"There can be no tolerance for the suggestion that expansion of the economy must be slowed down, by increasing interest rates or in any other way, while there is still so much to be done," he told the biennial convention of the building and construction trades department, AFL-CIO, in San Francisco.

It was the strongest attack yet on tight money theory by an administration spokesman. It went beyond a weekend speech by Treasury Secretary Henry H. Fowler, who said any further restriction of credit would be "premature and unwise"—at least until next year's Federal budget is known.

The argument over tight money versus relative monetary ease has become a major dialog, with large segments of the banking and business community urging higher interest rates to dampen and head off the threat of inflation.

But Wirtz said "if there should develop signs of the economy heating up, the answers would not be to slam on brakes or put a weaker mixture in the gas tanks."

His remarks were construed not only as a rebuttal to the tight money thesis but oblique counsel to the independent Federal Reserve Board not to restrict credit further.

Earlier this year the Fed abandoned its policy of moderate credit ease for one of moderate restriction. It has maintained commercial bank reserves at a negative level—that is, the Nation's banks on average have had to borrow more from the Fed to satisfy customer demands than they have in free reserves against which they can make new loans.

"The fact of skill shortages in particular occupations is leading to two dangerously wrong suggestions," Wirtz told the convention, "that there is no unemployment problem now which warrants further pressing of economic expansion; and even that there is danger of inflation because of upward pressures on wages coming from these demands."

TREASURY BONDS DIVE, YIELD RISES

NEW YORK, December 1.—Money markets apparently have rebuffed—at least for the time being—the U.S. Governmet's hold-the-line plea on interest rates.

Though the trend could be reversed tomorrow, the flow of money turned negative today as far as U.S. Treasury securities were concerned. Treasury bond prices skidded. That had the effect of boosting interest yields on some issues to their highest levels in 40 years—4.5 percent or more.

The significance of today's bond price developments is that Treasury bond yields now have hit the level charged by a bank for a loan to its most creditworthy customer—the so-called prime rate.

From interest levels on Treasury securities are scaled prices and yields of all other kinds of debt.

Today's development puts the Government in the position of asking banks to maintain a basic interest rate which the Government is unable to enforce on its own bonds.

Put another way: banks would be more inclined to buy Treasury bonds yielding 4.53 percent than lend the money to corporations at 4.5 percent.

The Secretary of the Treasury said recently in New Orleans that the administration was opposed to any interest rate rise or credit tightening and that such action would be premature and unwise. (See p. 350.)

Shortly after these very clear indications of administration policy, the Federal Reserve Board met on December 3 and decided to change monetary policy without waiting for full development of the administration's program. The Board voted 4 to 3 to tighten money at once.

The facts are obvious. While the rest of the executive branch of Government were coordinating their activities and plans preparatory to submitting them to Congress in accord with the law, the Federal Reserve, under the chairmanship and leadership of Mr. Martin, by their action, declared their independence of any coordinating effort.

No other conclusion can be drawn. On December 7, one day after the Federal Reserve decision was announced, Vice President Humphrey found it necessary to declare that the Government policies, which had been coordinated for 57 months, were no longer coordinated as a result of the Federal Reserve increase in the discount rate.

The Vice President specifically mentioned that the Federal Reserve did not give full consideration to the administration-proposed budget in making its decision. The Vice President went on to say that "part of the task will be to develop an appropriate fiscal-monetary policy in light of the Federal Reserve action."

The Federal Reserve action poses several serious issues:

1. What is the meaning of these two changes? What do they indicate concerning trends in monetary policy as executed in recent months by the Federal Reserve and as they are likely to execute it in the months ahead?

2. What is the legal basis for this action, and is it within the constitutional guidelines as to the authority of the Federal Reserve?

3. Does the current and prospective economic situation justify a shift in monetary and fiscal policies; particularly, are there present or immediate prospective dangers of inflation such as call for a more restrictive set of Government policies?

4. What is likely to be the effect of the Federal Reserve actions on the economy?

5. Was there appropriate coordination with the President, his advisers, and the Congress concerning the mix of economic policies as called for by section 2 of the Employment Act of 1946, and which this committee is directed to study by section 5(b)(2) of the same statute?

The legal issues are clearly matters for the legislative committees of the House and Senate to consider. The economic questions cannot be answered fully until the President completes his budget and economic program and submits them to the Congress in January. We can, however, reasonably demand a full and frank answer now to the last and most important question: Was there proper coordination of economic policies, and if not, why not?

We are glad to hear your response. But preceding that, any member of the committee who desires to make a statement, may do so. I hope that under the circumstances, it will be as brief as you can consistently make it, but I am not trying to fix any time limit.

Senator Javits, would you like to say anything?

Senator JAVITS. Mr. Chairman, I have a statement to enter into the record on the part of the minority members of the committee—myself, Senator Miller, Senator Jordan, Congressman Curtis, Congressman Widnall, and Congressman Ellsworth. I make the following statement:

We agreed to these hearings in order to develop all of the facts on the recent Federal Reserve action in a dispassionate and objective manner. To accomplish this aim, we felt that it was essential for all parties vitally concerned to appear before us in order to develop a balanced and a complete record.

In this spirit, the distinguished chairman of this committee asked the administration to send witnesses. However, the administration declined to take advantage of this opportunity to make its views fully and publicly known, and the examination of the list of witnesses indicates no administration witnesses.

The minority members of this committee request the chairman to renew his invitation to the administration in a most emphatic manner, and I do so now on behalf of the minority. Should the administration again refuse to present its views at this time and in the present context, we feel this would considerably reduce the results that could flow from these hearings.

If the administration believes that the most opportune time for this inquiry would be sometime next month, we feel that the interested parties should appear together at that time. (See p. 305.)

After further reflection, the emotionalism that surrounded the announcements of the Federal Reserve Board's action has largely subsided. There has been a calm acceptance of the Board's decision by the public, one evidence being the behavior of the stock market in recent days. We believe that the administration itself does not disagree with the basic decision, although it may have some reservations

about the timing of it. If this is, indeed, the case, the Nation would be reassured to know that our fiscal and monetary authorities are essentially in agreement about the Board's action.

We recognize the great importance of close coordination in the formulation of economic policies. We want to emphasize that this is the obligation of both the Federal Reserve and the administration. We hope that this matter will be fully explored in these hearings.

Clearly, one of our purposes here should be to determine the degree and nature of coordination which ought to exist, without undermining the essential independence of the Federal Reserve Board.

May I just now make it very clear to the press that I will now speak only for myself when I say the following very briefly:

I, too, am deeply concerned about the timing of this move. Generally, I am for lower interest rates, not higher interest rates, and I will be very deeply interested in the question of timing, which I consider a major issue. I agree with the chairman that this hearing may develop into a confrontation between the question of the independence of the Federal Reserve Board and whether we shall in some way change the law or recommend its change as far as it relates to the coordination of the Federal Reserve Board with the rest of the Government. Upon that question, Mr. Chairman, I shall seek to question the witnesses. I would like to thank the Chair, first, for consulting us about these hearings, which he did, and second, for giving this opportunity for a brief statement to any member who may feel so disposed.

Chairman PATMAN. May I say, Senator Javits, there is a misunderstanding about one point; about the chairman conferring with the administration. That is a misunderstanding. The chairman has not conferred with any branch of the administration—the President or any of his assistants, the Bureau of the Budget, or the Council of Economic Advisers, not one of them.

I did tell the Senator, in talking to him over the telephone, that I had heard—I hadn't heard it directly from anybody in the administration—that the administration would probably have an answer about the time that they were under law compelled to file their report in January, when the Federal Budget figures would be presented. To that extent, of course, the Senator's statement is correct, but I did not confer with the administration.

Senator JAVITS. Would the Congressman yield?

Chairman PATMAN. Yes, sir.

Senator JAVITS. The statement does not say the Congressman conferred with the administration. I might just make it plain. It only makes the point that the administration should produce witnesses now, in this hearing, contemporaneous with the appearances which we have recorded, and it is in that respect that we make the request of the chairman to invite, and I emphasize the word "invite," the administration to submit its testimony contemporaneously between now and Thursday night so that the world and the Congress may have both sets of arguments upon which to judge.

That is all that we say.

Chairman PATMAN. Thank you, sir. Senator Sparkman?

Senator SPARKMAN. I have no statement.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Yes, Mr. Chairman, I certainly want to confirm the statement that has been issued and read by Senator Javits, and also thank the chairman for the courtesy of consulting with our side on these hearings.

In order to put these hearings in correct context, I would like to read from an article that appeared in the New York Times this morning by M. J. Rossant—the first paragraph.

If past performance is a guide, the Joint Economic Committee's new investigation of Federal Reserve-administration relations will get bogged down debating the pros and cons of the latest policy decision of the money managers, neglecting the far more important issue of whether the latter should be making their decisions independently.

Because I can see those two issues continually arising through our hearings I want to say for myself that I agree that the most important issue before us, and the reason for which the chairman, I believe, has called these hearings, is largely this question of the independent role of the Federal Reserve System. The recent actions of the Federal Reserve Board that have received this publicity merely give us an opportunity to examine this basic question in that light.

Let me also put in the record a reference to the Constitution of the United States, article I, section 8, Powers of Congress:

"To coin money, regulate the value thereof"—and the Federal Reserve Act of 1913, which established this Board as independent, in section 10 provided that the Board should consist of seven members, with terms of appointment of 14 years.

To put this into broader context, we have to look at these other so-called independent agencies that the Congress created. I am afraid we are losing sight of the fact that all of them were created to carry out powers of the Congress, and not powers of the President; the ICC, the Federal Power Commission, the Federal Trade Commission, and so forth.

Above all, I might point to the creation of the General Accounting Office, with the Comptroller General appointed for 14 years. There is, fortunately, little question about that being an arm of the Congress.

I would argue, as these hearings develop, that the Federal Reserve Board is essentially a creature of the Congress, to carry out its responsibilities in this very important area of monetary policy.

Then let me finally state, just to put this further in context, as one who serves on the Ways and Means Committee, where we have a responsibility of managing the Federal debt, that the relationships that exist between the executive branch of the Government and those whom Congress has put in charge of monetary policy in this area, become increasingly crucial.

I have made the point that if we had no Federal debt, we probably would have to create a new monetary system. This shows the basic tie-in between debt management and our monetary policy.

Thank you, Mr. Chairman.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. I will have some questions later, Mr. Chairman.

Chairman PATMAN. Yes, sir. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Mr. Chairman, on December 10, in the Wall Street Journal, appeared the article under "Washington Wire" which had a caption "A special weekly report from the Wall Street Journal's Capital Bureau: Administration anger against the Federal Reserve fades—and for good reason."

Now, the article goes on to say:

Officials make clear privately that they object mainly to the timing of last weekend's discount rate rise more than to the action itself. The administration actually favored some increase—but not until January, as part of a whole bundle of fiscal-monetary actions. Fowler and Ackley aim to shun next week's congressional hearings to avoid reviving the fire. There will be no special loosening of Federal pursestrings to offset higher credit costs.

Johnson men worry that the plant and the equipment spending boom could inflate prices of labor, materials, machinery. Officials have considered selective restraints, including a temporary boost in the corporate tax rate or a moratorium on the tax credit for investment. These are less likely now, but not entirely out the window.

In order to provide a setting for the testimony I am sure we will receive, I would like to merely point out my deep concern over the continued and increasing inflation. There has been a lot said about the "danger of inflation," and I suggest that it is the danger of "more inflation" that should be talked about, because we already have been having inflation.

The Economic Indicators, which all of us have before us for November 1965, will point up what I am talking about. It is necessary merely to make a comparison of the first column of gross national product in stable prices with the gross national product in current dollar prices to discover the amount of inflation that we have been enduring. For 1961 the amount comes to $6.8 billion; for 1962, $7.5 billion; for 1963, $8.9 billion; last year, $11.9 billion; and during the first three quarters of this year, $11.4 billion, with indications that it will probably top off at around $16 billion.

So we are having inflation, and the problem is the danger of worse inflation, and it is worsening. I suggest that the inflation problem is serious, although it is not galloping. It is serious when nearly one-third of our increased gross national product consists of inflation.

Now, I share with Senator Javits the concern and the regret over increased costs of credit, but I would like to point out that the increased cost of credit for building of schools and homes and hospitals is nothing compared to the increased cost of inflation in building homes, schools, and hospitals.

So I believe that the action of the Board, regrettable as it may have been, is timely, and is necessary, as one element of attack in stopping this inflation, or at least preventing the inflation from getting worse.

We hear a lot of talk about the balance-of-payments deficit and the amount of money that is running out of the United States to the short-term interest money market in London. It seems to me that we have to make a choice. Are we going to handle the balance-of-payments problem, or are we going to persist in lower interest rates which, in turn, help to fan the fires of inflation?

I look forward with great interest to the testimony of the members of the Board present here this morning.

Finally, Mr. Chairman, I would like to ask consent to have included in the record some figures showing the consumer retail price index and the purchasing power of the dollar for the years 1963, 1964, and through October 1965, which show the Consumer Price Index steadily going upward and the purchasing power of the dollar steadily going downward.

Chairman PATMAN. Thank you, Senator Miller.

Senator MILLER. May I have that consent, Mr. Chairman?

Chairman PATMAN. Without objection, it is so ordered.

(The figures referred to follow:)

Consumer Price Index (1939=100) and purchasing power of the dollar (1939=100)

	1963		1964				1965	
	Consumer Price Index	Purchasing power of the dollar (cents)	Consumer Price Index		Purchasing power of the dollar (cents)		Consumer Price Index	Purchasing power of the dollar (cents)
			Old	New	Old	New		
January	219.0	45.7	222.314	222.521	44.981	44.940	225.000	44.444
February	219.2	45.620	222.314	222.314	44.981	44.981	225.000	44.444
March	219.4	45.6	222.727	222.521	44.898	44.940	225.207	44.404
April	219.421	45.579	222.140	222.727	44.815	44.898	225.826	44.282
May	219.421	45.574	223.720	222.933	44.856	44.898	226.446	44.161
June	220.24	45.405	223.6	223.1	44.7	44.8	227.479	43.960
July	221.280	45.188		223.760		44.691	227.686	43.920
August	221.280	45.188		223.554		44.732	227.273	44.000
September	221.280	45.192		223.967		44.649	227.686	43.920
October	221.488	45.147		224.174		44.608	228.099	43.841
November	221.900	45.065		224.587		44.526		
December	222.314	44.984		224.793		44.485		
Yearly average	220.455	45.351		223.347		44.773		

Source: Library of Congress, Maureen McBreen, Economics Division.

Month and year	Consumer Price Index (1939=100)	Purchasing power of the dollar (cents)
1961		
January	214.5	46.6
February	214.6	46.6
March	214.6	46.6
April	214.6	46.6
May	214.5	46.6
June	214.9	46.5
July	215.7	46.4
August	215.5	46.4
September	216.1	46.3
October	216.1	46.3
November	216.1	46.3
December	215.9	46.3
Yearly average	215.3	46.4
1962		
January	215.9	46.3
February	216.5	46.2
March	216.8	46.1
April	217.3	46.0
May	217.3	46.0
June	217.6	46.0
July	218.0	45.9
August	218.0	45.9
September	219.2	45.6
October	219.0	45.7
November	219.0	45.7
December	218.6	45.7
Yearly average	217.8	45.9

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I have no statement, Mr. Chairman.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

I would just like to affirm the statement on behalf of the minority which was read by Senator Javits. I wholeheartedly concur in that statement.

I personally believe that the greatest internal danger that this country faces at the present time is the question of inflation, and I sincerely hope that these hearings will shed complete light on the timeliness of the decision of the Federal Reserve Board.

Chairman PATMAN. Thank you, sir.

May I say one word to reply to Mr. Curtis, in order to get this in proper perspective, I believe.

Mr. Curtis properly referred to the Constitution, clause 5, stating that the Congress shall have power to coin money and regulate the value thereof, but Mr. Curtis did not mention about clause 18 in the same section 8 of article I. After reciting the powers of Congress, it is then stated:

> The Congress shall have power to make all laws which shall be necessary and proper for carrying into execution the foregoing powers.

Of course, the point that some of us make is that this law—the Federal Reserve Act—is just like any other law; that it is made by the Congress—the Congress makes the laws—and all laws are executed by the President of the United States. That should be considered, I believe, in connection with Mr. Curtis' statement.

Representative CURTIS. Would the gentleman yield?

Chairman PATMAN. Certainly.

Representative CURTIS. This would be a good debate. Let's have it next January in the House.

Chairman PATMAN. Certainly.

Mr. Martin, are you ready to proceed?

Mr. MARTIN. I am ready, Mr. Chairman.

Chairman PATMAN. We would like to have an understanding with you gentlemen. We understand that you and two other members of the Board present have a statement to make. Also, I have one here from Governor Robertson which, without objection, I will place in the record at the point right after Mr. Martin. Copies have been furnished to the members of the committee, and also to the press.

Now, let us see if we can have an understanding about the time. Would 20 minutes be enough for you, Mr. Martin?

Mr. MARTIN. I would think so. I am speaking for the Vice Chairman, Governor Balderston, and for Governor Shepardson, also. I think I can do it within that time, if I have a few minutes on either side.

Chairman PATMAN. That will be satisfactory. Would 20 minutes each be satisfactory for the other two gentlemen?

Mr. MITCHELL. Yes, sir.

Chairman PATMAN. All right, then we will proceed along that line, and after all of you have finished—the three of you—then we will proceed with questions.

Mr. Martin, you are recognized.

TESTIMONY OF HON. WILLIAM McCHESNEY MARTIN, CHAIRMAN, FEDERAL RESERVE BOARD; ACCOMPANIED BY GOVS. C. CANBY BALDERSTON (VICE CHAIRMAN), CHARLES N. SHEPARDSON, GEORGE W. MITCHELL, AND SHERMAN J. MAISEL

Mr. MARTIN. Mr. Chairman, I am glad to appear before your committee to make this further report on the recent Federal Reserve actions raising the maximum rate payable by member banks on time deposits and the discount rate member banks pay on their borrowings from the Federal Reserve banks.

I understand that you have asked that witnesses this morning confine their remarks to brief summaries of their views. In making this brief statement, I speak for the majority of the Board of Governors. With your permission, Mr. Chairman, I would like to offer for inclusion in the record of these hearings a copy of the Board's press release announcing these actions.

I would like to explain that Governor Daane is in Paris on important financial activities of the U.S. Government, and Governor Robertson is away on a speaking engagement, but has filed a statement with you. I merely want to explain their absence so that you will understand that they would have been glad to be here if they had been available.

The Federal Reserve acted because it believed that the previous level of the discount rate and of time deposit rates was out of line with conditions in the money and credit markets and especially with the need to keep the flow of bank credit large enough to satisfy the needs of our expanding economy, but not so large as to threaten to turn that expansion into an inflationary boom.

The actions were taken not to hamper but to further the goal of the administration—shared by the American people as a whole—to do the best that can be done to assure the continuance of our economic expansion, maintenance of generally stable prices, and restoration of reasonable equilibrium in our international payments.

As we have sought to make clear from the outset, the recent increase in rates is intended not to reduce the pace of our upswing, but to moderate mounting demands for bank credit that might jeopardize that pace by overstimulating the economy.

Throughout 1965, the Federal Reserve System has followed a policy that permitted member bank reserves to grow in response to the credit needs of a growing economy. It became increasingly apparent, however, that the rate at which we were supplying reserves to the banking system, even though it supported a strong rise in the money supply and in bank credit, was not enough to meet the intense demand for credit at prevailing interest rates.

In response to this demand, interest rates rose in most financial markets. As a result, money market rates rose above the discount rate, and time deposit rates pushed against the established ceilings, hampering the efforts of banks to tap available funds to meet the mounting demand for credit.

The Federal Reserve faced a choice between (1) attempting to check or reverse the rise in interest rates by accelerating the rate at which it was providing reserves to the banking system, or (2) raising the time deposit rate ceiling to allow the economy to use more efficiently the funds already available and raising the discount rate to bring it more

in line with market rates. We chose the latter course because we believed the former course posed too great a risk to the economy.

A brief review of developments over the past 12 months in production and employment, the balance of payments, and prices will provide background for this assessment of the potential effect of our actions on the economy.

The production and employment record of our economy has been excellent, as you all know. Our industrial output will be at least 7 percent higher this year than in 1964. For the first time since 1957 it seems likely that we may soon reach our interim goal of pushing unemployment down to, if not below, 4 percent of our labor force. Despite such progress, labor costs per unit of output in manufacturing remained virtually unchanged until recently, when they moved up somewhat.

Our record on international payments balance is fair, but less satisfactory than in the field of production and employment. Over the first three quarters of the year, our deficit on so-called regular transactions was at an annual rate of $1¾ billion—smaller than in any calendar year since 1957, but still too large for comfort.

But in another critical area, maintenance of general price stability, our record has not been so good as in other recent years. In the summer of 1964, the index of industrial wholesale prices began to rise after 4 years of virtual stability—one of the great achievements, I think, of our recent experience—and has since risen 1.7 percent. Consumer prices have risen 1.8 percent in the past year—again a somewhat faster rate than prevailed earlier.

It is quite true that prices have not broken out of the pattern of modest and selective advance in recent months. In order to avert such an eventuality, the Government has taken action relating to prices of a number of individual key commodities. But selective intervention to deal with price pressures necessarily has limits. In the longer run, it would be ineffective if not accompanied by measures that affect the source of price pressures rather than the prices themselves.

The closer an economy comes to full employment of manpower and capital resources, the greater is the risk that bottlenecks will develop in strategic areas so that large new injections of bank credit and money would serve to raise prices more than production.

As long as unemployment of manpower and plant capacity was greater than could be considered acceptable or normal, we had every reason to lean on the side of monetary stimulus. While this posture did risk some spillover of funds abroad, the adverse effect on our payments balance was more than offset by the benefit to our domestic economic growth. We have tried to combat excessive capital outflows by selective fiscal and monetary measures, including the programs for voluntary restraints of foreign credits and investments.

But despite the splendid cooperation of the financial community and the dramatic slowdown in foreign lending by financial institutions, foreign investments of nonfinancial corporations were large enough to explain the persistence of our international payments deficit. As financial institutions reduced drastically the availability of new dollar credits abroad, and thus had more funds to devote to domestic uses, their domestic customers were in a position to use part

of the newly available funds to finance their ventures abroad. This is an example of the leakage inherent in selective credit controls.

Our closer approach to a satisfactory level of domestic output and employment has diminished the weight of the arguments against the use of general rather than selective measures to help counter price pressures at home as well as to help correct our payments imbalance. Obviously, no one, and least of all those of us responsible for monetary policy, would ever want to do anything that could undercut the sustained progress of the economy. But those who are fearful of the economic consequences of any move even toward the mildest restraint—any drop of free reserves below zero, any slight rise in interest rates—would do well to consider the record of the economy's performance over the past 12 months.

Let none of us overlook the fundamental difference between a change in interest rates imposed by a central bank contrary to the trend of basic economic forces, and a change permitted by the central bank in line with those forces.

If the Federal Reserve had followed the advice offered by some and had tried to force interest rates up at a time when the demand for investible funds—even at relatively low rates—was not sufficient to employ our idle resources and to move our economy vigorously toward fuller employment, such a policy would indeed have harmed our domestic economy, and in consequence the economy of the entire free world.

Conversely, if the Federal Reserve had strained to keep interest rates from rising by providing reserves without limit at a time when funds borrowed from banks were beginning to generate an aggregate demand in excess of output from available resources, the result would clearly have been inflation.

We believe that we have managed to steer a constructive middle course between these two policy extremes, providing a beneficial degree of monetary stimulus when the economy was slack and then gradually moderating this stimulus as the expansion gained strength and demands began to press harder upon available resources. The Federal Reserve will continue to shape its policies with flexibility, firming, or easing as may be necessary to help the economy move forward at the fastest sustainable pace.

Now, with your permission, Mr. Chairman, I would like to submit for the record a copy of the Board's announcement of its actions, and also a supplementary statement extending my brief comments this morning.

Chairman PATMAN. Without objection, it is so ordered.

(The press release and statement follow:)

The Federal Reserve announced today two complementary actions to reinforce efforts to maintain price stability, and thus to foster balance in the economy's continued growth and strength in the dollar's international standing.

The actions, intended not to cut back on the present pace of credit flows but to dampen mounting demands on banks for still further credit extensions that might add to inflationary pressures, were as follows:

1. The Board of Governors in Washington approved actions by the directors of the Federal Reserve Banks of New York and Chicago increasing the discount rates of those banks from 4 to 4½ percent, effective Monday, December 6, 1965. The discount rate is the interest rate charged member banks for borrowing from their district Federal Reserve banks.

2. Simultaneously, the Board increased the maximum rates that member banks are permitted to pay their depositors to 5½ percent on all time deposits and certificates of deposit having a maturity of 30 days or more. This change is also effective Monday, December 6. Previously, the maximum rates payable were 4 percent for time deposits and certificates of 30 to 90 days and 4½ percent on those of 90 days or more. No change was made in the rate payable on savings deposits (4 percent).

The increase in the rates that member banks are permitted to pay their depositors is intended to enable the banks to attract and retain deposits of businesses and individuals and thus to make more effective use of savings funds already available in the economy to finance their loan expansion.

The increase in discount rates is intended to moderate additional bank reliance on short-term borrowings from the Federal Reserve to meet intensifying loan demands.

The action contemplates, however, the continued provision of additional reserves to the banking system, in amounts sufficient to meet seasonal pressures as well as the credit needs of an expanding economy without promoting inflationary excesses, primarily through the Federal Reserve's day-in and day-out purchases of government securities in the open market.

The changes in discount rates and the maximum rates that banks may pay depositors were the first in either respect since November 24, 1964.

Since then, total borrowing by consumers, business, and State and local governments has risen sharply, and interest rates at all maturities from the shortest to the longest have been rising under demand pressures. In these circumstances, the Federal Reserve would be forced to increase bank reserves at an accelerated pace if all demands for borrowing money at present rates were to be satisfied.

With slack in manpower and productive capacity now reduced to narrow proportions, with the economy closer to full potential than at any time in nearly a decade, and with military demands on output and manpower increasing, it was felt that excessive additions to money and credit availabilities in an effort to hold present levels of interest rates would spill over into further price increases in goods and services. Such price rises would endanger the sustainable nature of the present business expansion. Moreover, increases in costs and prices would make it more difficult for American goods to compete in markets at home and abroad.

In addition, a pattern of interest rates that is accepted by borrowers and lenders as fully reflecting market forces should add assurance of a smooth flow of funds to all sectors of the economy. Discount rate increases in 1963 and 1964 did not stop business or credit growth, but helped to keep the economy within an expansion that was sustainable.

In sum, the actions taken today should have the three-pronged impact of—

1. Backing up the Government's efforts to prevent inflationary excesses from damaging an economy now carrying the added burden of military operations in Vietnam;
2. Bolstering the Government's programs to overcome persistent deficits in the U.S. balance of payments; and
3. Demonstrating anew the U.S. determination to maintain the international strength of the dollar.

Governors Robertson, Mitchell, and Maisel dissented from the discount rate action on the ground that it was at least premature in the absence of more compelling evidence of inflationary dangers. Governor Robertson also dissented from the action to increase the maximum rates on time deposits.

Prepared Supplementary Statement of Wm. McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System

Mr. Chairman, in making this response to your request for a further report on the recent Federal Reserve actions, I should like to begin by taking up the points raised in your press release announcing today's hearing.

Your first point relates to the nature of the Board's actions, and suggests that the actions represent "a most important shift" in monetary policy. In my judgment, the actions simply extend the policy that the Federal Reserve has been following of permitting money and credit to expand enough to satisfy the needs of our growing economy but not so much as to threaten inflationary disturbances. Until recently, this policy was executed primarily through open market operations, which brought about a reduction in the free reserve position of member banks from a moderate plus at the end of last year to a moderate minus.

Now—as happened twice before in the course of the present economic upswing—these open market operations have been supplemented by increases in the discount rate and the maximum rate that member banks may pay on time deposits. These actions implement our policy further; they do not change it.

Your second point relates to the factors that entered into the Board's decision. These factors include the rapid improvement in output and employment; persistence of the deficit in international payments; the upcreep in prices; a buildup in credit demands due to rising Government expenditures over the rest of this fiscal year and to a considerably faster pace of expansion in business investment during this same period; a declining trend in liquidity of both banks and nonfinancial corporations; and an increasing difficulty encountered by banks in expanding their lending capacity at then existing time deposit rates.

Your third point relates to the effect of the actions on the economy. In my judgment, this effect will be beneficial. The actions should help to sustain progress in raising output and employment by averting monetary overstimulation of the economy. They should moderate the rate of expansion in the demands for credit and at the same time enable the banks—and especially the smaller banks—to attract deposits to help meet those demands. These favorable consequences should more than outweigh any additional costs of Treasury borrowing and the increased costs of credit to business. In fact, in the longer run, the resulting increase in these costs of borrowing would be very much smaller than would be the rise in both borrowing and operating expenses that inflation would cause.

Finally, you ask whether there was appropriate coordination with the President. I can assure you that the administration has been kept continuously informed of the position of the Federal Reserve System and that there has been a continuing frank exchange of views between the Federal Reserve and administration officials, both before and after the Board's actions. The administration and the Federal Reserve are equally dedicated to doing everything possible to assure the most rapid growth of our economy compatible with reasonable stability of prices and reasonable equilibrium in our international payments. The administration has indicated by its actions as well as by its pronouncements that it considers price inflation and a persistent payments deficit to be serious dangers to continued domestic prosperity. The actions of the Federal Reserve will help to avert these dangers and thereby will assist in achieving maximum employment, production, and purchasing power.

I should like now to discuss in more detail the factors that entered into the Board's decision, and the prospective effects of the actions upon the economy.

Over the past year, industrial production has increased 7 percent, employment 4 percent, and personal income more than 7 percent. For the first time since 1957, we can expect to see unemployment reduced to or below 4 percent of the labor force. The gains in recent years have been facilitated, and indeed made possible, by the absence of inflationary expectations on the part of both labor and management. If labor had had reason to fear a persistent substantial rise in the cost of living, it would have felt compelled to seek compensatory increases in wages; and if management had had reason to expect a general increase in the price level, it would not have felt compelled to resist such demands. In that case, wages would certainly have risen faster than productivity; prices would have been raised in consequence; and the feared inflationary spiral would have become actuality.

Our persistent deficit in international payments has been greatly reduced but not eliminated. In fact, the deficit this year will probably be about midway between last year's level and full equilibrium. And even this limited success has been achieved only by means of serious restraints upon the outflow of U.S. capital to foreign-developed countries, in the form of a broadened interest equalization tax and of a voluntary foreign credit restraint effort by banks, other financial institutions, and nonfinancial corporations. The cutback in bank credits to foreigners so far this year has been larger than the entire expected improvement in our balance-of-payments from 1964 to 1965. While the voluntary restraint effort, together with the interest equalization tax, probably did not account for the entire change in the flows of bank credit, it presumably played a crucial role. Hence, the restraints on capital flows, which are generally considered to be only temporary stopgaps, have been responsible for a large part if not for the whole of the improvement in our payments balance. We certainly will need to do better than that in order to assure lasting payments equilibrium.

In the field of prices we have done less well. The cost of living and the wholesale price index have both risen faster than in any other year since 1958. And the crucial index of industrial commodity prices has begun to rise, after 4 years

of virtual stability. It is true that prices have not broken out of the pattern of modest and selective advance in recent months. In order to avert such an eventuality, the Government has taken action relating to prices of a number of individual key commodities. But selective intervention to deal with price pressures necessarily has limits. In the longer run, it would be ineffective if not accompanied by measures that affect the source of price pressures rather than the prices themselves.

Recent developments in the financial sector of the economy have indicated some developing threat of imbalance even more clearly than have the persistence of our payments deficit and the movement in commodity prices.

In October and November of this year, bank loans to business rose at an annual rate of 11 percent—substantially more rapid than the increase in business activity. It is true that this rate was much lower than that of the unusually fast increase in the first half of the year; but in the first half, credit demand was stimulated by the rapid buildup of inventories in expectation of a steel strike, while in recent months steel inventories have been liquidated. This liquidation is expected soon to come to an end, and once accumulation starts again, we can expect a substantial increase in business loan demands, over and above the present high level.

In order to accommodate the loan demand, banks have attempted to increase their lending resources in two ways: by adding to their time deposit liabilities, and by shifting their assets from securities into loans. But efforts to attract additional time deposits were hampered by the existing ceiling on time deposit interest rates. Offering rates of prime banks for certificates of deposit were at or near the ceiling, thus leaving smaller banks no leeway for offering the premium necessary to induce corporations to entrust their funds to a less well-known institution. Partly in consequence, the growth of negotiable deposit certificates has slowed in recent months to a small fraction of the rate prevailing during the first 8 months of the year.

Over the year, banks have been obliged to finance some part of their new loans to business by reducing their holdings of U.S. Government securities and by slowing down their acquisition of securities of local governments. In the last 2 months, the annual growth rate for bank holdings of securities of municipalities and Government agencies was 8 percent, as compared with 17 percent in the first three quarters of the year. Since local governments depend heavily on bank financing, this decline threatened to jeopardize the increase in capital outlays of States and municipalities for schools, hospitals, roads, and other installations needed to provide our rising population with facilities commensurate with our rising standard of living.

The decline in bank holdings of Government securities was particularly serious because at the same time the liquidity of nonfinancial corporations—and therefore their ability to increase their holdings of such securities—was being reduced. The market's reception of the Treasury's refunding offerings in mid-November was indicative of the difficulties the Treasury was encountering in distributing its securities to investors.

All these factors brought upward pressure to bear on interest rates. And these pressures increased although the Federal Reserve kept the net borrowed reserve position of member banks roughly stable after the spring of 1965, adding about $2½ billion of Government securities to its portfolio in the process.

In recent weeks, two further developments made it evident that pressures on real and financial resources would intensify.

First, business plans to spend for plant and equipment projected a considerably faster pace of expansion than was previously considered likely. The results of the Government survey, just released, document that business outlays are scheduled to rise at an annual rate of 15 percent, at least throughout the first half of next year. Of late, actual spending typically has exceeded the estimates based on the surveys.

Second, the course of the war in Vietnam made certain a stepup in the rate of Government expenditures. In consequence, Federal needs for funds over the next few months will be significantly heavier than expected only a few months ago.

Both these developments are adding to the pressures on financial markets. In this environment, the only way by which the Federal Reserve could have averted a further rise in interest rates would have been to accelerate sharply its provision of reserves to the banking system. This would have been a serious departure from the course the Federal Reserve has been following, which was designed to keep the rise in bank credit and money from becoming excessive. In my judg-

ment, the course of moderation the Federal Reserve has been following has helped to provide the financial basis for the satisfactory development of our economy this year.

Reflecting the intensity of credit demands, however, interest rates in money markets had risen above the discount rate. This relation could not be permitted to last indefinitely because it could stimulate an excessive resort by banks to borrowing from the Federal Reserve.

Demand pressures have not been confined to money markets. The issue of corporate securities also has greatly expanded, and is expected to expand further. Internal funds, and especially undivided profits, of manufacturing corporations have been rising more slowly than their investments in plant, equipment, and inventory. The rising need for external financing has made it necessary for corporations to increase both their borrowing from banks and their recourse to capital markets.

All these considerations justify, in my judgment, not only the substance of the Board's actions but also their timing. At present, we can expect a modest rise in interest rates to restore equilibrium between the flow of savings and credit demands. Delaying action further would probably have made it necessary to take stronger measures later.

Let me stress once more, in conclusion, that the recent actions of the Board have been, in my judgment, a further unfolding of a policy designed to keep the expansion of credit in line with the needs of the economy, avoiding both inflationary and deflationary disturbances.

If the Federal Reserve had followed the advice offered by some and had tried to force interest rates up at a time when the demand for investible funds (even at relatively low rates) was not sufficient to employ our idle resources and to move our economy vigorously toward fuller employment, such a policy would indeed have harmed our domestic economy, and in consequence the economy of the entire free world. Conversely, if the Federal Reserve had strained to keep interest rates from rising by providing reserves without limit at a time when funds borrowed from banks were beginning to generate an aggregate demand in excess of output from available resources, the result would clearly have been inflation.

The Federal Reserve will continue to shape its policies with flexibility, firming or easing as may be necessary to help the economy move forward at the fastest sustainable pace.

Mr. MARTIN. Just now, I should like to read only the opening part of that statement, which relates to the statement in your announcement of today's hearings that the Board's actions represent what you have called a most important shift in monetary policy.

In my judgment, the action simply extends the policy that the Federal Reserve has been following, of permitting money and credit to expand enough to satisfy the needs of our growing economy, but not so much as to threaten inflationary disturbances. Until recently, this policy was executed primarily through open market operations, which brought about a reduction in the free reserve position of member banks from a moderate plus at the end of last year to a moderate minus. Now, as happened twice before in the course of the present economic upswing, these open market operations have been supplemented by increases in the discount rate and the maximum rate that member banks may pay on time deposits. These actions implement our policy further; they certainly do not, in my judgment, change it.

Your second point relates to the factors that entered into the Board's decision. These factors include the rapid improvement in output and employment; persistence of the deficit in international payments; the upcreep in prices; a buildup in credit demands due to rising Government expenditures over the rest of this fiscal year, and to a considerably faster pace of expansion in business investment during this same period; a declining trend in liquidity of both banks and nonfinancial corporations; and an increasing difficulty encoun-

tered by banks in expanding their lending capacity at then existing time deposit rates.

Your third point relates to the effect of the actions on the economy. In my judgment, this effect will be beneficial. The actions should help to sustain progress in raising output and employment by averting monetary overstimulation of the economy. They should moderate the rate of expansion in the demands for credit and at the same time enable the banks—and especially the smaller banks—to attract deposits to help meet those demands. These favorable consequences should more than outweigh any additional costs of Treasury borrowing and the increased costs of credit to business. In fact, in the longer run, the resulting increase in these costs of borrowing would be very much smaller than would be the rise in both borrowing and operating expenses that inflation would cause.

Finally, you ask whether there was appropriate coordination with the President. I can assure you that the administration has been kept continuously informed of the position of the Federal Reserve System and that there has been a continuing frank exchange of views between the Federal Reserve and administration officials, both before and after the Board's actions.

The administration and the Federal Reserve are equally dedicated to doing everything possible to assure the most rapid growth of our economy compatible with reasonable stability of prices and reasonable equilibrium in our international payments. The administration has indicated by its actions as well as by its pronouncements that it considers price inflation and a persistent payments deficit to be serious dangers to continued domestic prosperity. The actions of the Federal Reserve will help to avert these dangers and thereby will assist in achieving maximum employment, production, and purchasing power.

I want to close by stating, as I said to the Life Insurance Institute in the course of a talk last Wednesday noon, and as I have said to this committee many times, the American people, through the legislative process, can change the authority and the responsibility of the Federal Reserve System whenever they choose to do so, but unless and until the law is changed, I should consider it a violation of my oath of office to vote for or against a policy measure for any reason other than my best judgment of that measure on its merits.

Thank you very much.

Chairman PATMAN. Thank you, sir.

(Governor Robertson's statement follows:)

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
Washington, December 9, 1965.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. PATMAN: In response to your request that members of the Board of Governors of the Federal Reserve System appear before your committee on Monday, December 13, I regret to advise you that because of an out-of-town engagement related to the President's balance-of-payments program, I will be unable to appear on that date.

However, in order to assist as fully as possible in the achievement of your objective of disclosing the factors that entered into the Federal Reserve's recent decision to raise the discount rate and the ceilings on interest rates payable on time deposits, I am enclosing copies of two statements which set forth my own reasons for opposing both actions. The one relating to the discount rate increase was presented to the Board at the time that action was taken. The one opposing higher maximum interest rates was written subsequent to the meeting and submitted for the Board's record. These statements include the main points that I would make orally if it were possible for me to be present Monday.

In the event you wish to make these statements available to members of your committee, its staff, and other interested people, I am submitting additional copies herewith.

Sincerely,

J. L. ROBERTSON.

PREPARED STATEMENT OF JAMES LOUIS ROBERTSON, MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Changes in monetary policy should not be triggered by fear of prosperity. A prosperous and growing economy has been the goal of public policies, and substantial achievement in that direction in the 1960's should be a cause of gratification rather than concern. It is not inevitable that inflation, boom, and bust must follow from the kind of prosperous performance the U.S. economy has been giving, and consequently there are no valid grounds for arguing that tightening now is needed to forestall inflationary developments that are sure to come later.

This is not to deny the need for very careful scrutiny of the progress of economic events and a willingness to act to further restrain credit if and as excessive demand pressures actually emerge. I conceive of the present as a time of delicate balance in the economy. Supply and demand forces seem so tentatively poised that abrupt action to change monetary conditions could tip the scales significantly—toward inflation if policy was actively eased, or on the other hand, toward recession if credit availability were sharply tightened.

Financial markets have only recently calmed somewhat after being buffeted by rumors of an impending discount rate change. Such a rate increase now would come as a distinct surprise, with reactions aggravated by the impending seasonal peak of money market pressures. Such action would insure undoubtedly that the heavy volume of Treasury cash borrowing to be done in January would have to be undertaken at substantially higher interest costs to the Government.

If, for whatever reasons, a tightening action is to be initiated, it would be far preferable to use a subtle rather than a slam-bang method. An appropriately mild and indirect line of action might be to (1) dampen bank issuance of promissory notes by defining them as deposits; (2) hold regulation Q ceilings on time deposit interest rates at existing levels for the time being; and (3) take no action on the discount rate, expecting that banks would undoubtedly have to cover some portion of their net December loss of CD's by substantial temporary resort to the discount window. This combination of steps should

serve to moderate somewhat the rate of advance in bank credit, while not triggering immediate expectations of higher interest rates in the market and yet, at the same time, placing banks in a position of dependence on the discount window that could lead fairly naturally to a more overt tightening of monetary policy should inflationary developments begin to appear.

Whether or not a breakout of inflationary pressures will in fact occur cannot now be predicted. Accordingly, the best practical course is to adopt a policy of "watchful waiting," meanwhile continuing to supply a reasonable flow of reserves to finance much-needed economic growth. Despite large and sustained expansion since the last recession in 1961, a small but significant margin of human and real capital resources remains unutilized in this country. Further orderly expansion in aggregate demand can effectively employ some of these resources. The accompanying growth in credit and money during this period has been orderly, and has contributed to overall economic growth. Continued orderly credit expansion is needed if our economy is to move on up to the goal of sustainable full employment of available resources.

The price pressures to date from this economic growth have been small and selective, stemming mostly from worldwide shortages of particular nonferrous metals, temporary scarcities of certain agricultural products, and market-testing markups in a few administered-price industries. These are not the types of price increases appropriately dealt with by a dampening of aggregate domestic demand. The temporary nature of some of the recent increases is indicated by the fact that the rate of rise in the wholesale price index has already slowed since midyear from an annual rate of 2 percent to 1 percent. Meanwhile, recent successful administration actions against aluminum and copper prices reduce the likelihood of other administered-price increases.

The U.S. balance-of-payments performance does not now supply reasonable grounds for further monetary tightening. The chief burden for further improvement in the balance falls on other polices. The allegedly interest-sensitive components are already performing very well under the discipline of the voluntary foreign credit restraint program. I see no sign that this program is weakening insofar as its influence on financial institutions is concerned. Corporate direct investment abroad, the category of capital flow that has been least reduced to date, is notoriously insensitive to changing general credit conditions in the United States.

U.S. interest rates are already high by historical standards, and I believe they are generating all the credit restraint that ought to be attempted in the current delicate situation. The Federal fiscal position will be shifting to a somewhat less stimulative policy for a time after the turn of the year, and we should be wary of imposing a coincident restraining influence from additional monetary tightening at this juncture. The appropriate monetary policy for later in 1966 can be best judged after we have the benefit of the official Federal budget message in January and see the public reaction thereto.

STATEMENT OF GOVERNOR ROBERTSON'S REASONS FOR OPPOSING AN INCREASE OF THE CEILINGS ON INTEREST RATES PAYABLE ON TIME DEPOSITS FROM 4 AND 4½ TO 5½ PERCENT, DECEMBER 3, 1965

Governor Robertson dissented from this action generally for the same reasons given for his dissent from the action to raise the discount rate. The latter action, he assumed, was designed to tighten credit, in view of the rapid expansion of bank credit; it surely was not designed simply to raise interest rates. However, in his view, the raising of the ceilings on interest rates payable on time deposits would—in virtually the same breath—enable banks to acquire more funds to expand their lending but at higher rates and thus not serve to reduce bank credit expansion—if that were the aim. In addition, he felt, the larger banks would be able to attract funds away from smaller financial institutions which did not actively engage in the issuance of time deposits but relied on inflows of savings and demand deposits with which to meet loan demands, or, alternatively, to force those smaller banks to also engage in the risky business of competitively bidding for highly interest-sensitive short-term funds with which to make long-term loans.

Chairman PATMAN. Governor Mitchell?

Mr. MITCHELL. Mr. Chairman, it is a pleasure to appear before your committee this morning.

STATEMENT OF GEORGE W. MITCHELL, MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MITCHELL. Consideration of the issues involved in the December 3 actions by the Federal Reserve Board must begin with the state of the economy and its prospects for the future.

The current expansion, which has been going on since early 1961, received a new impulse from the tax cut of 1964. Output accelerated, unemployment declined, and the capacity utilization rate rose; by the summer of 1965, unemployment was down to 4½ percent and an estimated 91 percent of manufacturing capacity was in use. Just when there was some danger of a fall-off in the rate of expansion—as the steel wage settlement led to an inventory runoff—the commitment to greater involvement in Vietnam provided a new impulse in the form of stepped-up Federal spending and the expectation that more was in the offing. And we now know that business outlays for plant and equipment have accelerated in recent months and are expected to forge ahead in the first half of 1966. In the past year or so, we have experienced some upward creep in wholesale prices after several years of virtual stability in that index.

These economic developments pose both a promise and a challenge. The promise is that the economy continues to move steadily toward full use of its labor force. The challenge is to achieve that goal and to maintain it without inflation. It is to be expected that differences of opinion regarding economic policy measures will assert themselves in these circumstances. For my part, at this time the highest priority attaches to a combination of economic policies that will ease the economy onto a steady growth path at full employment. I believe this can be done with reasonably stable prices. I would grant that as we

achieve full employment, and are in orbit so to speak, our efforts to expand aggregate demand should inevitably be limited by growth in productivity and the labor force.

What is currently at issue is whether a further shift toward restraint—and a spectacular signal of the sort implied by a discount rate increase—was needed. The difference in view on the appropriate monetary policy at the moment is based on differences in judgment on three questions regarding the recent and prospective performance of the economy.

1. Does the nature of the price advances we have had during the past year indicate that inflationary pressures are responsible? Food prices have risen significantly—but because of supply conditions in agriculture. Several internationally traded commodities have risen sharply—but because of political uncertainties and strikes in supplier countries and demand conditions outside as well as in the United States.

Among industrial prices, increases have been selective rather than widespread, and more recently have tended to slow. In one-half of 70 industrial groupings, wholesale price changes since August 1964 have been within plus or minus 1 percent.

As guides to monetary action, our price indexes—both the Consumer Price Index and the Wholesale Price Index—leave much to be desired. The Consumer Price Index accentuates the illusion of rising prices properly attributable to higher incomes and rising consumption standards. As pointed out in the Stigler report, it does so by the upward bias inherent in its treatment of quality changes in goods and services. And the public tends to think of its consumption standards as constant and prices as rising whereas a significant part of the "price rise" has purchased improved products and better services.

The Wholesale Price Index has its defects too—mainly that it moves sluggishly and understates the magnitude of price adjustments that are normal in our economy. Interpreting the movements in both these indexes gives rise to many shades of opinion. The price picture has changed in the past year and expectations regarding prices may also have changed. But the evidence on prices does not, in my view, now call for more monetary restraint than is already being applied.

2. The second question underlying the current debate on monetary policy has to do with the rate of unemployment and the potentiality for reducing it further without generating excessive upward pressures on costs and prices. Those who regard 4 percent unemployment, or 3 million persons, as the approximate total of the frictionally unemployed and the unemployable, and who are especially impressed with the fact that the unemployment rate among married men is down to 2 percent, may feel that we have achieved our employment goals and that any further progress in reducing overall unemployment cannot come from aggregate demand. I am not one of those. And I would not choke off growth of aggregate demand if it risked committing a million or more workers, many of them young and the most recent products of our educational system, to the dole or a new category of welfare dependence.

There is no doubt that shortages of skilled labor are being felt at various points in the economy. On the other hand, I remember clearly that many observers a year and more ago were doubtful that unem-

ployment—then about 5 percent—could be reduced further by expansion of aggregate demand. Yet it has been reduced and unit labor costs have remained relatively stable. On this basis, I am not yet ready to agree that there is no further room for compression of the unemployment rate—with significant benefit to disadvantaged groups. I would also stress, incidentally, that the age distribution of our population is such that there is little increase in numbers among the 30- to 45-year-olds. To achieve adequate growth in the economy, our labor force must grow, and for this we must absorb the younger entrants into employment.

3. The third question on which I would like to comment concerns the rate of growth of bank credit. Many observers look at the numbers—showing that bank credit has expanded by about 10 percent this year, while GNP has been increasing at a rate of about 7 percent—and conclude that the economy is being oversupplied with bank credit. This is a matter for analysis and judgment. In arriving at judgments on this question, one must keep in mind that bank credit statistics have become very difficult to interpret because of the significant expansion in the role of commercial banks as financial intermediaries. Commercial banks, by offering negotiable certificates of deposit and other new savings instruments, have in recent years captured a larger share of the flow of funds on their way from savers to borrowers. This enlargement in the banking system's share of the savings flow necessarily brings with it a much more rapid growth of bank assets than would flow from the 4-percent increase in demand deposits that occurred.

The question whether credit expansion is excessive because of monetary creation has no easy answer. It is significant, however, that the rate of growth of bank credit has declined in the course of this year, from an annual rate of over 12 percent in the first quarter to less than 5 percent in the third quarter.

This points up the fact that the posture of monetary policy has changed in 1965, especially in the second half. In the recent preoccupation with the discount rate little attention has been given the shift in monetary policy toward greater restraint brought about by open market operations. That monetary policy has become more restrictive over a period of months is evidenced in the advance in interest rates on public and private securities of all maturities since the spring of this year. Long before the discount rate action, Treasury bill yields had risen—from 3.8 percent in the early summer to 4.1 percent at the end of November; long-term Government bond yields had risen—from 4.14 percent in June to 4.34 percent in late November; the yield on new issues of high-grade corporate bonds had risen—from 4½ percent in the spring to about 4¾ percent in late November; and mortgage yields had also begun to move up.

Recent public discussion of Federal Reserve actions has largely ignored the fact that open market operations—not discount rate policy—are the principal instrument of Federal Reserve policy. The major task of the Federal Reserve is to regulate the volume of bank reserves, which affects the rate of expansion of bank credit and money, and thereby influences interest rates and other credit conditions. The discount rate has important psychological and an-

nouncement effects, but the real muscle in monetary policy will be found in the open market actions that follow. Thus the impact of monetary policy on the economy in the weeks and months ahead will depend more on the open market policy to be followed than on last week's discount rate action. And open market policy should, in turn, depend on the strength of the private economy and on the impact of fiscal policy.

The recent increase in the discount rate has been interpreted by the public as a decisive shift toward more restrictive monetary policy. And it may prove to be so. A higher discount rate can influence future open market policy toward greater restrictiveness, insofar as the policymakers come to regard the new discount rate as the level toward which Treasury bills and other money rates should gravitate. This is one of the reasons I opposed the discount rate increase last week.

It seems to me that such an action, given its announcement and psychological effects, should have awaited, and been coordinated with, other Government decisions to be taken over the next several weeks and to be announced in the budget and the Economic Report. Such consultation and coordination, in my view, would not in any way have been inconsistent with the independence of the Federal Reserve.

The issue of independence of the Federal Reserve calls for a brief comment. In my view, independence of judgment is much more than a matter of legal right, for laws can be changed. Real independence, the only enduring kind, rests on wise and responsible behavior. The measure of independence that the System has retained over the years reflects its sparing use of dissent and the care and skill with which the System's views have been negotiated, mainly by the Chairman, in controversial analyses and judgments. I might add that a similar sort of independence is found within the Federal Reserve where individual policymakers prize and use—as I and others did last December 3—the right to dissent.

Turning now to a matter on which I did not dissent, the increase in maximum rates payable on time deposits was justified, in my view, whether or not the discount rate was advanced. This move must be viewed against the background of the past several years in which we have witnessed what could be called a revolution on the liability side of bank balance sheets. Banks have been transformed from relatively passive acceptors of deposits to competitively active seekers of deposits. While this situation must be under constant surveillance so as to guard against imprudent lending, more active competition from banks should be a benefit to the entire economy.

In the current circumstances, rates on negotiable certificates of deposit were pressing the ceiling. It seemed desirable to remove this impediment to competition among banks and to the free flow of funds. This does not mean that I sought or expected a substantial upward adjustment of short-term interest rates in response to the raising of the ceiling. It does mean that I saw the need for more leeway for banks and for them to know that they could offer higher yields, if necessary, as they sought funds.

On past occasions when regulation Q ceilings were raised—actions in which I also concurred—banks put their enlarged flows of deposits to work in purchasing mortgages and State and local government securities, with downward adjustment in the interest rates on these

obligations. There is little scope for such downward interest rate movement now, but there was a danger, before the ceiling was raised, of a sharp rise in rates if the inability of banks to continue to attract time deposits forced them to limit further their acquisitions of municipal securities and cut back on mortgage lending.

The month of December usually witnesses an exceptional concentration of money market pressures. I do not claim that a rise in regulation Q ceilings was essential to see the money market through this period. Rather, the provision of reserves by the System could have accomplished this task by offsetting tendencies for money market yields to rise and making it possible for banks to sell certificates of deposit within the existing ceiling to replace CD's maturing this month. But the continuation of such a policy into next year might well have required too rapid an increase in bank reserves and consequently too rapid a rate of monetary and credit expansion, given the strength of aggregate demand.

In brief summary, my position on the posture of monetary policy in the current changing circumstances is that the discount rate action could have been delayed, to await coordination with other Government policies. My willingness to delay discount rate action in this way is based on the fact that monetary policy has already tightened, on the lack of evidence that inflationary pressures are strong or accumulating, and on the belief that we should continue to set high standards for the performance of the economy and, especially, for the reduction of unemployment.

Chairman PATMAN. Thank you, Governor Mitchell.

Governor Maisel?

Mr. MAISEL. Mr. Chairman, I have a written statement, but if the committee will permit, I will try to summarize it somewhat, to save time. I believe the written statement is before you.

Chairman PATMAN. The statement will be included in the record.

Mr. MAISEL. Thank you, sir.

(Governor Maisel's testimony and prepared statement follow:)

TESTIMONY OF SHERMAN J. MAISEL, MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MAISEL. I welcome this opportunity to appear before the committee. I feel that an important aid to the independence of the Federal Reserve System is that it report frequently on its stewardship, and that it make clear to the people of the country the difficult problems of monetary policy.

I am sorry that the disagreement among the members of the Board will be spread on the record in this way, but I think it should be clear that I, at least, did not dissent because I feared the action of the Board would lead to an immediate recession or depression. I also did not dissent for the various reasons given in the press.

I felt strongly that the decision of the Board was a very difficult one. I think all Board members recognize the problems of our position. We have to examine all of the data on prices, production, employment, and the balance of payments. This large notebook contains just a small number of those that we brought with us—some that we look at every day. When we look at these figures, we find that frequently they are

conflicting and frequently they are less accurate than we would hope. But they are the ones available—the ones we must use.

In looking at these figures as to what has happened, we had to make up our minds as to what we thought would happen if we raised the discount rate. What would happen to the level of production in the economy? What would happen to prices? What would happen to employment? As I looked at these figures, it was my decision that the country would be better off if we did not raise the discount rate. We would maintain a better level of employment and a better level of production. The type of production we would be getting would be preferable, and our price policy would be maintained.

For these reasons, I felt that the action of the majority of the Board was wrong. I felt it was wrong for three reasons: (1) it was done at the wrong time; (2) it was done in the wrong way; and (3) it was done for the wrong reasons. I would like to expand upon those matters slightly, Mr. Chairman.

I think all agree that the economic picture of the country is mixed. It can be no secret that, like people throughout the country, every Board member has diligently watched each critical economic variable.

Growth this year has been excellent. Unemployment has decreased toward our interim goal. Our balance of payments has moved toward equilibrium, but not as rapidly as some hoped. Price pressures have exceeded those in recent years. Credit expansion was high. The strains of growth have been severe.

Continued progress toward full employment is bound to bring further pressures. Still, in prices, wages, and credit, distortions have been less than would be expected for a period of such rapid expansion. For example, in nonfood commodities, those most likely to be influenced by monetary policy, we note that although the rate of increase since midyear is slightly over 1 percent a year, wholesale prices are only 1 percent higher than 6 years ago. Nonfood commodity prices in the consumer price index rose about 3 percent in the 6-year period. Their increase in the past year was seven-tenths of 1 percent.

The U.S. price stability record in this period far surpasses that of almost every nation in the world. The credit picture has been mixed, but here, I think, there is some failure to understand the relationship of a central bank—the Federal Reserve System—to the money markets and the problems of credit in the economy.

The critical fact is the amount of reserves furnished by the System to the banks. When we examine this point, we find that while the major credit indexes show a high general rate of expansion in the first part of the year, from June through November commercial bank reserves held in the Federal Reserve System actually declined slightly on a seasonal basis.

We have an economy expanding at a rate of over 7 percent annually, yet during the last 5 months no additional reserves were furnished to help finance that expansion. Because existing reserves did shift to support time deposits attracted from other savings sources, total commercial bank credit continued to expand. The rate, however, was slower than in the first half of the year, or than in the 2 previous years.

Other individual measures of credit showed differing reactions to the lowered reserves. Almost all grew more slowly than in the first half, and most at rates well below previous years.

As a result of this moderate credit restraint, interest rates rose sharply. On December 3 rates on short-term Governments were about a half a percent higher than earlier in the year. Corporate and municipal bond rates had risen about as much, while long-term Governments were up over a third of a percent. All interest rates were close to their 30-year highs.

On the whole, one could conclude on December 3 that the price and credit picture showed signs of pressure arising partly from higher demand, and partly from a slowing in the rate of credit expansion. While unwanted price increases threatened, the cooperative effort to hold the wage-price level undertaken by labor, industry, and Government seemed to be working.

The critical forces which would determine price movements for the next several months appeared to be the relative expansion rates for total demand and potential output, on expectations and on the success of the President's price and wage programs. Price movements of the past year could be considered as normal and logical, given the previous rapid rate of expansion. They offered no evidence as to how prices might react in a period of steady expansion at full employment.

The critical question was, What about demand for next year? Most forecasts done by private consultants throughout the country and by academic groups, showed a balance between supply and demand. In all of them, however, the critical questions were the Government's budget and expectations. A small change in Government expenditures and revenue for next year would be very important in determining whether we would have too much demand or not.

Given the importance of the Federal budget it seemed to me vital that we wait for the President to determine what the budget was to be. Clearly, since the budget hadn't been determined by the administration, the Federal Reserve could not know it. In fact, the Federal Reserve had no inside information on what would happen during the last half of this fiscal year. Therefore, it seemed to me necessary to delay at least until the budget was formulated. The delay would entail but slight cost. A failure to delay by raising the discount rate, would be irreversible. Interest rates would have to stay high for a considerable period in the future.

Secondly, I believe the action was taken in the wrong way. I felt that if action were to occur, it should be as part of a coordinated program announced jointly with the administration.

I saw four strong reasons for urging this path: One: failure to do so might be misunderstood as an attack on the administration's policy, for full employment growth with stable prices.

Two: it seemed to be an irresponsible use of independence. It would decrease the system's value in the future.

Three: it would diminish the antiinflationary impact desired by the majority.

Four: it broke tradition and labeled the step as "urgent," which I felt it did not deserve.

With respect to the question of independence, a critical fact was that it reduced the choices on national policy available to the President. We were informing him that monetary policy would be tighter, leaving him to adjust fiscal and wage-price policy accordingly.

Many people recently have argued that the country can achieve a proper level of total demand by a policy of high interest rates offset by high budget deficits. They point out that each dollar of demand curtailed by higher interest rates can be offset by a budget deficit. As a fiscal conservative and a believer in leaving the maximum of choices to our market economy, I dislike this theory.

I think we may well be better off with a smaller budget deficit and lower interest rates. That is a path I personally prefer; but more important than my own beliefs is the fact that I dislike attempting to impose them unilaterally on other parts of the Government. I would have preferred to explore all possible channels in an attempt to get a coordinated program.

The Board's freedom to act requires that it use responsible statesmanship in achieving better economic policy. History has shown that dividing the monetary from the fiscal functions of the Government is wise. Otherwise, the creation of money to fill the public purse can become an engine of inflation.

Because the Federal Reserve has a unique responsibility for maintaining monetary integrity, we must work as hard as possible to make certain that it is used properly. That, I take it, is the purpose of our meeting today.

Costs of conflict between monetary, fiscal, and wage-price policies are high. Achieving sound policies which will enable our economy to grow with stable prices, at full employment, is a most difficult task. In such decisions, the Federal Reserve System has a vital role. It must remind other agencies of the need for monetary probity, and must insist that the value of the dollar be maintained.

However, our independence and right to act should be used primarily as a valuable ace in the hole. An unnecessary use of power may dangerously weaken the System. The weapon of independence is clearly a major bargaining force. However, because monetary and fiscal policies are necessarily interdependents, national goals may be more easily achieved if the ability to act leads to a coordinated program rather than independent action.

Weapons held in reserve may be more powerful than those committed at the earliest sign of conflict.

Finally, as to the use of the discount rate, with its upper ratcheting of interest rates, it seemed to me that this action was incorrect, and diminished the noninflationary force of a policy change.

Senator Robert Taft, when he was on this committee, used to point out frequently the need in analyzing tax and interest rate increases to consider three different effects of an action: (1) the direct or decreased effect on demand which lowers prices; (2) the fact that interest is a business cost and, therefore, raises prices (the gross interest payments in our economy are about $70 billion a year, so that this is not a minor cost); and (3) the announcement effect on expectations and actions of others which may result from the action.

It seemed to me that the procedure used by the majority of announcing a discount rate at this time increased the inflationary indirect effects; that is, of the side effects of this movement. Therefore, the total deflationary impact would be less than could otherwise be gained.

Now, interestingly enough, as I came down this morning, I was sent a result of a computer simulation of this point. It brought this fact out well. This was done on one of the very large models of the economy at the Brookings Institution. It showed that the manner in which this action was taken tended to increase the price influences rather than decrease them. Whereas, if it had been taken in the way suggested by Governor Mitchell, it would have probably had a more deflationary impact. I must say that I felt that this conflict between the method and the goal existed at the time the action was taken, but I did not have the evidence—if it can be called evidence—of the computer. However, it was not a line of reasoning that could be successfully used to convince my colleagues.

Finally, I believe the reasons given for the raise were wrong. I felt that the stress on the balance-of-payments factors was simply incorrect for reasons I have made clear in the past. I agree strongly with Secretary Fowler, the man who is charged by the President with the responsibility in this matter. I might quote the headline in the New York Times today: "Fowler on Interest Move Denies That Rising Rates Will Succeed in Cutting Flow of Dollars Abroad."

I think that his analysis is proper. I also fear that the use of balance of payments as an excuse to raise interest rates—this is the third or fourth time that this has been done—will greatly weaken our whole foreign policy and our international relations in this field.

Also, as was made clear earlier, I felt that the discussion of credit was only partial. The critical factor was that the System had not been furnishing reserves. I also felt that small additions to reserves do not have the large influence which many people feel. I believe that there is a direct relationship between the amount of money, the amount of reserves in the economy, and increases in demand.

Some people apparently have a view that a small increase in reserves can cause a runaway increase in credit. This would have to result from a speeding up of the use of money. I have tried to check this out. I have asked our staff to go over it very completely. I have asked many of the monetary historians in the country, many of the monetary theorists, whether they have seen any evidence of such action in the past, and whether they feel that this is a logical way for the economy to act. Their answer—I think in every single case—was no, that while some people have this view of the economy, they see no evidence of it either in history or theory.

Well, Mr. Chairman, it was for all of these reasons that I opposed the action taken by the majority, but I want to make it clear again that while I believe the discount rate change at this time was incorrect policy, it is a move that can and will be absorbed by the economy without causing an immediate recession.

I think we must recognize our limited experience in operating for any length of time at full employment. However, the potential gains to our national welfare from the successful development of policies that will allow rapid expansion with stable prices are enormous. I hope that we can think of the current action as behind us, and feel that now it is the time to try again to work out a better coordinated use of all types of policies which can help in achieving our national goals.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir. Your prepared statement will also be placed in the record.
(The statement follows:)

PREPARED STATEMENT OF SHERMAN J. MAISEL, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I am pleased to have the privilege of appearing before the Joint Economic Committee. The Employment Act of 1946 and the knowledge developed in the reports and hearings of this committee have made major contributions toward the rapid, orderly, noninflationary, growth of the U.S. economy and toward better public understanding of the problems involved in maintaining such progress.

I also welcome this opportunity because I believe the independence of the Federal Reserve System to be a keystone in our economy's proper functioning. Maintenance of independence is possible only with full public support. Hearings such as this give the Federal Reserve System an opportunity to explain the complexities of monetary policy. They enable the System to report on its stewardship while helping the people of the United States to shape their views as to a proper monetary policy.

I am sorry that as a result of these hearings internal conflicts will receive wide publicity. However, the action of the Board raising the discount rate was significant and worthy of a report to the country. I trust that the net results will be positive. I hope we will gain a better understanding of past action plus improved policies for the future.

AGREEMENTS AND DISAGREEMENTS

I was somewhat unhappy about the action taken by my fellow Board members on December 6. However, I want to make it clear that my dissent was not based on some of the reasons carried in the press. I do not fear that at this time higher interest rates will lead to an immediate depression or deflation. I respect the motives of all my fellow Board members. Each voted according to his own view of how a better economy could be achieved. The action was deliberative. Its timing did not arise from political or other ulterior motives. An attempt to characterize the votes as based on a belief in "hard money" or "easy money" is not helpful either. Each member clearly based his vote on how he believed the Board could best insure sound money and sound growth for the economy.

I disagreed on positive grounds. I felt that a discount increase at this time was premature. Furthermore, this action posed a net threat to longrun price stability. More specifically I concluded that—

(1) No sound decision was possible without firm information on the Federal budget. A delay of 1 month to await such knowledge could do little harm. It would enable us to make a much sounder choice.

(2) To act without far more effort at obtaining agreement on a coordinated monetary, fiscal, and wage-price policy was wrong. The method and timing of the discount rate increase decreased its hoped-for impact. It threatened to introduce undesired, inflationary side effects. It made the future development of sound full-employment policies more difficult. Unilateral action could only weaken the President's leadership in a critical war period.

(3) Two major reasons cited by the majority for immedate action are, I believe, based on faulty theoretical reasoning. Their continued use as a basis for policy can only do harm.

(4) In departing from its normal and publicized policy of not making discount moves in advance of the market, the Board invested its recent decision to curtail credit expansion and raise interest rates with an urgency that I feel was unwarranted.

If I may, Mr. Chairman, I would like to expand on each of these four points.

A MONTH'S DELAY SEEMED ADVANTAGEOUS

It can be no secret that, like people throughout the country, every Board member has diligently watched each critical economic variable. Growth this year has been excellent. Unemployment has decreased toward our interim goal. Our balance of payments has moved toward equilibrium, but not as rapidly as some

hoped. Price pressures has exceeded those in recent years. Credit expansion was high.

The strains of growth have been severe. Continued progress toward full employment is bound to bring further pressures. Still, in prices, wages, and credit, distortions have been less than would be expected for a period of such rapid expansion. For example in nonfood commodities (those most likely to be influenced by monetary policy) we note that although the rate of increase since midyear is slightly over 1 percent a year, wholesale prices are only 1 percent higher than 6 years ago. Nonfood commodity prices in the Consumer Price Index rose about 3 percent in the 6-year period. Their increase in the past year was seven-tenths of a percent. The United States price stability record in this period far surpasses that of almost every nation in the world.

The credit picture has been mixed. The major credit indexes show a high general rate of expansion in the first part of the year. From June through November, however, commercial bank reserves held in the System decreased. An economy expanding at a rate of over 7 percent annually received no additional reserves.

Because existing reserves shifted to support time deposits attracted from other saving sources, total commercial bank credit continued to expand. The rate, however, was slower than in the first half of the year or in the 2 previous years. Other individual measures of credit showed differing reactions to the lowered reserves. Almost all grew more slowly than in the first half and most at rates below previous years.

As a result of this moderate credit restraint, interest rates rose sharply. On December 3, rates on short-term Governments were about a half a percent higher than earlier in the year. Corporate and municipal bonds had risen about as much, while long-term Governments were up over a third of a percent. All rates were close to their 30-year highs.

On the whole, one could conclude on December 3 that the price and credit pictures showed signs of pressure arising partly from higher demand and partly from a slowing in the rate of credit expansion. While unwanted price increases threatened, the cooperative effort to hold the wage-price level undertaken by labor, industry, and the Government seemed to be working.

The critical forces which would determine price movements for the next several months appeared to be the relative expansion rates for total demand and potential output, expectations, and the success of the President's price and wage programs. Price movements of the past year could be considered as normal and logical given the rapid rate of expansion. They offered no evidence as to how prices might react in a period of steady expansion at full employment.

Most projections of demand and supply available when the Board made its decision were in balance. In all forecasts, however, a recognized critical problem was inexact knowledge as to next year's growth rate for Federal expenditures and revenues. Depending on growth in the Federal budget, the country's demand might expand either more slowly or somewhat faster than capacity.

The Federal Reserve had no special information as to likely changes in the budget. Since, in attempting to formulate a correct policy for next year, the budget figures are critical, it seemed to me improper to make a drastic monetary change until this information became available. Reinforcing this reasoning was the fact that although a 1-month delay was technically feasible, an increase in discount and interest rates would be irreversible for a considerable period. The arguments for immediate action seemed weak.

THE NEED FOR COORDINATION

A more significant reason for urging a delay than incomplete information was my belief that this action failed to give sufficient weight to the necessity for a proper coordination of fiscal, wage-price, and monetary policies.

It would be interpreted by many as an attack by the Federal Reserve on the national consensus or program for meeting price pressures. Some would feel that the Board was assailing recent governmental policies. Others would assume that the Board did not accept maximum full-employment growth with stable prices as a national goal. Raising the discount rate would be interpreted as a view by the Board that because full employment increases inflationary problems, restrictive monetary policy must be invoked at its mere approach.

More important, I felt that a failure to coordinate was an irresponsible use of our independence. It reduced the choices on national policy available to the President. We were informing him that monetary policy would be tighter, leaving him to adjust fiscal and wage-price policy accordingly.

Many people recently have argued that the country can achieve a proper level of total demand by a policy of high interest rates offset by high budget deficits. They point out that each dollar of demand curtailed by higher interest rates can be offset by a budget deficit. As a fiscal conservative and a believer in leaving the maximum of choices to our market economy, I dislike this theory.

I personally think that in the current situation, adjustments through fiscal policy might be more advantageous. The country may be better off with lower deficits and lower interest rates. If demand is great enough, we may need a budget surplus. Increasing interest rates primarily penalizes growth and improvements in urban life. It tends to restrict modernization of plant and equipment, growth in housing, and the expansion and rebuilding of vitally needed State and local improvements. It increases the Federal deficit. It makes the task of the small businessman more difficult.

But more important than my own beliefs is the fact that I dislike attempting to impose them unilaterally on other parts of the Government. I would have preferred to explore all possible channels in an attempt to get a coordinated program. The Board's freedom to act requires that it use responsible statesmanship in achieving better economic policy.

History has shown that dividing the monetary from the fiscal functions of government is wise. Otherwise the creation of money to fill the public purse can become an engine of inflation. Because the Federal Reserve has a unique responsibility for maintaining monetary integrity, we must work as hard as possible to make certain that it is used properly.

The costs of conflict between monetary, fiscal, and wage-price policies ae high. Achieving sound policies which will enable our economy to grow with stable prices at full employment is a most difficult task. In such decisions, the Federal Reserve System has a vital role. It must remind other agencies of the need for monetary probity and must insist that the value of the dollar be maintained. However, our independence and right to act should be used primarily as a valuable ace in the hole. An unnecessary use of power may dangerously weaken the System. The weapon of independence is clearly a major bargaining force. However, because monetary and fiscal policies are necessarily interdependent, national goals may more easily be achieved if the ability to act leads to a coordinated program rather than independent action. Weapons held in reserve may be more powerful than those committed at the earliest sign of conflict.

It also seemed clear that a precipitate action by the Board in the light of recent history would decrease its hoped-for deflationary impact. People might mistakenly believe that the action was taken on far firmer grounds than it was. They might assume that the Board was convinced that inflation was imminent. This sudden action could easily cause a rise in expectations and a sharp runup in demand. Others might not understand the significant difference between banks raising their prices and unions and other industries doing likewise. They might feel justified in demanding higher wages or prices.

To some people's surprise my views on the requirements for evaluating the total (both direct and side effects) results of this interest rate action have been highly influenced by Senator Robert Taft. As a member of your committee, he pointed out on numerous occasions that tax (and by implication, interest) increases have three separate influences: (1) Demand is decreased, thus tending to reduce prices; (2) costs are raised, tending to raise prices; (3) the changed situation (announcement effect) may lead to independent price increases.

Most people concerned with the discount change stress only the first factor; that is, that higher interest rates make credit more expensive. People decrease their desires to purchase equipment, plants, houses, autos, etc. The lowered demand for goods means a lowered demand for employment. There is less pressure for wage and price hikes.

In addition though, we all recognize that interest is a cost of doing business. Gross interest payments in this country total about $70 billion a year. Raising a cost must have some influence on prices.

The announcement effects are expected to be mixed. However, any procedures that raised expectations or decreased the ability of the administration

to maintain its wage-price guidelines would diminish the desired price influences.

It seemed clear to me that the method used by the Board of raising the discount rate failed to coordinate monetary, fiscal, and wage-price policies. It was bound to increase the undesired price-increasing side effects at the expense of the hoped-for deflationary impact. A delay of a month to enable the Government to announce a unified policy would greatly increase the effectiveness of the Board's action.

IMPROPER REASONS

I am also concerned because it appears to me that the reasoning and action of the majority tend to enthrone as causes for monetary restraint two pieces of theory which I feel are invalid and dangerous precedents. These are: (1) the continuing use of higher interest rates in the U.S. economy for balance-of-payments purposes; and (2) the concept that one must act in advance of changes in demand for fear that once demand starts to grow it can be contained only with much higher sacrifices.

I have previously stated my views on the balance-of-payments argument. The United States is doing extremely well in restraining interest-sensitive items through present programs. Further rate increases might simply be matched again overseas. Indeed, higher rates may have a perverse effect. U.S. interest payments abroad would rise immediately. Higher financing costs would make our exports less competitive. Slower growth in this country might make direct investments abroad—our chief problem area—look even more inviting.

The traditional belief in higher interest rates for balance-of-payments reasons assumes either (1) rates high enough to raise unemployment sufficiently to curtail imports or (2) interest high enough to change capital flows. No one admits to desiring the first path. The second path I regard as dangerous and almost impassable.

When the discount rate was raised, the President was in the process of announcing a revised balance-of-payments program designed to bring about the necessary return to equilibrium. I believe the President's program was proper and sufficient. The constant use of balance of payments as a theme to raise interest rates can only have a most unfortunate longrun impact.

I am not certain I understand the argument that it was impossible to delay action for a month or until sufficient information about demand, prices and credit became available. This is contrary to what we know about most decision processes. As I understand this reasoning, it holds that delays and small infusions of additional credit are extremely dangerous. They lead to highly magnified inflationary conditions in the future. The use of credit gains momentum and runs away after some critical point.

We must admit that anything, including such results, may be possible. However, most people who have studied our monetary system carefully believe such a situation is extremely unlikely to occur. A large-scale credit expansion without added reserves would require peculiar types of discontinuities in our monetary system. There is no indication they exist. They have not appeared in the past. I spent considerable time trying to track down the basis of this idea. No one I asked on our staff or among monetary historians or theorists could find any support for this doctrine.

I concluded that neither the idea of a critical mass of credit nor the balance-of-payments argument was a proper basis for policy decisions.

THE METHOD OF CURTAILING CREDIT EXPANSION

When it became evident that a majority of the Board felt that a curtailment of credit was desirable, a question arose as to the best method of procedure. This is clearly far more a question of judgment than of analysis or of values. I felt that an immediate discount rate change should be avoided. The Board has had an established policy of letting discount rate changes follow the market. It has stated that it rarely deviates from this policy unless it desires to stress the importance of the change and to obtain a magnified effect. The disadvantages of decreasing credit at this time seemed sufficiently great. I saw no special circumstances requiring a break with traditional policy.

In addition to all other disadvantages, the rate change method together with the change in regulation Q, made it possible that the level of credit and demand would be raised rather than lowered. The System would have to furnish additional reserves for the transition period. A shift from demand to time de-

posits would mean that the existing reserve base could support a credit expansion. As a result, the action would bring higher interest rates, but at least initially an undesired increase in real demand could occur.

Given the expressed desire to curtail credit rather than to ratchet the interest rate structure upward, a more traditional and simpler approach appeared preferable. The System could simply determine not to furnish additional reserves and not to raise regulation Q. The discount window could have been opened wider to meet urgent needs. Borrowed reserves have been low by past standards for periods of restraint. Tighter money and larger borrowed reserves would have led to higher rates which could then have been ratified by a later discount rate change. This would have avoided the uncertainties and misunderstandings of the present situation. There would have been time for coordination with the fiscal authorities. If no agreement was possible, there at least could have been an announcement of a joint agreement to disagree.

Mr. Chairman, this concludes my statement. I want to make it clear again that while I believe the discount rate change at this time was incorrect policy, it is a move that can and will be absorbed by the economy without causing an immediate recession.

We must recognize our limited experience in operating for any length of time at full employment. However, the potential gains to our national welfare from the successful development of policies that will allow rapid expansion with stable prices are enormous. I hope that we can think of this action as behind us. Now it is time to try again to work out a better coordinated use of all types of policies which can help in achieving our national goals.

Chairman PATMAN. Without objection, we will ask Mr. Knowles, the staff director, to designate someone to keep the time, and each member will be recognized for 10 minutes. Each member will assume the responsibility of stopping at the end of 10 minutes so other members will have a chance, too.

If it is all right, we will try to continue until all the members of the panel here today have an opportunity, before we recess for lunch.

I would like to take my 10 minutes at this time.

I have here three charts that I would like to call your attention to. The first is a chart on outstanding negotiable time certificates from 1960 to 1965. They increased from about $1 billion at the end of December 1960 to about $16.5 billion December 1, 1965. That is the first chart I would like to put in the record. (See p. 35.)

Chairman PATMAN. Mr. Martin, I would like to ask you this question: Did you approve the banks buying these certificates of deposit in the amounts in which they have bought them?

Mr. MARTIN. From time to time we have had questions about whether it was a wise course for them, but we have neither approved nor disapproved them.

Chairman PATMAN. You have neither approved nor disapproved.

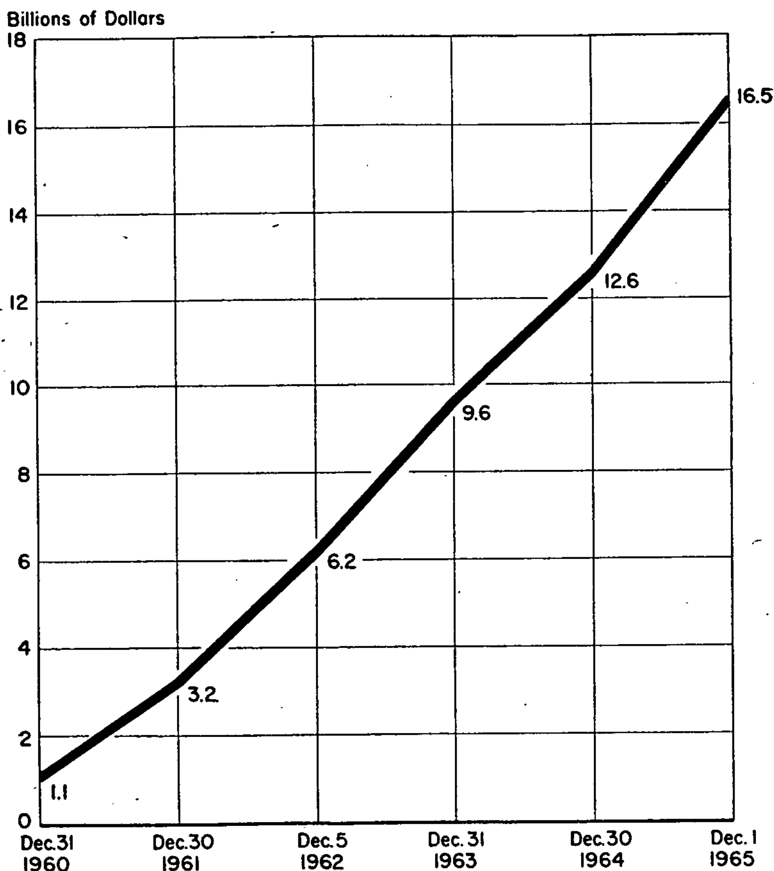
But they were practically unknown before 1960, weren't they, Mr. Martin?

Mr. MARTIN. Their great use has come in since that time, but it has been extremely beneficial in the sense that it has made possible lower rates for municipal financing and has taken some of the savings and projected them in useful ways.

Chairman PATMAN. We will go into the reasons for their increase a little bit later, if you don't mind.

Now, the second chart I insert in the record shows the yields on U.S. Government securities from 1941 to date. If you will notice here from 1941—really, from 1939—to 1951, the Federal Reserve

OUTSTANDING NEGOTIABLE TIME CERTIFICATES OF DEPOSIT, ANNUALLY, 1960-1965



Source: Basic data from Federal Reserve Board

kept the rates practically uniform. Twelve years of the worst difficulties of our history; deflation, inflation, depression, and war; but the Federal Reserve, cooperating with the administration, kept Government bond rates—long-term—at 2½ percent or below. Every person who wanted to sell his bond always had a market for it, and got his money back. Government bonds sold at par.

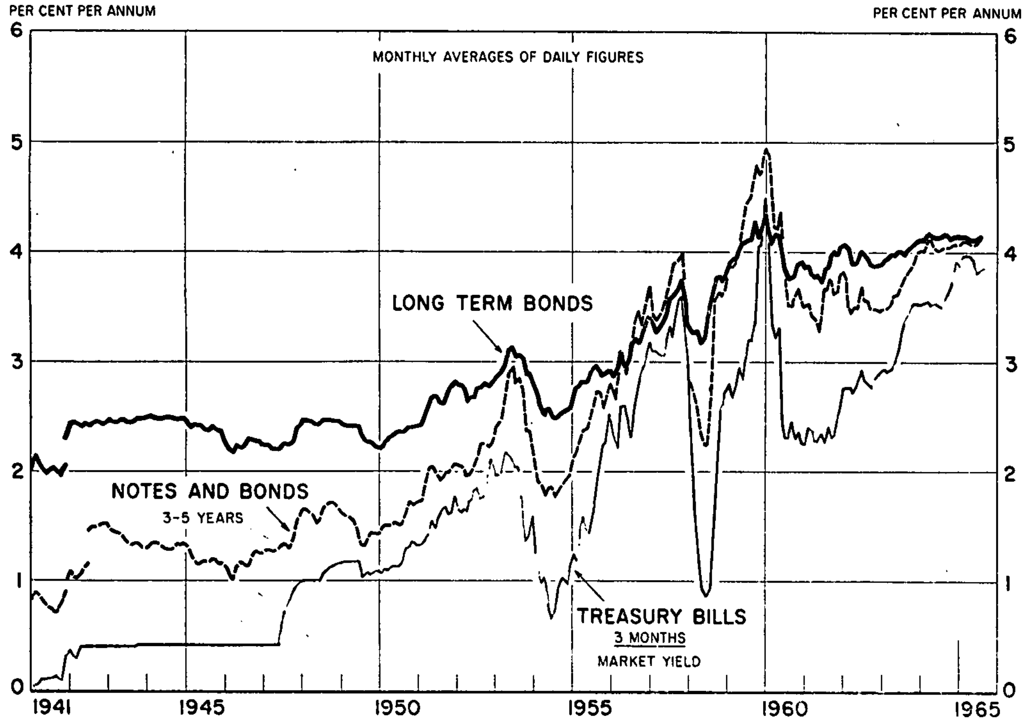
I will put that in the record at this point, without objection.

(See p. 36.)

Chairman PATMAN. Now, one more chart: long- and short-term interest rates. It will be put in the record, and we will take it up later on, but it tells a good story about the fluctuation of both long-term and short-term.

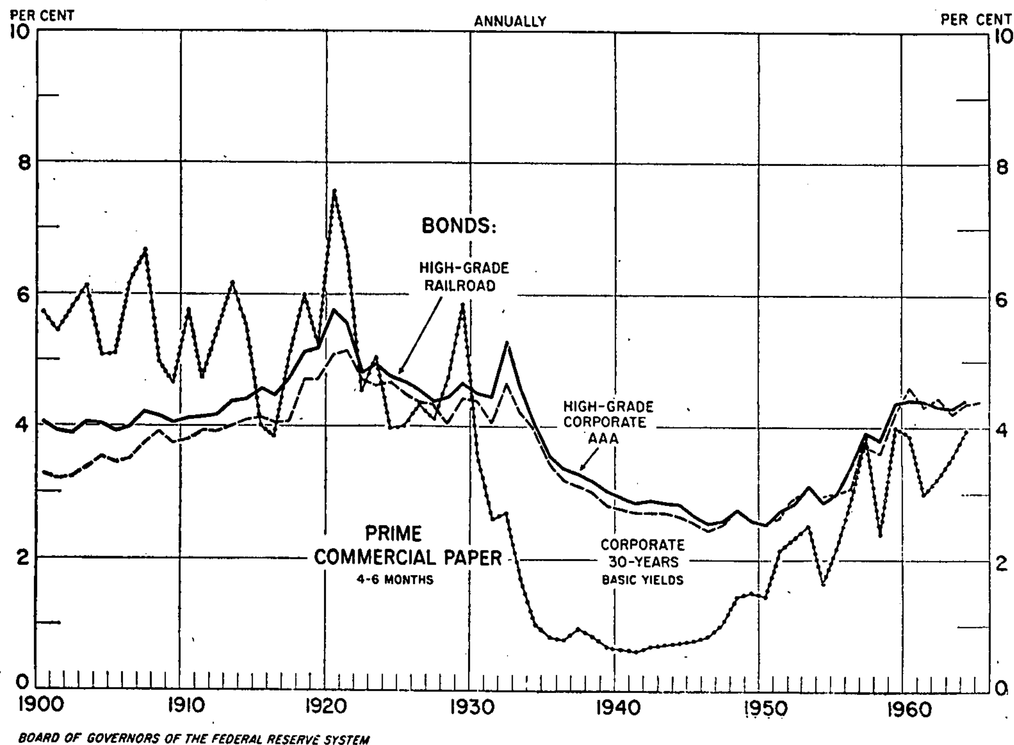
(See p. 37.)

YIELDS ON U.S. GOVERNMENT SECURITIES



Source: Board of Governors of Federal Reserve System

LONG- AND SHORT-TERM INTEREST RATES



I believe, Mr. Martin, since you went in as Chairman, interest rates have gone up on Government securities about 100 percent.

Now, have you ever considered an alternative to increasing interest rates every time you want to stop real or fictitiously assumed inflation? Have you considered other alternatives? I assume that you have.

Mr. MARTIN. We always have.

Chairman PATMAN. You always have.

Chairman PATMAN. You have never raised reserve requirements. You know that is a wonderfully effective weapon. It is just as good as raising interest rates, and will not put added costs on the consumer.

Mr. MARTIN. We have been over this many times, Mr. Patman. Reserve requirements have been changed about four or five times.

Chairman PATMAN. I know we have, but you always have one answer, higher interest.

Mr. MARTIN. And you always have one answer, lower interest.

Chairman PATMAN. I know. I am against tight money. I am not for easy money; I am for easier than tight.

Mr. MARTIN. You are for low interest rates under all circumstances, all conditions——

Chairman PATMAN. That is right—I want to see lower rates.

Mr. MARTIN (continuing). And as I have frequently testified, I would like to see interest rates as low as we can have them without producing inflation, because you get the maximum of capital formation, but I am not for low interest rates under all circumstances and conditions, because I think inflation is a very disastrous thing for little people.

Chairman PATMAN. Where I object to your judgment is the fact that you always wind up using higher interest. You never end up suggesting anything else.

Mr. MARTIN. That is not correct, Mr. Patman. The record doesn't show that. I have on a number of occasions in the last 4 years——

Chairman PATMAN. It would be refreshing to me as well as interesting to know about it.

Mr. MARTIN. Well, the record should show that I have, on certain occasions, urged lower interest rates as well as higher rates, depending on economic conditions, and at one time we got the bill rate down to a half of 1 percent.

Chairman PATMAN. If we were to have a real inflation, do you know of any better way to skim off the excess purchasing power than equitably increasing taxes?

Mr. MARTIN. I would certainly favor that; and in the period that you referred to there of pegged interest rates during the war, I think we would have been better off if we had used tax policy a little bit instead of letting the Federal Reserve become an engine of inflation.

Chairman PATMAN. Well, it worked pretty good. We kept the interest rates down to 2½ percent and below for 12 years, the worst——

Mr. MARTIN. During the wartime period it worked pretty well, but when the war was over and we found that people just had a "put" on the Government at 2½ percent, there came a time when it was like dealing with Niagara Falls and this meant the Federal Reserve faced a flood of Government securities.

Chairman PATMAN. There was a big lobby moved into town, you know, about that time. I could tell you more about that.

Mr. MARTIN. There was no lobby. I was Assistant Secretary of the Treasury, and there are always lobbies in Washington, but there was then no unusual lobby.

Chairman PATMAN. To switch to another point—have you really tried to protect the 4¼-percent maximum rate on long-term bonds as the law requires? You know, the law passed back in Woodrow Wilson's administration says that we shall not pay any more than 4¼ percent on long-term bonds, and Congress has stayed by that. Efforts have been made to take the ceiling off, and will probably be made again. These efforts failed before and I predict that they will fail again.

Mr. MARTIN. I have consistently done everything I can to see that we have as low interest rates as we can have without producing inflation.

Chairman PATMAN. Mr. Martin, there is another thing that I would like to ask you about at this time. If you don't want to answer it fully now, we can do it later on, of course, but you have in the vaults of the New York bank $40 billion in bonds, about $41 billion now, isn't it?

Mr. MARTIN. I think that is roughly correct.

Chairman PATMAN. Through your Open Market Committee and its operators you took one form of Government obligation, Government credit and Federal Reserve notes and traded for another—Government securities. They have been paid for once. Now who has custody of those bonds?

Mr. MARTIN. The Federal Reserve has custody of them.

Chairman PATMAN. Which part of the Federal Reserve?

Mr. MARTIN. Well, the Federal Reserve Bank of New York. Now you say it is the only bank in the System; but we have 12 banks, all of which participate.

Chairman PATMAN. I know, but I am talking about custody now. Custody. The Federal Reserve Bank of New York really is the Federal Reserve System, isn't it, because the other 11 banks don't know what is going on. They have to get a report from the Federal Reserve Bank of New York.

Mr. MARTIN. No, no, Mr. Chairman.

Chairman PATMAN. Now wait just a minute. They have to get a report from the Federal Reserve Bank in New York before they can issue a condition statement. Isn't that correct?

Mr. MARTIN. Every 3 weeks we have a meeting of the Open Market Committee.

Chairman PATMAN. Is that correct or not? I object to your going into that. I want you to answer this question, if you please.

Mr. MARTIN. Well, you can't answer the question the way you are asking it without giving the answer that you are trying to get, which is not the right answer.

Chairman PATMAN. I asked you a very simple question. The simple question is: Isn't it a fact that not 1 of the other 11 banks can make a condition statement?

Mr. MARTIN. I refuse——

Chairman PATMAN. Until the Federal Reserve Bank of New York tells them their condition?

Mr. MARTIN. This is proper procedure, proper organization, and the Congress gave us the open market setup. We meet every 3 weeks.

Chairman PATMAN. So the answer is "Yes."

Mr. MARTIN. The answer is "No." The answer is "Yes" the way you want to construe it.

Chairman PATMAN. Well, there is only one answer the way I see it, and I have gone over it with you before. Is anybody under bond for the safekeeping of those $40 billion in bonds?

Mr. MARTIN. Mr. Patman, we have been over this many times.

Chairman PATMAN. Well, tell me who is under bond to keep those bonds?

Mr. MARTIN. We have had an extremely good record through the years of handling securities. Even in the case of the securities that you have raised the point about in San Francisco, no one has sustained a loss——

Chairman PATMAN. No; just carefully handled them and lost them and haven't accounted for them yet. That is only $7½ million, though. I am talking about $40 billion now.

Mr. MARTIN. $40 billion.

Chairman PATMAN. There is no one under bond to keep those bonds safely.

Mr. MARTIN. The procedures of the Federal Reserve in this area are as good as any procedures that have been devised in the world. I am not trying to say we are perfect, but the procedures by which we handle these securities are recognized throughout the world as proper and effective.

Chairman PATMAN. But the conclusion is that you have $40 billion in bonds that have been paid for once by Government credit and Government Federal Reserve notes. You are a fiscal agent of the U.S. Government. A fiscal agent is supposed to do the right thing, of course, in regard to its principal.

Now, when you trade one form of Government obligation for another form, don't you think you should cancel the one that you get? Otherwise, both of them are outstanding, and it becomes a double obligation. It is similar to this; if you had a home that you had a mortgage on in the amount of $10,000, and you gave your agent—we will call him a fiscal agent—a $10,000 check to buy that mortgage, not due yet, he took your check, he paid the balance due on your $10,000 mortgage, and the check was canceled, the money was taken from your funds, but the fiscal agent, just like the Federal Reserve, has a mortgage transferred to him and then when the interest becomes due, it becomes due for the interest, then when the actual debt comes due, it comes back to you to pay it again.

Isn't that exactly the same way that the Federal Reserve is doing that right now?

Mr. MARTIN. This is this double accounting that we spent a whole morning discussing, as you know, and I will be glad to put into the record again what I said at that time.

(Material relevant to the discussion at this point was later furnished by the Federal Reserve Board and follows herein:)

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,
Washington, August 19, 1965.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D.C.

DEAR MR. PATMAN: At your recent hearings on H.R. 7601 I was asked to supply additional information as to transactions in Government securities, particularly with reference to whether the Federal Reserve System forces the Government to pay its debts more than once, or had advocated giving away Government securities to commercial banks.

I am attaching comments on these points for the record of your hearings. Briefly, my views are that—

(1) Interest-bearing obligations of the United States are issued by the Treasury, and can be paid off only by the Treasury;

(2) The Federal Reserve banks pay for the Government securities they buy by assuming a deposit liability to a commercial bank—not, as you have stated, by issuing Federal Reserve notes;

(3) Federal Reserve notes are direct liabilities of the Federal Reserve System, and only contingent liabilities of the Treasury;

(4) The System pays for the securities it buys, but cannot be said to pay them off unless one treats the liabilities of the System as if they were liabilities of the Treasury;

(5) Distinguishing the assets and liabilities of the System from those of the Treasury is essential to keep the credit functions of the System separate from the borrowing functions of the Treasury;

(6) Your assertion that the System in 1959 advocated giving away $15 billion of its Government securities to commercial banks, whereas it now opposes saving taxpayers $1.1 billion a year in interest costs by transferring $30 billion of its securities to the Treasury, is unfounded because—

(a) The System has never advocated giving away any of its Government securities, let alone $15 billion of them; and

(b) H.R. 7601 would not save the taxpayer a penny.

The attached comments open with a case history of a U.S. Government security, as requested by several members of the committee, that provides a background for the other comments that follow.

Sincerely yours,

WM. McC. MARTIN, Jr.

Attachments.

ATTACHMENT 1

A CASE HISTORY OF A U.S. GOVERNMENT SECURITY

The U.S. Treasury issues interest-bearing obligations of the U.S. Government, either for cash, when it needs money to cover current expenditures, or to refinance maturing obligations as they come due. There are usually special provisions in the case of a refinancing which permit holders of the maturing securities to exchange their holdings for the newly issued securities. Hence, for the sake of simplicity, let us consider only the case where the securities are being sold to raise new cash.

Such securities are sold to the public—in the broadest sense of the word. Anyone may subscribe. If—as is practically always the case—total subscriptions exceed the amount offered, the available securities are allotted by the Treasury. Smaller subscribers are usually allotted 100 percent and the remainder is divided pro rata among the larger subscribers. There are no fees or commissions in connection with these offerings. A buyer may subscribe through his bank, as a matter of convenience, or he may go directly to a Federal Reserve Bank, if he prefers.

Let us assume that the XYZ insurance company purchased a 4¼-percent, 20-year $100,000 bond in such an offering. It would, of course, get the bond; its account at its bank would be debited $100,000; and, in turn, the bank's account

at the Federal Reserve would likewise be debited and the account of the U.S. Treasury credited. The Treasury could then draw checks on this account to make the payments for which it borrowed in the first instance, so that the money would finally end up in the account of someone who had sold goods to or performed services for the Government.

At this point, the net change is that the insurance company has given up cash in exchange for a promise from the Treasury to repay in 20 years, with interest, and the Treasury has discharged a debt for which payment was due and taken on an obligation to pay in 20 years, with interest.

Government bonds of this sort, as distinct from savings bonds, are completely negotiable. Anyone can sell them anytime to anybody at any price. They are also widely used as collateral for loans.

They may be sold directly by one individual to another, by a bank to an individual, or they may move through the hands of a dealer who specializes in buying and selling these securities. Unlike stockbrokers, these dealers do not charge a commission. They hope to cover their expenses and make a profit from the spread between the prices at which they buy and those at which they sell, and sometimes from the fact that the yield on the securities they carry in inventory is higher than the cost of the money they have to borrow in order to carry them.

There are no restrictions on entry into this business and no license is required. The only requirements are that the dealer have enough capital so that those who do business with him can be confident he will be able to honor his commitments and that he is prepared, in fact, to "make a market" in Government securities. The Federal Reserve Bank of New York, as agent for the Open Market Committee, will buy from or sell to any dealer who meets these qualifications.

Thus, if the XYZ insurance company wishes to sell its Government bond, say, to make a mortgage loan or to pay a beneficiary, it can sell to anyone it chooses for the best price it can get. This may be more or less than $100,000, depending on the yields on alternative investments at the time it sells. It is possible, perhaps likely, that it can do better by selling to a dealer than to any other purchasers it can readily locate. So, it sells to the ABC securities company. Since no dealer ordinarily has enough capital to carry his entire inventory, ABC would, in all likelihood, pledge the bond as security for a loan from its bank, using the proceeds of the loan, in effect to pay XYZ insurance company.

The dealer now has the bond, along with many others, "in stock" and he is constantly in touch with customers who are interested in investing part of their resources in Government bonds. He may sell it again in a few minutes, a few days, or may hold it for some months.

Now, for reasons which are set forth in various readily available publications (e.g., the Federal Reserve System—Purposes and Functions), from time to time the Federal Reserve System buys Government securities to inject funds into the economy or sells them to absorb funds that would otherwise constitute an oversupply. Generally, those transactions are in Treasury bills, with maturities of 1 year or less, but on occasion the System does buy or sell longer-term, coupon issues. Thus the "desk" at the New York Federal Reserve Bank, which trades for the System account, might decide to buy bonds while the $100,000 bond was being offered for sale by ABC securities company. Accordingly, ABC's bond might be included in a package to be sold to the System. In this case, ABC would have the bond released from its collateral account at its bank by paying off a corresponding part of its loan or substituting another bond so that the released bond could be delivered to the Federal Reserve Bank. The Reserve bank would pay for the bond by crediting the reserve account of a commercial bank designated by ABC, and this bank would, in turn, credit ABC's checking account. There would, of course, be no change in the Treasury's account, since this time the Treasury played no part in the transaction.

The securities acquired for the open market account are allocated among the 12 Federal Reserve banks; let us assume that the $100,000 bond ends up in the account of the Federal Reserve Bank of Minneapolis. In order to include a transaction that is closely related to H.R. 7601, let us assume that at about the same time the Federal Reserve Bank of Minneapolis is anticipating that member banks in its district will be calling on it for more currency to meet the

needs of individuals and businesses in its area. It could decide to use this bond as part of the 100 percent collateral it is required to post for every Federal Reserve note it issues. In this case, the bond would go over into the Federal Reserve agent's account, where it would have to remain as collateral as long as the corresponding Federal Reserve notes were in circulation. Of course, this specific bond could be withdrawn and another substituted for it. The currency issued to the commercial banks would be charged to their reserve accounts when it was issued.

Nowhere in this process has the bond been paid off.

At some stage, let us assume, as happens after the Christmas holidays, less currency is needed in the Minneapolis district. Banks return to the Reserve bank the currency that is no longer needed and, in return, get credit for it in their accounts. The Reserve bank can "retire" the currency (Federal Reserve notes) thus turned in and get back from the Federal Reserve agent's account the bond it had posted as collateral for these notes. About the same time the Open Market Committee may decide that economic conditions require sale of some of the System's bond holdings to reduce reserves of member banks. The bond it had purchased from the ABC securities company may be in a package sold back to ABC. ABC pays for the securities through its checking account at its bank, and that bank's reserve account is charged the same amount; reserves are reduced, just as they were increased when the System bought. Finally, let us say that ABC sells the bond to the MNO pension fund, which holds it for the remainder of its life.

At maturity MNO can present the bond at any Federal Reserve bank for redemption. As agent for the Treasury, the Reserve bank will give MNO a check drawn on the Treasurer of the United States, which MNO will deposit in its bank. The bank will present the check to the Reserve bank for credit to its reserve account, and the Reserve bank will charge the amount of the check to the same Treasury account it credited when the bond was originally sold to XYZ insurance company. The bond is then paid off, for the first and last time.

During its lifetime, interest, represented by coupons attached to the bond, falls due. This interest goes to the legal owner of the bond at the time—whether he is an individual, a bank, an insurance company, a pension fund, or a Federal Reserve bank. It is collected by presenting the coupon for redemption in the same way the bond is redeemed at maturity. If the interest is paid to the Federal Reserve System all of it, after expenses (including dividends and payments into surplus), is returned to the Treasury. To any other holder, bank or nonbank, interest received is no different from any other taxable income.

Obviously, there are literally hundreds of other possible transactions that might take place in the life of a bond, and hundreds of ways in which the proceeds might be paid and used. This is only an illustrative exposition—simplified but covering the essentials—of transactions that go on every day.

ATTACHMENT 2

DOUBLE PAYMENT OF PUBLIC DEBT?

The contention has been made that when the Federal Reserve System buys Government securities such securities are subject to "double payment" by the Government and, hence, should be canceled.

This conclusion apparently is reached by reasoning along the following lines:

(1) If the holder of a Government security decided to exchange that security for another—with a different maturity date, for example, as he could in an advance refunding offer—he would have to turn in the original security to the Treasury in order to get the new security. Under such circumstances, the Treasury would cancel the original security and no further interest payments would be made on it.

(2) The Federal Reserve System uses Federal Reserve notes to pay for its open market purchases of Government securities.

(3) Federal Reserve notes by statute are in obligation on the U.S. Government. Therefore, when the Federal Reserve System uses Federal Reserve notes to acquire Government securities, it is merely exchanging one form of Government obligation for another.

(4) This exchange is similar to that described in paragraph (1) and, accordingly, to avoid double obligation by the United States on the same debt, Government securities acquired by the Federal Reserve System in exchanging for Federal Reserve notes should be canceled.

This line of reasoning involves two basic misunderstandings.

The first misunderstanding is that open market purchases of Government securities by the Federal Reserve System are paid for with Federal Reserve notes. Actually, the payments are made through immediate credit in the reserve accounts of member banks designated by the dealer from whom the securities are purchased.

The System's open market transactions are handled through 19 dealers, of whom 7 are banks. The nonbank dealers have standing arrangements that when they sell securities to the Federal Reserve System the Federal Reserve Bank of New York will credit the reserve account of a designated member bank and that bank will credit the dealer's account.

The point to be noted here is that, while Federal Reserve notes, by statute, are "obligations of the United States," balances in reserve accounts of member banks are not. When the Federal Reserve System purchases a Government security and pays for it by a credit in the reserve account of a member bank, it has become a holder in due course and there has not been in any sense a payment by the United States.

The difference between paying for System purchases of Government securities by issuing Federal Reserve notes or by giving credit in member bank reserve accounts is not merely a bookkeeping matter. An important difference in objectives is involved. Federal Reserve notes are put into and retired from circulation as the needs of the public for hand-to-hand currency rise and fall. These needs fluctuate in response to factors that are different from—sometimes in conflict with—the factors that lead to purchases or sale of Government securities, which are made to implement monetary policy.

The second of the two misunderstandings I mentioned earlier is with respect to the effect the statutory provision that Federal Reserve notes are obligations of the United States has on operating procedures. The cause of concern apparently stems from an assumption that Federal Reserve notes are like any other Government obligation except that they bear no interest.

The fact is that Federal Reserve notes are not like other Government obligations. The financial operations of the Treasury are not affected by redemptions of Federal Reserve notes, because the Treasury does not pay for them. The Reserve banks themselves pay for such redemptions, usually by assuming a deposit liability for which the Treasury has no obligation.

As stated in the Circulation Statement of United States Money published by the Treasury Department, "Federal Reserve notes are contingent liabilities of the United States." The only exception to this—the only instance in which the Treasury has direct liability for redeeming Federal Reserve notes—results from the Old Series Currency Adjustment Act, approved June 30, 1961. Under that act, the Federal Reserve Bank paid into the Treasury about $36 million, the amount then outstanding of Federal Reserve notes issued before July 1, 1929 (the old large-sized bills). Under section 5 of the Old Series Currency Act, this payment transferred to the Treasury the liability for redeeming the notes. Section 2 of H.R. 7601 similarly provides that the liability for $30 billion in Federal Reserve notes would be transferred "on the books of the Treasury, from contingent liability on Federal Reserve notes to direct currency liability." These examples confirm that in the first instance Federal Reserve notes are a liability of the Reserve bank that issues them, and that an act of Congress is required if this primary liability is to be transferrred to the Treasury.

Let us now consider the present statutory provisions governing liability on Federal Reserve notes. Paragraph 1 of section 16 of the Federal Reserve Act

provides that Federal Reserve notes "shall be obligations of the United States * * *." In addition, however, paragraph 2 of the same section provides that, before Federal Reserve notes can be issued to a Reserve bank, the applying bank must tender "collateral in an amount equal to the sum of the Federal Reserve notes thus applied for * * *"; paragraph 4 of the same section provides that "Federal Reserve notes issued to any such bank shall, upon delivery * * * become a first and paramount lien on the assets of such bank"; and paragraph 2 of section 7 provides that should "a Federal Reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States * * *."

When all of these provisions are considered together, it seems clear that their intent is—

(1) To provide assurance that the current liability for Federal Reserve notes could always be met by the collateral required to cover such notes.

(2) To put the statutory obligation of the United States for Federal Reserve notes in the form of a contingent liability that would only materialize in the extremely unlikely event of a Federal Reserve bank being liquidated under such conditions as to make the assets of such bank, including the collateral behind its Federal Reserve notes, insufficient to meet its liability for such notes.

Since the Treasury has no current liability for the redemption of Federal Reserve notes, it likewise seems clear that no double payment by the Treasury would be involved even if the System used Federal Reserve notes in paying for Government securities purchased in the open market.

A step-by-step illustration of these transactions follows:

ILLUSTRATION

(1) Treasury announces a new bond issue, and Community Bank, of Cooperstown, N.Y., wishing to invest idle funds, sends to the Federal Reserve Bank of New York ("New York Fed") an instruction to subscribe for $100,000 of new bond issue. New York Fed issues the $100,000 bond to Community Bank as agent for Treasury and transfers $100,000 from the reserve account of the Community Bank to the account of the Treasurer of the United States.

(2) Community Bank, seeking funds to make business loans, sells the $100,000 bond to ABC Security Co., a security dealer in New York. In payment, ABC sends to Community Bank a check drawn on the Metropolis Bank, New York City. The collection of the check results in Community's reserve account at New New York Fed being increased $100,000, and Metropolis' reserve account at New York Fed being decreased $100,000.

(3) New York Fed, as agent for the Federal Open Market Committee, buys the $100,000 bond from ABC Securities Co. (In actual practice this bond would be one of a package usually totaling several hundred thousand dollars or more. For simplicity's sake, let us assume the bond is allocated to New York Fed rather than one of the other Reserve banks.) This transaction increases ABC's checking account at Metropolis Bank by $100,000 and Metropolis' reserve account at the New York Fed by the same amount.

(4) The $100,000 bond matures and is paid off out of the Treasury's account at the New York Fed. The canceled bond is removed from the assets of the New York Fed.

(5) Community Bank requisitions $100,000 in Federal Reserve notes from New York Fed and authorizes the Fed to charge its reserve account for these notes.

(6) Community Bank turns in to the New York Fed for redemption $100,000 in Federal Reserve notes so worn from usage that they are not fit to continue in circulation. This deposit is credited to Community's reserve account, and thus the Fed reduces its liability for Federal Reserve notes outstanding and increases its deposit liability.

Recapitulation

[In thousands]

Transaction number	Effect of transaction	Increase or decrease in—	
		Assets	Liabilities
	TREASURY		
1	Increased bond debt		+$100
	Increased balance with Fed	+$100	
4	Decreased bond debt		−100
	Decreased balance with Fed	−100	
	Net change		
	NEW YORK RESERVE BANK		
1	Decreased balance due Community		−100
	Increased balance due Treasury		+100
2	Increased balance due Community		+100
	Decreased balance due Metropolis		−100
3	Acquired Government bond	+100	
	Increased balance due Metropolis		+100
4	Gave up Government bond	−100	
	Decreased balance due Treasury		−100
5	Increased Federal Reserve notes outstanding		+100
	Decreased balance due Community		−100
6	Decreased Federal Reserve notes outstanding		−100
	Increased balance due Community		+100
	Net change		
	COMMUNITY BANK		
1	Decreased reserve balance	−100	
	Acquired Government bond	+100	
2	Gave up Government bond	−100	
	Increased reserve balance	+100	
5	Decreased reserve balance	−100	
	Acquired Federal Reserve notes	+100	
6	Gave up Federal Reserve notes	−100	
	Increased reserve balance	+100	
	Net change		
	ABC SECURITIES CO.		
2	Decreased balance with Metropolis	−100	
	Acquired Government bond	+100	
3	Gave up bond	−100	
	Increased balance with Metropolis	+100	
	Net change		
	METROPOLIS BANK		
2	Decreased balance due ABC		−100
	Decreased reserve balance	−100	
3	Increased balance due ABC		+100
	Increased reserve balance	+100	
	Net change		

ATTACHMENT 3

"$15 BILLION GIVEAWAY?"

Part of the argument put forth for canceling $30 billion of the System's portfolio is an allegation that the Federal Reserve has tried to devise methods of giving its Government securities away to the commercial banks that are members of the System. To prevent this, it is argued, the securities should be canceled.

As proof of this danger, Mr. Patman has said that the Federal Reserve System sponsored legislation in 1959 to give away $15 billion of its portfolio to member banks. It is true that the Board submitted a bill, ultimately enacted in amended form as Public Law 86–114, on July 28, 1959. This bill as proposed by the Board—

(1) Authorized the Board to permit member banks to count the currency or coin in their tills as reserves;

(2) Authorized the Board to classify individual banks in central reserve and reserve cities as "country banks" with lower reserve requirements if the nature of their business justified such treatment; and

(3) Reduced the minimum Reserve requirement for central reserve city banks from 13 to 10 percent and the maximum from 26 to 20 percent.

When the Congress acted on this bill the vault cash holdings of all member banks amounted to about $2 billion. There were at the same time some small banks in central reserve cities and reserve cities whose business was similar to that of a typical country bank. The Board, as a matter of equity, felt that member banks should be allowed to count their vault cash as part of their reserves, as was already the case for most nonmember banks, and that small banks in large cities should be allowed to meet the lower reserve requirements that applied to country banks.

Nothing in the bill, as proposed or as enacted by the Congress, constituted a "giveaway." Its purpose, as stated by the House Banking and Currency Committee was "to create a more rational and equitable structure of reserve requirements." The commercial banks legally own the reserves they maintain with the Federal Reserve, just as much as they own any other asset on their books. The bill gave them nothing they did not already own. It did permit them, in the long run, to lend or invest a somewhat larger percentage of their funds. This has in fact resulted in banks increasing their loans to commerce, industry, and agriculture, rather than their portfolios of Government securities.

The bill, as reported out by the committee and passed by the Congress, contained a provision to remove the central reserve city classification. This resulted in lowering the reserve requirement for central reserve city banks from 18 to 16½ percent. This amendment to the original bill, which was proposed in the course of the hearings by representatives of New York and Chicago banks, was specifically opposed by the Federal Reserve Board.

Despite charges by Mr. Patman that the Federal Reserve is dominated by bankers, Vice Chairman Balderston, testifying for the Board during the House hearings on the legislation, opposed "the proposals for changes made by the Economic Policy Commission of the American Bankers Association and * * * other plans for fundamental revisions of the reserve requirement structure." He stressed that drastic changes were not needed, and characterized the bill as a means of "removing from the present law some structural inequities and difficulties of administration." When the House Banking Committee amended the bill, over the Board's opposition, to do away with the "central reserve city" classification for reserve purposes, Mr. Patman circulated a letter headed "S. 1120 as Reported Enacts American Bankers Association Plan Over the Vigorous Protest of the Federal Reserve Board."

How Mr. Patman figures the bill authorized a giveaway of $15 billion (or $25 billion, the figure he originally used) has never been clear. Even if one accepts the premise that lowering reserve requirements is a giveaway, and that the Federal Reserve was bent on using its authority to cut reserve requirements to the bone, it is difficult to see how the vault cash bill would have played much of a role in this effort. When the bill was proposed, the Federal Reserve already had authority to lower reserve requirements much more drastically than the bill permitted.

This is clearly shown in a table Mr. Patman included in his dissenting views in the committee report on the bill (H. Rept. No. 403, 86th Cong., 1st sess., pp. 26 and 27). In this table, Mr. Patman showed that without any legislation, the Board could have cut reserve requirements by about $6.5 billion. The bill, of course, freed about $2 billion of member banks' reserves by allowing them to count their vault cash as reserves. Mr. Patman's table indicates that the bill would have authorized release of about $2.8 billion more by a further cut in reserve requirements; he calculated this by assuming that the Board would use its authority to reclassify certain individual banks in Reserve cities, as granted by the bill, to reclassify every member bank in the country as a "country bank" entitled to the minimum country bank reserve requirement of 7 percent. This result was never contemplated by anyone but Mr. Patman, and of course it did not occur.

What has happened as a result of the bill? As required by the committee amendment, New York and Chicago banks have had their reserve requirements reduced from 18 percent to 16½ percent on demand deposits. As Mr. Balderston had testified[1] this necessitated an increase from 11 to 12 percent in the reserve requirements of country banks on demand deposits. The System's portfolio of Government securities has not been reduced by $15 billion, or $5 billion, or $1; it has risen by about $11 billion. Member banks' holdings of Governments have dropped and their business loans have risen.

Mr. Patman's explanation of why the "$15 billion giveaway" did not take place is that the conference report on the bill included a statement that "it is not the intent of this legislation to encourage or cause the Federal Open Market Committee to reduce the Federal Reserve System's holdings of Government securities. As was made clear in the House debate, the purpose of this bill is simply to make needed reforms in the structure of reserve requirements." Mr. Patman concludes that this statement, even though it simply repeated testimony previously given by Mr. Balderston on behalf of the Board, somehow prevented the Board from doing what Mr. Patman believes the Board wanted to do. Why the statement in the conference report was any more binding on the Board than previous statements in Mr. Balderston's testimony, in the report of the majority of the committee, and by the bill's supporters in the House debate is not clear. But it is perfectly clear that, contrary to Mr. Patman's assertion, the Board did not advocate giving away $15 billion of its Government securities.

ATTACHMENT 4

DOES THE FEDERAL RESERVE FAVOR BANKS OVER TAXPAYERS?

Accompanying the "$15 billion giveaway" accusation discussed above is the companion charge that the Federal Reserve, while advocating help for banks, refuses to help the taxpayer.

H.R. 7601 would not save the taxpayer a penny. This is because the System's income from interest on its portfolio of Government securities is paid back to the Treasury, in the form of interest on Federal Reserve notes, after paying expenses and the statutory 6 percent dividend on Federal Reserve bank stock and setting aside enough to maintain a surplus equal to paid-in capital. In 1964, the Reserve banks' income from interest on Government securities amounted to about $1.3 billion. After paying expenses of about $197 million and dividends of about $31 million, the balance was paid back to the Treasury.

Neither the Treasury nor the taxpayer nor the public will be served by taking actions—such as that provided in H.R. 7601—that could be interpreted as repudiating the debt, or using Federal Reserve credit to finance Government deficits without regard to the effect on the economy, or removing safeguards against excessive issuance of currency. Perhaps this risk would be worth taking if it could be shown that some important benefit to the public would ensue. But the only tangible benefit claimed is a reduction of $1.1 billion in interest payments on the debt. Since this reduction in payments by the Treasury to the Federal Reserve System would be exactly balanced by an identical reduction in payments by the System to the Treasury, this claimed benefit is illusory.

Mr. MARTIN. On this matter of bonding with respect to these securities, I doubt if we are going to get anybody who will write a bond for $40 billion.

Chairman PATMAN. Well, that is the point I am making. Nobody is bonded for $1 million, or $1 billion, or the $40 billion.

Mr. MARTIN. I return to my point that the procedures and the methods that the Federal Reserve has been employing have been time tested and extremely competent.

Chairman PATMAN. If Congress were to pass a resolution instructing the Federal Reserve to support the 4¼ percent, the Government long-term bond market, you would do that, would you not?

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[1] "If requirements at central Reserve city banks were lowered to the present level of Reserve city banks, the effect would have to be absorbed by raising requirements for country banks." Hearings on H.R. 5237, Subcommittee No. 2, House Banking and Currency Committee, Apr. 7, 1959, p. 6.

Mr. MARTIN. This has been the law, as I testified——

Chairman PATMAN. I am asking you a question, though.

Mr. MARTIN. I am saying to you that as long as it is the law, of course, we will support it, but the Treasury in certain circumstances might have to finance in less than 5 years, which is what that law provides.

Chairman PATMAN. Well, the rate on the short term has gone up, too, to where now some 91-day bills are yielding more than 4½ percent.

Mr. MARTIN. And I think there would have been lower interest rates across the board if there had never been any 4¼-percent ceiling. That is my judgment as a money market man, and certainly my judgment is not necessarily——

Chairman PATMAN. My time has expired.

(Additional information on the $40 billion in bonds held by the New York Federal Reserve Bank, subsequently supplied for the record by Chairman Patman, follows:)

The following quotes of exchanges between Mr. Patman and Mr. Marriner Eccles, former Chairman and member of the Federal Reserve Board, and Mr. Martin, Chairman of the Federal Reserve Board, clearly prove that when the Federal Open Market Committee purchases Government securities in the open market they trade one form of Government obligation (Federal Reserve notes or credit on the Federal Reserve books) which is noninterest bearing for another form of Government security (Federal Government marketable securities such as Treasury bills, notes, and/or bonds) which is interest bearing. Since, then, these securities purchased in the open market have been paid for in either Federal Reserve notes or credit on the Federal Reserve books, the interest-bearing Federal securities should be canceled since the debt has been paid once.

The following quotes extend over a period of time from 1941 to 1965 and in each instance the same conclusion as above is reached.

TESTIMONY OF MARRINER ECCLES REGARDING TRANSFER OF NONINTEREST GOVERNMENT OBLIGATION FOR INTEREST BEARING[1]

"Mr. ECCLES. The Open Market Committee can buy either those bonds or any other bonds either from the bank that you indicate or from a dealer or from any other bank.

"Mr. PATMAN. I am just giving that as an illustration, not as a specific case.

"Mr. ECCLES. But the System does not operate that way. No Reserve bank buys Government bonds from any bank. The Open Market Committee does the purchasing, and they do the purchasing in the open market because the law requires that they do the purchasing in the open market, and requires that they cannot buy directly.

"Mr. PATMAN. Of course I am not taking that into consideration, but the effect of it is the same. If the bank sold a million dollars in bonds, although it was through the open market, the effect is the same. You have transferred——

"Mr. ECCLES. Credit. As a practical matter, the bank that sold the bonds would sell those bonds in the market.

"Mr. PATMAN. In the open market; that is right.

"Mr. ECCLES. And would get credit either at the Reserve bank or at a correspondent bank, for which they could get Federal Reserve notes if they wanted them.

"Mr. PATMAN. So if the statement that you are transferring one Government obligation that is noninterest bearing for another Government obligation that is interest bearing is correct, then you continue to draw interest until those bonds are due and payable?

"Mr. ECCLES. That is correct; yes, sir."

* * * * * * *

[1] Hearings before the Banking and Currency Committee of the House of Representatives, June 21, 23, 24, and 25, 1941, on S. 1471, p. 78.

FEDERAL RESERVE NOTES A GOVERNMENT OBLIGATION THE SAME AS INTEREST-BEARING GOVERNMENT SECURITIES [2]

"Mr. PATMAN. Now, I want to ask you about these Federal Reserve notes. You consider them obligations of the U.S. Government, do you not, Governor Eccles?

"Mr. ECCLES. I do.

"Mr. PATMAN. They are just as much an obligation of the Government as a Treasury bond or any security that is issued by the Government?

"Mr. ECCLES. They are just as much an obligation as, say, the silver certificates or what we speak of as the greenbacks, of which some are still out.

"Mr. PATMAN. Or the bonds that have coupons on them that you clip?

"Mr. ECCLES. That is right. They are just a little different form of obligation.

"Mr. PATMAN. I understand they are a different form of obligation, but at the same time they are Government obligations and a Government responsibility?

"Mr. ECCLES. That is right."

* * * * * * *

COMMERCIAL BANKS USE CREATED MONEY TO BUY GOVERNMENT BONDS [3]

"Mr. PATMAN. Governor, in regard to the excess reserves, it is not contemplated that you expect to change these reserves so that the larger banks can buy more Government bonds? You do not have that in mind now?

"Mr. ECCLES. Well, it is not done, I would say, for that purpose, primarily or specifically. If we wanted to enable the banks to buy a lot of bonds we could.

"Mr. PATMAN. By lowering the reserve requirements?

"Mr. ECCLES. By lowering the reserve requirements, yes; or we could step up and buy a lot of bonds directly by Fed itself, and put more reserves in by open-market purchases.

"Mr. PATMAN. * * * Any way, the commercial banks, when they buy bonds or anything else, create the money, so to speak, to buy them with?

"Mr. ECCLES. That is right."

* * * * * * *

"Further testimony of Mr. Eccles: [4]

"Mr. PATMAN. Those Federal Reserve notes, as we have often discussed, are obligations of the U.S. Government?

"Mr. ECCLES. That is right.

"Mr. PATMAN. Then you use those Government obligations to buy interest-bearing Government obligations and you place them with the Federal Reserve banks, 12 of them?

"Mr. ECCLES. That is right.

"Mr. PATMAN. And they would continue to receive interest on those Government obligations as long as they were outstanding?

"Mr. ECCLES. That is right.

"Mr. PATMAN. So the result is the Government's credit has been used and the Government has gotten nothing for the use of that credit; the Federal Reserve banks are using it free, are they not?

"Mr. ECCLES. Well, the Government in effect, for all practical purposes, owns the Federal Reserve banks." (See pp. 25–26.)

* * * * * * *

COLLOQUY OF MR. ECCLES AND REPRESENTATIVE CHARLES S. DEWEY (REPUBLICAN, ILLINOIS): FED CREATES CREDIT WHEN FOMC BUYS BONDS [5]

"Mr. ECCLES. Whenever the Federal Reserve System buys Government securities in the open market or buys them direct from the Treasury, either one, that is what it does——

"Mr. DEWEY. What are you going to use to buy them with?

"Mr. ECCLES. What is who going to use?

"Mr. DEWEY. The Federal Reserve bank to make these purchases.

"Mr. ECCLES. What do they always use?

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[2] Op. cit., p. 74.
[3] Op. cit., p. 68.
[4] Hearings before the Banking and Currency Committee of the House of Representatives, June 17, 19, 1942, on H.R. 7158, pp. 25–26.
[5] Op. cit., p. 21.

"Mr. DEWEY. You are going to create credit?

"Mr. ECCLES. That is all we have ever done. That is the way the Federal Reserve System operates. The Federal Reserve System creates money. It is a bank of issue."

* * * * * * *

"FEDERAL RESERVE NOTES ARE AN OBLIGATION OF GOVERNMENT AS ARE GOVERNMENT BONDS: FROM STATEMENT OF CHAIRMAN MARTIN AT HEARING ON MONETARY POLICY, BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION OF THE JOINT ECONOMIC COMMITTEE, 1956

"Mr. PATMAN. You have $24 billion worth of bonds. Now, those bonds were bought by giving Federal Reserve notes in exchange for the bonds were they not?

"Mr. MARTIN. Well, Federal Reserve credit.

"Mr. PATMAN. What is that?

"Mr. MARTIN. Federal Reserve credit. They were not specific——

"Mr. PATMAN. That is what I mean. But everyone of them is an obligation of the U.S. Government; is it not?

"Mr. MARTIN. That is correct.

"Mr. PATMAN. That is what makes it good.

"Mr. MARTIN. That is right.

* * * * * * *

EXCERPTS FROM STATEMENT OF MR. MARTIN, JULY 15, 1957, BEFORE THE BANKING AND CURRENCY COMMITTEE OF THE HOUSE ON S. 1451

"Mr. PATMAN. Now then, Mr. Martin, isn't it a fact that these Federal Reserve notes that you issue and exchange for these bonds are obligations of the U.S. Government, just as are the bonds?

"Mr. MARTIN. That is right.

"Mr. PATMAN. In other words, each note says on its face: 'The United States promises to pay to bearer on demand so many dollars.' That is just as much a Government obligation as a U.S. bond maturing 10 years from now, isn't it?

"Mr. MARTIN. It is money.

"Mr. PATMAN. It is an obligation of the Government."

QUESTION BY CHAIRMAN WRIGHT PATMAN AND ANSWER BY WILLIAM McCHESNEY MARTIN, CHAIRMAN

[Taken in testimony on H.R. 7601, a bill to provide for the retirement of $30 billion of interest-bearing obligations of the United States held by the 12 Federal Reserve banks, on July 7, 1965, pp. 78–80 of the transcript]

The CHAIRMAN (Mr. Patman). I want to clarify this for the record one more time, Mr. Martin. How in the world can you insist that bonds that are paid for once should continue in existence with the taxpayers having to pay interest on them after they have been paid for once? Now, of course, you claim that these bonds have to be there to back up Federal Reserve notes. But that does not conform with your reasoning in 1959 when you presented to Congress a bill, and it was passed on by this committee, which said that you wanted the power to lower reserve requirements and count vault cash as reserves; and that, if you got that power, you would transfer $15 billion of the then portfolio of $24 billion to the private banks. You further stated that the private banks needed the income from these bonds, and that the Federal Reserve does not need it. You do not need the $15 billion. The remaining $9 billion in the portfolio, as you stated in a staff report, would provide enough flexibility for you to operate. Now then, when the Open Market Committee owns $38.5 billion worth of bonds—which of course is about $14.5 billion more than it was then, you insist that it is impossible for those bonds to be canceled, although $15 billion under the same circumstances could be given to the private banks, after giving them (through reducing reserves) the reserves to buy the bonds.

The Fed pays nothing for them; it merely creates new reserves. Then it continues to get interest on those bonds, and then when the bonds become due, they can collect the principal again.

I cannot get the reasoning there at all, Mr. Martin. If that makes sense, I am unable to comprehend it. Of course, there may be something in my background—lack of knowledge—that would account for it, but I do know this: No one should be compelled to pay his debts more than once, but in this instance you would compel the Government to pay its debts more than once. You would compel the Government to continue to pay interest on bonds that have already been paid for. When you bought these bonds, you paid for them. You will admit that, will you not, Mr. Martin?

Mr. MARTIN. The bonds were paid for in the normal course of business.

The CHAIRMAN. That is right.

Mr. MARTIN. And that is the only time they were paid for.

The CHAIRMAN. Just like we pay debts with checks and credits.

Mr. MARTIN. Exactly.

The CHAIRMAN. In the normal course they were paid for once, you will admit that, will you not?

Mr. MARTIN. They were paid for once, and that is all.

The CHAIRMAN. That is right.

(The following information on the Federal Open Market Committee is also submitted for the record by Chairman Wright Patman.

(This document: "The Development of Open Market Powers and Policies," was prepared by the staff of the House Banking and Currency Committee and appears on pages 1985–2001 of the hearings before the Subcommittee on Domestic Finance of the House Banking and Currency Committee, the "Federal Reserve System After 50 Years," 88th Congress, 2d session, 1964.

(It traces the history and evaluation of the Federal Open Market Committee, its policies and powers.

(The history of the Open Market Committee has evolved from a situation in 1913, when the Federal Reserve Act was passed, when open market activities were conducted by the 12 regional Reserve banks on an autonomous basis, to today when this action has become completely centralized in the New York Federal Reserve Bank. As a result, it is not the Federal Reserve Board which determines monetary policy for the Nation, but rather the Federal Open Market Committee, which is dominated over by people who owe their office and allegiance to the private commercial banks of the country.)

THE DEVELOPMENT OF OPEN MARKET POWERS AND POLICIES

A Staff Memorandum

THE EARLY YEARS

The Federal Reserve System was created as a semiautomatic reserve banking mechanism with few policymaking functions. In 1913, the discount rate was viewed as the principal monetary policy tool and final determination of this rate was vested in a body of public officials—the Federal Reserve Board. Five of the members of the Board were appointed to serve 10-year terms by the President of the United States and confirmed by the Senate. In addition, the Secretary of the Treasury and the Comptroller of the Currency were ex officio Board members. But the Federal Reserve was not conceived as an economic policymaking body. Essentially, the functioning of the System through the district banks would be passive. Its activities would be limited in scope to providing a supply of currency and reserves and the development of a market for bankers acceptances to assure an efficient and flexible commercial banking system—one which would work.

The original Federal Reserve Act passed in 1913[1] was virtually devoid of policy prescriptions. This is not surprising in view of the specific defects to be remedied by the new statute, as conceived by its framers. From the outset, there was doubt or hesitancy among those charged with managing the System as to what guidelines should serve to direct overall monetary policies of the Reserve banks. This is especially apparent in the complete lack of guidelines for the conduct of open market operations. Should the Reserve banks adapt their open market purchases and sales to the end of stabilizing commodity prices, maximizing production, facilitating the reestablishment of the gold standard throughout the world or protecting the gold dollar ratio? Or should they be guided solely by the possibility of earning income for themselves?

What technical methods, furthermore, were the Reserve banks to develop to enforce their judgments with respect to the monetary needs of the country? Open market operations were to be conducted by the Reserve banks under rules and regulations prescribed by the Board. But there were indications that the Board was unsure of the nature and effects of open market operations.

On the other hand, Paul Warburg clearly perceived the significance and possible effects of open market operations.[2] In 1915, he believed that large investments by the System would upset the economy but at the same time could solve the problem of obtaining adequate earnings for the Reserve banks, a solution he rejected as improper.[3] In this connection, it is notable that early in 1916, the Board encouraged the Reserve banks to undertake open market purchases in connection with the retirement of circulating national bank notes. Since Warburg knew these purchases could have an inflationary effect and we were then in the midst of an inflation, it is clear that these purchases may be explained in part by concern over Reserve bank earnings. Warburg, who up to 1916 had been hostile to the open market purchases, now expressed approval of an increase in the volume of such operations.[4]

In the latter part of 1916 and early 1917, the policy was reversed.[5]

An additional aspect of the purchase of U.S. Government securities, and the retirement of related national bank circulating banknotes, was the competition among the several Federal Reserve banks, the inevitable purchasing inefficiency that developed, and the agreement to form a committee to act as purchasing agent for the 12 district banks. This committee was probably the precursor of the informal Open Market Committee that was formed on May 16, 1922. It was deemed economically expedient to dispose of investments that had been purchased for the purpose of increasing income since war, and hence increased inflation was imminent.[6] At this time the Board announced that sales by the Reserve banks should also be made to offset imports of gold and thus to reduce the danger of inflation.[7] But later in the year (1917), because of wartime requirements, questions of the appropriate economic policies to be followed were subordinated to, or at least handled within, the context of Treasury requirements. During the war the Reserve banks restricted their open market operations "largely to relieving the money market when large transfers were made to the Treasury."[8]

It is important to recognize that almost from the start the initiative in the determination of open market policy lay with the Reserve banks. The Board conceded this somewhat grudgingly and, at the same time, expressed its sense that it had the right to regulate open market transactions.[9] This fact is significant for understanding later developments in open market operations, particularly as they gained in importance in the postwar years. There was from the beginning a struggle over control of open market operations. The law gave the Reserve banks power to initiate and conduct open market transactions but under rules laid down by the Board. The power to conduct transactions, however, was supreme, especially as the Board's rulemaking powers were—in retrospect—limited to determining what paper was eligible for open market transactions. With respect to conflicts between the banks and the Board, Carter Glass, then Secretary of the Treasury and hence ex officio Chair-

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[1] 38 Stat. 251 (1913).
[2] 1 Harris, "Twenty Years of Federal Reserve Policy," pp. 146, 147 (1933).
[3] Ibid., at p. 146.
[4] Ibid., at p. 147.
[5] Ibid., at p. 148.
[6] Ibid.
[7] Ibid.
[8] Ibid.
[9] Ibid., at p. 146.

man of the Board, recognized the Board's inability to control operations when he said that "Strong [head of the New York Federal Reserve Bank] was trying to dominate [the] Treasury and Federal Reserve Board." [10]

The Reserve banks, however, as indicated, did not control eligibility regulations. The Board had the authority to prescribe the rules and regulations under which Reserve banks might carry on open market operations, and had interpreted that provision liberally.[11] This limited, but not importantly, the power of the Reserve banks to determine open market policy.

THE DEVELOPMENTAL PERIOD—DRIFT TOWARD CENTRALISM

It was not until industry and agriculture began to recover from the reaction of 1920 that the formulation of applicable principles of open market policies commenced. From October 1921 to May 1922 the Reserve banks individually bought approximately $400 million in Government securities, in the absence of suitable amounts of discounts, advances, and bills. Their purpose was to obtain earnings. They were apparently not concerned with the influence of these purchases on the money market.[12] Noteworthy, however, is the fact that these large open market purchases coincided with the Reserve banks' low-interest-rate policies which, in turn, had resulted from the 1920 depression and a congressional investigation of the System's role in that downturn. Still there probably was no dominating economic purpose behind the purchases of the early 1920's. Rather, as stated above, open market operations at the time largely stemmed from individual Reserve bank efforts to increase their own earnings.[13] Certainly, at this time, there was no preponderating sentiment with respect to what the System's primary economic responsibility ought to be.[14] Instead, the System was marked by a display of divergent activities on the part of the district banks.[15]

Numerous complaints were voiced in the 1920's to the effect "that the Reserve banks were becoming too vigorous competitors of member banks," and that the institutions which supply the capital of the Reserve banks were being deprived of earnings because of the depressed money rates which the Reserve banks had helped to generate.[16] Put otherwise, open market purchases were causing interest rates to fall and commercial bankers objected vociferously. Shortly after the Reserve banks individually entered the open market in 1921 and 1922, by resolutions at bankers' conventions and otherwise, commercial bankers began to demand that the Reserve banks operate less extensively on their own initiative.[17] Later it was insisted in some of these pronouncements that the Reserve banks should return to their "original" functions of rediscount and issue and that they should operate more as emergency, panic-allaying institutions.[18] The commercial banks, in short, did not like what the Reserve banks were doing and looked to the Board for relief. And, in fact, open market purchases by the Reserve banks were roundly condemned by both the Treasury and the Federal Reserve Board.[19] Their operations had disturbed the Government securities market as well as the commercial bankers.[20] Aroused by the potential dangers of a haphazard investment policy, and general dissatisfaction with the prevailing low interest rates, in May 1922 a committee of governors (presidents) of the five eastern Reserve banks was organized to exercise joint purchases and sales and to avoid conflicts with orders for Treasury account.[21] This unofficial committee, created by the inspiration of the Board and Treasury, was to supervise in such a manner as "to safeguard the interests of the security market, the Reserve banks, and the Treasury." [22] It was agreed that the committee would keep in close touch with the market, Treasury, and Board, would hold frequent conferences and make recommendations to the Reserve banks concerning the

[10] Friedman & Schwartz, "A Monetary History of the United States, 1867–1960," p. 255 (1963).
[11] Harris, op. cit., supra, note 2, at p. 149.
[12] Friedman & Schwartz, op. cit., supra, note 10, at p. 251.
[13] Reed, "Recent Federal Reserve Policy, 1921–23," 37 J. Pol. Econ. 249 (1929).
[14] Ibid., at p. 269.
[15] Ibid.
[16] Ibid., at p. 272.
[17] Ibid.
[18] Ibid.
[19] 1 Harris, op. cit., supra, note 2, at p. 150.
[20] Friedman & Schwartz, op. cit., supra, note 10, at p. 251.
[21] Ibid.
[22] 1 Harris, op. cit., supra, note 2, at p. 150.

advisability of purchases or sales of securities, and that these recommendations should receive serious consideration by each bank.[23]

Thus, in October 1922 the Committee of Governors (Reserve bank presidents) on Centralized Execution of Purchases and Sales of Government Securities actually took over the duty of centralized open market operations. At the October 1922 conference with the Board, President Strong pointed out that it was not intended that the committee control or direct the action or management of the 12 Reserve banks but merely that it should "prepare information assuring an intelligent (economic) policy."[24] Accordingly, from January 31, 1923, to April 23 of that year, the securities holdings of Reserve banks were reduced almost 50 percent without apparent regard for the effect on their earnings.[25] The purpose was to counteract the "monetary ease" brought about by the purchases made in the fall of 1922. This hope, however, was exceeded. Sales were more than enough to offset any inflationary danger and the result was a recession lasting into 1924.

In March 1923 the Board took the initiative in a successful attempt to revise the open market procedure, arguing that it had the authority to limit and otherwise determine the securities and investments purchased by the Reserve banks, because the time, manner, character, and volume of such purchases might exercise an important influence on the money market, and that an open market investment policy for the 12 Reserve banks was necessary in the interest of the maintenance of a proper relationship between discounts and purchases of the Reserve banks and the general money market.[26] Accordingly, on April 1, 1923, the committee of governors (presidents) was superseded by the Open Market Investment Committee for the Federal Reserve System. This committee was appointed by the Board, initially, with the same five members as is predecessor. The Board now also took a stronger position in the determination of overall monetary policy. It requested that securities and acceptances be disposed of and the buying rate be increased before it would consider suggestions for an increase in the discount rate. In a public statement the Board justified its demand for a System policy on the grounds that purchases and sales influence the "credit" situation primarily in the money centers where purchases or sales are made.[27]

Despite the Board's intervention, each of the Reserve banks continued to operate in the open market independently of the others until December 15. 1923. After that date, joint purchases were undertaken for the "System" account. But the issue of whether or not the Board had authority to control in detail and remove any initiative of the Reserve banks with respect to open market operations was not pressed to a final decision.[28] Individual banks still engaged in independent operations which the committee executed on their behalf, but they were generally small in amount, both absolutely and compared to "System" account transactions.[29] They were small, because all purchases and sales of any considerable amount had to be made in New York City through the New York Federal Reserve Bank. There simply was no other market for "Governments." Thus, the Reserve banks in the interior had no alternative in practice to the program adopted by the committee. Further, the committee could always plead peculiar and intimate knowledge of the market in favor of its decisions and frequently did so.

In this way the New York Federal Reserve Bank assumed an undue importance in determining the open market policy of the group.[30] Statistical analysis readily reveals how completely the open market policies of the Reserve banks were executed through the joint account of the System. The Federal Reserve Bank of New York acted as the agent and handled the System's orders which were executed in New York.

The Federal Reserve System had found a new banking technique, previously known but to a few in its effect upon money and credit. Those who had long realized its potency were in the forefront in the strenuous attempts to bring this power under centralized authority. But note that the authorities did not (evidently) believe there was anything inconsistent in trying to affect money and

[23] Ibid.
[24] Ibid., at p. 151.
[25] Reed, op. cit., supra, note 13, at 276.
[26] 1 Harris, op. cit., supra, note 2, at p. 151.
[27] Ibid., at p. 152.
[28] Friedman & Schwartz, op. cit., supra, note 10, at p. 251.
[29] Ibid.
[30] Willis & Chapman, "The Banking Situation," at p. 743 (1934).

credit simultaneously. This mistaken notion has plagued the System's policies from then until now.

Concerning policy in the twenties, the most notable feature was the close connection in timing between the movements in economic activity and the explicit policy measures taken by the Federal Reserve System.[31] As was earlier noted, restraint in early 1923, exercised by sales of Government securities and a rise in discount rates, was followed closely by a downturn in business and the onset of the 1923–24 recession.[32] A reversal of policy in late 1923 and early 1924 in the direction of ease was followed by an upturn in business in July 1924 and a vigorous cyclical revival.[33] Moderate restraint in the third quarter of 1926 was followed by a downturn in October, and easing measures in 1927, by a cyclical upturn in November.[34]

The economic consequences of the open market operations undertaken in 1926 and 1927 led the Board once more to attempt to assert its authority to regulate open market operations.[35] In May 1928, the Federal Advisory Council proposed that a committee of all governors (Reserve bank presidents) should be substituted for the acting committee representative of the larger Reserve banks, and the Board presented this proposal at a meeting of the governors (Reserve bank presidents) and agents.[36] In November 1928, a definite program of reform was formulated along these lines. The program provided for an Open Market Policy Conference which would be representative of all the banks and operate under the chairmanship of the Governor (Chairman) of the Federal Reserve Board, who alone was to have the privilege of calling meetings.[37] The new arrangement was justified by the Board on the ground that it "embodies a fuller recognition of the joint interest and responsibility of Federal Reserve banks and the Federal Reserve Board in the matter of open market policy." [38] It was put into effect on March 26, 1930, when the Open Market Policy Conference was formed, and replaced the Open Market Investment Committee.[39]

On close examination, the new setup was a victory for the interior Reserve banks since it provided that each Reserve bank would appoint a representative to the Open Market Policy Conference.[40] In this sense, then, the new arrangement gave the interior Reserve banks something to say about open market policy. The Board achieved at most a very limited victory by the reform. The Chairman of the Board was empowered to convene meetings of the Conference but nothing more. In view of the sorry performance of the Conference in the early 1930's when it sold securities, and the fact that some members of the Board (Eugene Meyer, for example) were urging open market purchases, it was unfortunate that the Board did not win a more meaningful victory in its efforts to wrest control over open market operations from the Reserve banks in the 1928–30 period.

THE BANKING ACT OF 1933—OPEN MARKET COMMITTEE LEGALIZED

Open market operations under a legally constituted central body finally were provided for in the Banking Act of 1933.[41] It had been 6 years since the McFadden Act [42] gave perpetual life to the Reserve banks; otherwise, their charters would have expired in 1933. During those years, the relative importance of open market operations had been demonstrated. From several quarters came very definite opinions on just what kind of banking system the country should have.

Several provisions of the Banking Act of 1933 were concerned with the Federal Reserve Board and the control of the Federal Reserve System. Senator Glass, the principal author of the act, felt that it was necessary to reconstitute the Federal Reserve and take measures needed to save it from being crushed by the Government. He also felt, in the view of one observer—

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[31] Friedman & Schwartz, op. cit., supra, note 10, at p. 296.
[32] Ibid.
[33] Ibid.
[34] Ibid.
[35] 1 Harris, op. cit., supra, note 2, at p. 153.
[36] Ibid.
[37] Ibid.
[38] Ibid.
[39] Ibid., at p. 154.
[40] Ibid.
[41] 48 Stat. 162 (1933).
[42] 44 Stat. 1224 (1927).

"that the commercial character of the system was being destroyed by subjecting its policies to Treasury domination and to speculation in the securities market; that the [present] policy of using the Federal Reserve banks as the market for extravagant issues of securities and as a means of inflation was a climax in this trend; that the Federal Reserve Board has sunk in relative importance, prestige, and authority, as the Federal Reserve banks, particularly of New York, rose; that the Board had been timid, uncertain, vacillating, and prone to follow considerations of immediate expedience." [43]

The same observer, Professor Westerfield of Yale, also noted that—

"The American Bankers Association in its publicity featured 'the demonstrated impotence of the Federal Reserve System to retain control over the situation * * * quite unable to coordinate its forces and marshal its resources with a unity of purpose that is adequate,' and suggested as a solution the 'formation of a Central Bank of the United States, with the present Reserve banks as branches. * * * Twelve scattered banks, each with its governor and its chairman and its board of directors, loosely ruled by a Board of eight in Washington, composed of men of diverse opinions, do not provide the country with an organization well adapted to act promptly and decisively.'" [44]

With a view to thus reorganizing the Federal Reserve System, the Senate subcommittee, headed by Glass, proposed to achieve a more decisive and independent Board by insulating its membership from public pressures by increasing their tenure of office, requiring that two members be men of experience in banking, and removing the Secretary of the Treasury from Board membership. Further, Glass proposed to increase the power of the Board; and to strengthen its control by giving a better definition of its power with respect to open market operations.[45]

The Banking Act of 1933 failed to accomplish all the subcommittee proposed. The Secretary of the Treasury was not removed from the Board or its chairmanship. This failure was scored by Senator Glass in vehement language; he resented making the Federal Reserve "the footmat of the Treasury. * * *"

"It was never intended that the Federal Reserve banking system should be used as an adjunct of the Treasury Department and particularly was it never contemplated that it should be so used to such an extent as recently has been done as to very materially curtail the capabilities of the Federal Reserve banks to serve the business interests of the country." [46]

The 1933 act, although making the Board more independent and, according to Senator Glass, therefore more decisive, did not give the Board control over open market operations. Control of open market operations continued to be vested in the Reserve banks. Transactions were now subjected by law, to the supervision of a committee representing the individual Reserve banks, and this committee was instructed to meet with the Board from time to time and to formulate general open market policies.[47]

To state the matter otherwise, the 1933 act provided for a Federal Open Market Committee of 12 members, each representing a Reserve bank. Its members, who in fact were the respective bank heads, were required to meet in Washington at least four times a year. Meetings might be attended by members of the Board and open market operations could be conducted only in accordance with the regulations of the Board. But specific transactions were to be recommended by the Committee. The time, character, and volume of purchases and sales were to be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country. The law thus paid lipservice to the principle of Board control over open market policy. Nothing in the law specifically required the Committee to recommend what the Board wished, and any Reserve bank, by filing a statement of objections, could refuse to make purchases or sales as recommended by the Committee.

It is self-evident that the Banking Act of 1933 failed to provide the Nation with a coordinated credit regulating facility with full responsibility for both formulating and executing open market policies. On the other hand, the act legally sanctioned control over open market operations by men selected by commercial bankers—the heads of the Reserve banks. From 1923 to 1933, these very men

[43] Westerfield, "The Banking Act of 1933," 41 J. Pol. Econ. 727 1933).
[44] Ibid., at p. 728.
[45] S. Rept. 584, 72d Cong., 1st sess. (1933).
[46] Westerfield, op. cit., supra, note 43, at p. 728.
[47] 48 Stat. 168 (1933).

did in fact control open market operations, as we have seen. But until 1933, control was not sanctioned by law.

Events in Congress leading up to final passage of the 1933 act are quite revealing of the attitudes in the Congress during the darkest days of the depression. With reference to the bill introduced on April 18, 1932 (S. 4412), by Senator Glass, the Senate Banking and Currency Committee made the following statement in its report: [48]

"*Strengthening of Federal Reserve System.*—The Federal Reserve System has been seriously impaired of recent years and has wandered far away from its original function. This is the result of many complex conditions. Among these conditions has been the uncertainty of policy in the matter of exercising plainly authorized control by the central supervising authority at Washington and the tendency to submit rather timidly to considerations of immediate expediency. Among the Reserve banks themselves there has been a decidedly dangerous drift toward the conversion of the System into a medium for transacting financial rather than commercial business. Further, the establishment of understandings or agreements with foreign central or other banks, and the attempt to carry out plans and measures of a hazardous nature, relating to discount dates and problems of technique, have had unfortunate results."

S. 4412 was superseded in the following Congress by S. 1631. On May 17, 1933, Mr. Steagall introduced H.R. 5661 in the House, by and large incorporating the provisions of the Senate bills upon which hearings had been held in the preceding Congress. Mr. Steagall explained:

"The legislation has been thoroughly considered in the Senate, both in committee and by the entire body. * * * The House committee had the benefit of the Senate hearings. In view of the peculiar conditions that exist and the emergency nature of the measure * * * it was decided by the committee that we should proceed to the consideration of the bill in executive session and report it immediately. * * * The committee decided it would not hold open hearings. * * *" [49]

Several Members of Congress were generally apprehensive about giving legal recognition to an Open Market Committee composed of individuals so closely connected with private commercial banking interests. Representative Lemke characterized the House bill:

"I can well understand why this bill was considered in executive sessions by the committee, because, if my friends and colleagues, the gentleman from Texas (Mr. Patman), the gentleman from Pennsylvania (Mr. McFadden), and others had been permitted to take part in the considerations, the bill would never have appeared on the floor of this House in its present form. * * * A bill of this kind could never have been born in the bright sunlight of day. It had to be born in executive session. And now we are asked to vote for it without knowing its contents and without having had time to digest its far-reaching results." [50]

Mr. Patman inquired of Mr. Steagall, the House manager, of H.R. 5661:

"I want to ask the gentleman a question about the bill: Is the bill similar to the Glass bill reported to the Senate yesterday?" [51]

Mr. Steagall replied:

"The bill, insofar as amendments to the banking laws are concerned, is practically the same as the Glass bill." [52]

Mr. Patman answered:

"The reason I asked the question is this: I asked permission to be heard before the committee on this bill. * * * I am awfully sorry I was not allowed that opportunity." [53]

H.R. 5661 was reported 2 days after introduction.[54] It passed the House on May 23.[55]

In the Senate debates on the original Senate version, Senator Huey Long also questioned the wisdom of the provisions in the bill to reorganize the Federal Reserve: [56]

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[48] Senate report, op. cit., supra, note 45.
[49] 77 Congressional Record 3492 (1933).
[50] Ibid., at p. 3907.
[51] Ibid., at p. 3491.
[52] Ibid., at pp. 3491–3492.
[53] Ibid., at p. 3492.
[54] H. Rept. 150, 73d Cong., 1st sess. (1933).
[55] 77 Congressional Record 4058 (1933).
[56] 76 Congressional Record 1624–1626.

"(T)here is something in this bill that was never brought to the attention of the Senate. It divorces the Federal Reserve bank from any control practically of the U.S. Government. I am ready to say that there is not a Senator in this Chamber who knows anything at all about what is in the bill. I do not make any exception * * *. The bill proposes to take the Secretary of the Treasury of the United States off the Federal Reserve Board. The bill would take the excise tax upon the surplus earnings that have been going to the U.S. Treasury away from the Treasury of the United States and give it to the banking combine in order that they could protect the chain banks * * *. We fought here for years and years that the U.S. Government might have some control over the banks handling the people's money, and we managed to write into the law that the Federal Reserve banking system would become responsible to the people of the United States. We made the Secretary of the Treasury of the United States the dominating member of the Federal Reserve Board. They have been trying, Mr. President, to remove from that Board the representative of the people ever since this act was enacted into law. They have tried to have control of the currency more or less removed from the people.

"Heretofore they have not been able to do that; but, with a Federal Reserve Act supposed to have been created so as to permit the Secretary of the Treasury of the United States to participate in the administration of these funds, the circulating currency for which the Government is responsible, they have come back here this time with a proposal to take the Treasury of the United States off the Board and to put it, boots, saddle, and breeches, into the hands of the machinating financiers * * *. When the people finally consented to have the rich treasure of their national banking reserves impounded in a central reservoir, they did not see that the results would be the loss of their financial freedom. They did not know that it would lead them into their present condition of starvation, unemployment, and general misery. Because a discount market requires the greatest possible concentration of gold and a centralization of all the money and credit resources of the Nation, they were led artfully by propagandists to believe that the country needed an entirely different kind of banking system. The literature of deception holds no parallel to what was issued to carry out that propaganda.

"That is what brought the collapse to this country sooner than it would have happened otherwise * * * (and now) they have come here with legislation trying to slip through a proposition that has done more harm to the people of the United States than every other calamity that has happened in the meantime. They do not want to take any chance. Oh, no! They must not take any chance now. It is a serious situation until they have put the fire out; and so they are removing the Secretary of the Treasury from the Federal Reserve Board in the Glass bill.

"Why? * * * Because it is the Secretary of the Treasury who has the power to stop this machinated manipulation of pyramided credits that have been hawked about by that gang up here in the name and form of the United States until they have brought calamity to this country; and now, for fear that there might be something done, they are trying to cure the whole thing by law. 'Hurry, hurry, hurry, and get the Glass bill through!'"

Senator Long concluded that the Glass bill would take the powers of the Federal Reserve Board further away from the Government:[57]

"It puts them in the hands of the big banks, the international cliques, takes them out of the hands of the Government, gives them the money the Government has been getting from them, gives them money out of the Government Treasury that we have there now, and extends their powers to cover up all they have done in the past."

S. 1631 was debated in the Senate, but the text of the Senate bill was substituted for the text of the House bill and H.R. 5661 was passed in lieu thereof. The measure became law on June 16, 1933.[58]

It becomes clear upon analysis that the depressed economic conditions and a political scene characterized by an atmosphere of great emergency made it easy for proponents of the 1933 Banking Act, behind strong leadership in the Senate, to induce the House to go along with the Senate version—the House virtually giving up its own legisaltive prerogatives. Much the same was to occur 2 years later when once again the Congress would consider drastic banking legislation.

[57] Ibid., at 1626.
[58] Public Law 66, 73d Cong., 1st sess. (1933).

THE BANKING ACT OF 1935—THE "THIRD BANK OF THE UNITED STATES" IS CREATED

The Banking Act of 1935[59] reorganized the Federal Reserve System. Open market powers were fully centralized by this measure. The Board was given majority representation on the Open Market Committee, thereby partly subjecting open market policy to control by a public body. On the other hand, the Board was rendered independent of the executive branch. The "emergency" atmosphere of the depression doubtless contributed to what was undeniably the establishment of a true central bank—independent and able to determine for itself its policies and goals.

The original bill, H.R. 5357, after having been introduced on February 5, 1935, in the House by Representative Steagall, chairman of the House Committee on Banking and Currency, was referred to that committee for consideration. Hearings were conducted by this committe from February 21 to April 8, 1935. On April 19, Chairman Steagall introduced a substitute bill, H.R. 7617, which, according to press reports, altered the provisions in the original bill so as to follow suggestions made by Governor Eccles.[60] The House committee reported the new bill favorably on the same day,[61] and after comparatively little debate the House passed it on May 9, 1935.[62]

The House committee report on H.R. 7617 suggested placing responsibility for national monetary and credit policies squarely upon the Federal Reserve Board, that national policies should be adopted and carried out in a national body in the public interest. The report asserted this to be the reason that the 1913 act gave the Board final authority over discount rates. Since open market operations had in more recent years come to be recognized as a much greater factor in credit policy than discount rates, it was believed to be entirely consistent with the philosophy of the original Reserve Act to vest in the Board final authority with respect to the open market policies of the System.

In testifying before the House committee, Mr. Marriner Eccles of the Federal Reserve stated that open market operations are the most important single instrument of control over the volume and the cost of credit in this country.[63] Eccles criticized the provision in H.R. 5357 (the original Steagall bill) for three public members and two bank members of the Open Market Committee by saying that—

"The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of the monetary policies, would under this proposal have to delegate its principal function to a committee on which members of the Board would have a bare majority."[64]

Eccles further testified:

"* * * that the best way in which to handle this proposal would be to place responsibility for open market operations in the Federal Reserve Board as a whole and to provide for a committee of five governors of Federal Reserve banks to advise with the Board in this matter. The Board should be required to obtain the views of this committee of governors before adopting a policy for open market operations, discount rates, or changes in reserve requirements. Such an arrangement would result in the power to initiate open market operations by either a committee of the governors or by the Board, but would place ultimate responsibility upon the Federal Reserve Board, which is created for that purpose."[65]

It was thus apparent that by 1935 the tremendous importance of open market operations to the general economy had come to be widely appreciated. The most bitterly disputed issues concerning the open market provisions in the Banking Act of 1935 were the locus of open market authority and a statement of objectives to guide the execution of that authority.

Opponents of the reforms in the revised House bill, H.R. 7617,[66] argued that increasing the power of the Federal Reserve Board over the member banks and open market operations and enlarging the authority of the executive branch of the Government over the Board tended to subject the monetary system of the

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[59] 49 Stat. 684 (1935).
[60] Am. Banker 1 : 2 (Apr. 23, 1935).
[61] H. Rept. 742, 74th Cong., 1st sess. (1935).
[62] 77 Congressional Record 7271.
[63] Hearings before the House Committee on Banking and Currency, H.R. 5357, 74th Cong., 1st sess., at p. 181.
[64] Ibid., at pp. 181–182.
[65] Ibid.
[66] H.R. 7617, 74th Cong., 1st sess.

country to political control. The argument is factually correct but essentially invalid. Governor Eccles in reply stated:

"The most widespread criticism of the bill has come from those who see in it an attempt to subordinate the Federal Reserve System and through it, the country's banking system, to political control. On this subject, there appears to be much misinterpretation of what the present bill provides, coupled with a lack of clear understanding of existing law and of the proper relationship between the Reserve System and the Government. This bill aims to clarify the powers and responsibilities of the Reserve Board in matters of national monetary policy and at the same time preserves and increases the regional autonomy of the Reserve banks in matters of local concern. There is nothing in this bill that would increase the powers of a political administration over the Reserve Board." [67]

On the question of "politics," Mr. Eccles further stated:

"It seems to me that an administration is charged, when it goes into power, with the economic and social problems of the Nation. Politics are nothing more or less than dealing with economic and social problems. It seems to me that it would be extremely difficult for any administration to be able to succeed and intelligently deal with them entirely apart from the money system. There must be a liaison between the administration and the money system—a responsive relationship. That does not necessarily mean political control in the sense that it is often thought of." [68]

Mr. Eccles supported provisions that, with respect to qualifications for appointment to the Board, would remove the requirement that members be appointed with due regard to agricultural, industrial, and geographical interests and substitute a statement that they should be persons who by training or experience or both, are qualified to formulate economic and monetary policies. Mr. Eccles also supported a provision in the House bill that the Board should exercise its powers in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration.

Dr. Goldenweiser of the Board's staff also testified strongly in favor of these provisions, which would provide improved guidelines for exercising economic powers:

"It is along the same line as the proposal which Governor Eccles has read to you stating the objectives of the Federal Reserve System in terms of maintaining the stability of various elements of the business structure; that is, to have men on the Board who will devote their energy to maintaining that stability insofar as it can be maintained by monetary means, and men who should be qualified to formulate national policies.

"I would like to say in this connection, that the idea the Federal Reserve Board has broader responsibilities than the mere accommodation of commerce and business and the serving of agriculture, trade, and industry, is an idea which has been forced upon the Federal Reserve System by actual experience and which has been gradually developed in the System.

"The accommodation of commerce and business, which is the only objective that was mentioned in the Federal Reserve Act, is a vague phrase, and has all the attributes of a statesmanlike pronouncement. It is vague, it is a glittering generality like the Declaration of Independence, and its content can be changed as circumstances change. It has, therefore, not served any very useful purpose, but has not done any particular harm.

"It is now time, in the light of 20 years' experience, to substitute a more clearly defined objective than this vague phrase, which, to my way of thinking, held the place for a more definite objective throughout these years." [69]

In the House debates, also, the point was clearly made that changes were necessary in the machinery for determining and carrying out the open market policies of the System. Representative Hancock stated that—

"The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the

[67] Hearings of subcommittee of the Senate Committee on Banking and Currency, S. 1715 and H.R. 7617, 74th Cong., p. 280.
[68] House report, op. cit., supra, note 58, at p. 191.
[69] Ibid., at p. 434.

formulation of monetary policies, would under this proposal be solely responsible in the execution of the will of Congress from whom such power is derived. Through exercise of this power depends to a large degree the country's economic, business, and social welfare. It is the first control in the sale and purchase of money which is the dynamo of commerce, industry, and agriculture." [70]

In rebutting the contention that under the House bill the Board would be able to force the banks to purchase Government obligations, Representative Hancock asked that if the banks would not be willing to buy the bonds of the Government:

"(D)o you mean to tell me that Congress has lost its sovereign power? Do you mean to tell me that private bankers have a monopoly upon the creation of money?" [71]

And—

"(T)he heart of this bill, as I have just said, revolves around the operations of the Open Market Committee. * * * Every power provided for in this bill exists today in the present law; but there is a transfer of power to take the control of the volume and the cost of money from private hands and place it in Government hands, where, in my opinion, it should have been for the past 20 years." [72]

Representative Sisson defended the increased powers given the Board in saying:

"I am heartily in favor of the main provisions of title II, which carry out nearly in whole the recommendations made by Governor Eccles to the Banking and Currency Committee, and in accordance with the program initiated by the (administration) to give us a sound and adequate currency and to place the control of the issue of money and the control of credit, which is at least nine-tenths of our money, in the Government of the United States rather than in the private bankers. * * *.[73] Gentlemen here have attacked this control as being a political control. The only way that it is a political control is that it is control by the Government itself, as representing all of the people, and as between public control and private control, I am for public control. Private control has been tried and found wanting." [74]

In summary, the House bill, insofar as open market operations were concerned, would vest complete authority in a public body not dependent at all on the banks, along with explicit directions in the form of a mandate as to objections, reflecting in substance the testimony of Mr. Szymczak, a member of the Board, before the Senate committee that—

"(A)ctual determination of what these open market policies should be seems to me a national and not a local question. Therefore, authority should be vested in the Federal Reserve Board." [75]

The House adopted title II as reported by the committee without amendment.

A companion bill to H.R. 5357 (S. 1715) was introduced in the Senate on February 6, 1935, by Senator Fletcher, chairman of the Senate Banking and Currency Committee, and referred to his committee. The Senate hearings, however, were conducted by the Subcommittee on Monetary Policy, Banking and Deposit Insurance, with Senator Glass as chairman. This subcommittee, and more specifically its chairman, in marked contrast to the attitude on the part of the majority of the House committee, challenged the validity of the philosophy apparently underlying title II of the bill, and in this connection solicited the views of a number of leading economists and bankers, not only as to the effect of the provisions under the bills introduced in the House, but also as to measures which might be substituted to improve the central banking system of the country. As a result of Senator Glass' persistence, title II of the bill was substantially rewritten.[76] He submitted the amended bill on July 2, 1935, for the Senate Committee on Banking and Currency, and the bill was passed by the Senate on July 26 as the committee had reported it.

The House bill and the Senate amendment subsequently went to a conference committee consisting of three Members of the House and six Senators. The conference committee accepted the provisions of the Senate amendment in

[70] 79 Congressional Record 6738.
[71] Ibid., at p. 6735.
[72] Ibid., at p. 6734.
[73] Ibid., at p. 6964.
[74] Ibid., at p. 6965.
[75] Hearings, op. cit., supra, note 64, at p. 971.
[76] S. Rept. 1007, 74th Cong., 1st sess. (1935).

almost all of the important differences between the two bills, and on August 19 the conference bill[77] was passed by both the Senate and the House. On August 23, 1935, the President signed it, and its provisions became, with certain exceptions, immediately effective.[78]

By the Glass Act, the name of the Federal Reserve Board was changed to the Board of Governors of the Federal Reserve System. Further, the number on the Board was fixed at seven members appointed for 14 years by the President and confirmed by the Senate. The Secretary of the Treasury and the Comptroller of the Currency were removed from the Board. The Open Market Committee was changed so that the Committee consisted of the seven members of the Board and five representatives of the Reserve banks. The Federal Reserve banks were forbidden to engage, or decline to engage, in open market operations except in accordance with regulations adopted by the Committee.

Senator Glass and most of the prominent witnesses who appeared before the Banking Subcommittee charged that the purpose of the Eccles bill was to establish a central banking system while maintaining the Federal Reserve System as a "front" and to use the banking system of this country to experiment in social planning.

In the debates in the Senate, Senator Glass, before discussing the open market question, made several interesting comments regarding the reorganization of the Board itself, particularly with respect to the reasons for eliminating the Secretary of the Treasury and the Comptroller of the Currency from membership on the Board. Mr. Glass asserted that the Secretary of the Treasury exercised undue influence on the Board, and mentioned his own term as Secretary as an example of Treasury domination of the Federal Reserve Board. This comment is of particular interest in view of the fact that Senator Glass had earlier complained that Benjamin Strong, of the New York Federal Reserve Board, was too powerful an influence at the time that Mr. Glass was Secretary of the Treasury.

With regard to the composition of the Open Market Committee, Senator Glass explained his committee's action by stating that the Open Market Committee was set up to enable the Reserve banks to enforce the discount rate in their districts and to provide earning assets and not to finance Government deficits, or speculate in the market. Mr. Glass charged that the Government of the United States had—

"(N)ever contributed a dollar to one of the Reserve banks; yet it is proposed to have the Federal Reserve Board, having not a dollar of pecuniary interest in the Reserve funds or the deposits of the Federal Reserve banks or of the member banks, to constitute the Open Market Committee. * * *"[79]

Senator Glass went on to describe the Reserve banks as privately owned and operated institutions.[80]

Senator La Follette, on the other hand, expressed fears that banker representation on the Open Market Committee would lead to undesirable results, where with cooperation of two Board members, the bank members could achieve policies concerning reserve requirements, discount rates, and open market operations contrary to policies followed by the Board in the public interest:

"It should be the duty and the responsibility of this newly constituted Board to attempt not only to prevent the excesses of a credit inflation but likewise to mitigate the disasters and the excesses of a credit deflation. Under the committee's bill it is entirely probable that the representatives of the bankers upon this Open Market Committee, in a period such as that, will be opposed to any attempts upon the part of the Board to exercise its control over open market operations in the interest of mitigating and preventing the excesses of a credit deflation. * * * (T)wo-thirds of the Directors who will select the representatives in turn to serve upon the Open Market Committee will be selected by the member banks; and I assume that, of course, they will be individuals of integrity and good repute. Nevertheless, they have the point of view of the banking community at a particular time when a situation may require action of the Open Market Committee, which is not supported by the banking community."[81]

The Senate nonetheless passed the Glass version without amendment and, as indicated, it was accepted in substance by the conference committee, and passed by both Houses of Congress.

[77] H. Rept. 1822, 74th Cong., 1st sess. (1935).
[78] Public Law 305, 74th Cong., 1st sess. (1935).
[79] 79 Congressional Record 11778.
[80] Ibid., at p. 11779.
[81] Ibid., at p. 11915.

One observer concluded that—

"As finally enacted, the stated qualifications of members of the Board remain unchanged, and the proposed statement of objectives was omitted, an apparent victory for Senator Glass and the American Bankers Association."[82]

When one recalls that the House bill retained the Secretary of the Treasury and the Comptroller as members of the Board, gave the Board sole control over open market operations, repealed rules as to eligible security for Federal Reserve notes, allowed the Board to compel the Reserve banks to buy directly from the Treasury, and provided meaningful economic guidelines for the conduct of open market and other monetary policies, one appreciates how radically the House proposals were altered before the law was passed.

INADEQUATE POLICY GUIDELINES—THE NEED FOR IMPROVEMENT

As we have seen, the framers of the original Federal Reserve Act did not feel a pressing need for setting up any definite standards of policy. A bitter fight had for years been waged in Congress to write into the Reserve Act some sort of price stabilization standard, and by 1933 some concessions had to be made to those who wished to define the policies of the Reserve Board. The concession, however, was woefully inadequate. The acts of the Open Market Committee were to be governed "with a view of accommodating commerce and business, and with regard to their bearing upon the general credit situation of the country."

In 1935, an even more drastic revision was undertaken further centralizing and strengthening the open market powers of the Reserve System. The 1935 act, as it passed the House, contained policy guidelines, referred to above, which were about as clear as circumstances permitted. Curiously enough, the same men who critized the New Deal for its enormous grants of power and meager definitions of policy forced the elimination of that policy statement. They were willing—or forced—to concede the power itself, but unwilling to enact a general statement of objectives. The act as passed contained only one amplification of policy—reserve requirements were to be altered "in order to prevent injurious credit expansion or contraction." This, too, is anachronistic and ambiguous.

The closest thing to an adequate statement of policy with respect to the exercise of the Federal Reserve's tremendous power over the Nation's economic well-being is that appearing in the Employment Act of 1946,[83] when Congress declared:

"(T)hat it is the continuing policy and responsibility of the Federal Government * * * to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining in a manner calculated to foster and promote free competitive enterprise and the general welfare conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to *promote maximum employment, production, and purchasing power.*" [Emphasis added.]

Unfortunately, however, the Federal Reserve has displayed a propensity to set its own policy standards, which at times have been at variance with the goals specified in the Employment Act. At times, Federal Reserve policies have even been in direct conflict, for instance, with maintaining maximum domestic employment and production by pursuing deflationary courses in attempts to solve the balance-of-payments problem or in combating the specter of inflation—real or imagined.

As Prof. David McC. Wright put it, in discussing the newly increased powers of the Open Market Committee:

"(W)hen we consider the range of fact and choice of action available to the Federal Reserve Board, we might perhaps conclude that it has been given the type of authority repudiated by Cardozo in the *Schechter* case—a 'grant of a roving commission to inquire into evils' and upon discovering them to do what it can to prevent them."[84]

Professor Wright continues:

"It is a rather remarkable exception, in our system of democratic government, that the governors of (money) should be comparatively exempt from the requirements imposed upon other branches of government. In large measure, this may be attributed to the fact that (monetary) control does not affect very

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[82] Smith, "The Banking Act of 1935," 21 A.B.A.J. 611 (1935).
[83] 60 Stat. 23 (1946).
[84] Wright, "Is the Amended Federal Reserve Act Constitutional?—A Study in the Delegation of Power," 23 Va. L. Rev. 628, at p. 650 (1937).

greatly the conscious daily life of the average man. He becomes excited over wage regulations, but changes in the rediscount rate seem to him far away and too remote to be important—yet one doesn't have to blame everything on the banking system to realize that (monetary) control is just as important as industrial regulation. What good does it do to establish careful wage standards by law, when unwise (money) policy may allow prices to fluctuate so greatly that the wage safeguard becomes meaningless? In view of the weaknesses and conflicts just outlined it may be best that the average man is not "bank conscious." There are, perhaps, good reasons why our (money) policy should be determined with the minimum of popular discussion, and that the Reserve Act should therefore contain no controlling standard. If the experts cannot agree, what may we expect of the rank and file? Yet cogent as this reasoning may be, it is certainly contrary to the accepted interpretation of the Constitution."[85]

In the interest of good public administration under our system of government, it would appear that explicit clarification of goals for the Federal Reserve System, with respect to open market operations especially, is an imperative which Congress must no longer postpone.

Chairman PATMAN. Senator Javits?

Senator JAVITS. Mr. Chairman, I think the principal issue here is not what you have done, but what effect what you have done will have, and what we can do about it.

I am for the independence of the Federal Reserve Board. But at the same time, I believe the impact of public opinion and of congressional opinion, and always the threat of our right to change the law, must be brought to bear upon what you do, so that you may find it a factor in what you do tomorrow.

Therefore, I would like to ask you this, Mr. Martin. What assurance can you give American business, now that the discount rate has been raised, as to what stability it may expect in interest rates for the foreseeable future?

Mr. MARTIN. I can't give you any assurance, Senator. As one who has been operating in this area for many years, even before I was with the Federal Reserve System, I have learned that a person in the position that I presently occupy can't make predictions about interest rates without tending to change the given monetary operational situation merely by the statement.

It is one of the difficulties that a person holding this position has. I have on a number of occasions tried to discuss in a perfectly open and general way what was going to happen, and the result was I changed the whole course of the market. And I don't think I ought to be making predictions.

Senator JAVITS. So that you are unable to——

Mr. MARTIN. I can't guarantee to you that this will be the last move that the Federal Reserve will make. All I can say to you is that the Federal Reserve is not anxious for high interest rates, that we will use our policy flexibly, and we do not move only in one direction. We can see interest rates lower. I want to continue to place in the record that I am not a high-interest rate man. I am not at all; I believe that we should have as low interest rates as we can have without producing inflation. I believe we will get the maximum capital formation that way.

Senator JAVITS. Well, now, do you believe also that the instability introduced by frequent changes up or down must be avoided?

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[85] Ibid., at pp. 652, 653.

Mr. MARTIN. To the best of our ability, we should. I look on the period that we had here recently, where we had relative stability, as one of the most successful.

I interjected in my prepared statement here that this applied also to prices. I think it was fine that we were able to get this period of 4-year stability in prices, and may I point out that we didn't really get this growth that we are all so anxious to have until we got this stable price level, and I don't want to see the interest rates bobbing up and down the way they did a number of years ago.

Senator JAVITS. Now Commissioner Maisel, I think, made an estimate of $70 billion as the interest cost of credit in this country. Do you wish to give us any statement so that we may juxtapose your statement with respect to the cost of inflation versus the increased cost of credit? Do you wish to give us any statement as to the amount that you expect that $70 billion to increase—in percentage—or in any other way you may wish to give it to us, as compared to what you think your action will amount to, say in the way of a barrier against inflation?

Mr. MARTIN. I want to keep away from projections at this juncture, Senator.

Senator JAVITS. In other words, you wish us to take those statements solely as generalizations, and you do not wish to give us any figures to implement them.

Mr. MARTIN. I don't think that I can, because the very point that has been made—let me comment about this matter of waiting until January. Let me emphasize that there is no question about the integrity of any member of the Federal Reserve Board. This has been one of the nice things about serving on it, as I have. I haven't the slightest question as to Governor Maisel or Governor Mitchell or my associates in the majority of their integrity and their purpose. None whatever.

There is an area of judgment, however, that comes into this picture, and at some point somebody has to make a decision, and I have great respect for Governor Maisel's integrity. I have respect for my own integrity, and I make this judgment on the inflation situation at this particular juncture. Time will tell whether I am to be vindicated or the reverse.

(The Federal Reserve Board subsequently supplied the following material:)

INTEREST PAYMENTS AND CHANGES IN THE DISCOUNT RATE

The statistical basis for alleging that "they (average consumers) are the ones who will be reaching down to pay an added $25 billion in interest charges in 1966, up 25 percent from the interest rate bill of $100 billion in 1965" is difficult to reconcile with regularly compiled and published Governmental statistics on interest payments by consumers.

According to the Department of Commerce, the grand total of money payments of interest by all governments (Federal, State and local), by all businesses, and by all consumers in 1964 amounted to only $65 billion. Moreover, this total includes $13.5 billion of interest paid out by financial intermediaries such as banks, savings and loan associations, credit unions, and other financial institutions on deposit accounts and other forms of investments.

Consequently, money interest payments by borrowers, as the man-in-the-street uses the term, amounted to $51.6 billion in 1964. These payments have been growing at the rate of about $4.5 billion each year, primarily as a result of in-

creased borrowing. The outstanding amount of debt owed by governments, nonfinancial businesses, and consumers increased by over $50 billion in 1964 alone. Rising interest rates in recent years have also been a factor, but this has accounted for a relatively small proportion of the additions to the annual interest payment totals in comparison with the additions attributable to increased borrowing.

To estimate the added interest payments likely to result from the recent Federal Reserve discount rate action is not easy. Outstanding debts are not affected. For example, none of the existing $200 billion home-mortgage debt on one- to four-family houses would be affected nor would any of the present $80 billion total of consumer credit. Only new money borrowed or existing debt refinanced would be affected in any way by the new rate patterns.

Moreover, in practice, the spread of a discount rate increase is not transmitted immediately and fully to interest rates on all types of credit. Rates on some types of debt respond relatively little and only over a period of time.

After taking into account these factors, the best estimate our staff can make for the added interest payments in 1966 resulting from the discount rate action would be about $750 million. About one-third of this total would be reflected in increased payments on the Federal debt, a large portion of which is short term and has to be refinanced each year, leaving roughly $500 million to be spread among State and local governments, business and consumers.

Neither is it easy to compare the relative burdens on the economy of added interest cost versus the potential costs of inflation. It is complicated because it requires an estimate of economic conditions that might have prevailed if there had been no discount rate change. It also involves a measurement of the relative effects of interest costs versus inflationary costs for families at differing income levels.

Nevertheless, it is clear that with the level of GNP presently approaching $700 billion even a one-half of 1 percent increase in prices would cost in the neighborhood of $3½ billion—nearly five times the estimate of added costs to 1966 interest payments that might result from the discount rate action.

Senator JAVITS. Mr. Martin, did you seek the concurrence of the administration in your action before you cast your vote?

Mr. MARTIN. I most certainly did.

Senator JAVITS. You sought the concurrence of the administration?

Mr. MARTIN. I did, indeed.

Senator JAVITS. In other words, you testified at the very end of your statement that you informed the administration, and conferred with them, consulted with them, but you did not testify that you sought its concurrence. You now say that you did?

Mr. MARTIN. I did, indeed.

Senator JAVITS. Now whose concurrence did you seek?

Mr. MARTIN. I would like to have had the the concurrence of the President, the Secretary of the Treasury, the Chairman of the Council of Economic Advisers. I did not consult beyond that.

Senator JAVITS. But you asked for their concurrence.

Mr. MARTIN. I urged them. I presented the situation as I saw it, and I indicated to them what the problems were, as I saw it. They did not agree with me. It was a very friendly and very useful discussion, and I also reported to my colleagues that I had done this.

Senator JAVITS. Now did you, nonetheless, go ahead, and after their refusal to concur?

Mr. MARTIN. I did.

Senator JAVITS. Now may I ask you whether you think any change in law or practice is required or desirable for the better coordination of your own activities and those of the administration in power, whatever it may be, in respect to their fiscal and economic policy as contrasted with your monetary policy?

Mr. MARTIN. There has been a lot of discussion, as you know, Senator, about this, and it may be that there could be some improvements in the informal procedures which have been developed through the years, where I usually have lunch with the Secretary of the Treasury on Monday. Treasury representatives come over to the Board frequently on Wednesday, almost as a routine matter. We have occasional meetings with the Council of Economic Advisers, and since Secretary Anderson's time, we have had small groups—recently the group has been called the Quadriad—that have met with the President periodically. The Quadriad has met about once a month.

Whether or not there would be anything achieved by making a legislative framework that might include others that would call for this sort of consultation depends, I think, on whether the Congress and the people believe that the coordinating body should have the authority to make a binding decision.

In the event, as in the current case, where the Federal Reserve, the majority of the Federal Reserve Board, have done their best to discuss this matter and have a different conclusion from the other members of the Quadriad, should they be bound by law to go along? If they were, it seems to me that there is no real need for a Federal Reserve Board. It would probably be better to replace the Board with a Cabinet official.

Senator JAVITS. Did you ask the Quadriad to concur in this decision?

Mr. MARTIN. I did not formally send them a letter asking them to concur, but I had a long meeting with the President and the Quadriad on this, as long ago as the 6th of October.

Senator JAVITS. And during all that time, they have known that you proposed this action?

Mr. MARTIN. They knew that that's my view, and they knew this was being discussed within the Federal Reserve System.

Senator JAVITS. But at a given time, you actually asked for their concurrence, and they couldn't give it to you, and that was before the vote?

Mr. MARTIN. Well, now you are getting into a very difficult area. I don't know that I gave them a formal statement saying, "If you don't concur with me, I will go ahead and act," no. That isn't the sort of coordination we have. But they were informed, Secretary Fowler—and he has been most cooperative and reasonable in this entire matter—was informed following the open market meeting of November 23 that this was clearly in the wind.

Senator JAVITS. Now were they informed that you would take this action at this particular meeting at which you took it? In other words, were the President and the other officials of our Government, the top officials, informed that you proposed to put this matter before the Board and have it voted on at this meeting in December?

Mr. MARTIN. I told Secretary Fowler on the morning of December 3 that I intended to act, if the Board would back me. I did not—I couldn't commit the Board.

Senator JAVITS. Of course.

Mr. MARTIN. I didn't know whether the Board would support me or not.

Senator JAVITS. Now as my last question, Mr. Martin, I would like to ask you to make your refutation to what I think to be the central

core of this argument on policy as set out by Governor Maisel in his statement, and it reads as follows:

"The System could simply determine not to furnish additional reserves, and not to raise regulation Q. The discount window could have been opened wider to meet urgent needs.

Now that was, I gather, the prescription of the minority. What's your direct answer to that alternative?

Mr. MARTIN. The minority, I think it is fair to say, has tended to think we have had a too restrictive monetary policy over the past year. If I am unfair to them, they can question this comment. And for this, I have every respect, and they are entitled to that view.

My answer to waiting until January on this was that most of the Treasury issues—and I happen to be a money market man, not a great economist or a great student of the balance of payments—most of the issues in the money market were selling in the neighborhood of 4½ percent already, before the Board acted.

Therefore, if we had not taken these actions, we would have had to supply reserves at an accelerated pace to maintain that rate for the Treasury until the middle of January, when we might have gotten a concurrence from the administration.

I also want to point out that waiting for the fiscal 1967 budget, which I was urged to do, was not in my judgment a major factor. I already knew roughly, and the newspapers have shown roughly, what the expenditures for fiscal 1966 were going to be. This was what we were dealing with. I am very much concerned about fiscal 1967, and I have every confidence that the President is going to come in with as tough a budget as the requirements in Vietnam permit. I have every confidence in the President and in the people I have worked with in the administration, but in my judgment, and I think I speak for the majority on this, we would not be justified in supplying reserves merely for the sake of making it possible for the Treasury to finance at lower interest rates than the market was calling for. And when you come to the middle of January and the early part of February, you have a very difficult period of judgment as to when, if at all, you could move.

Now this is a matter of judgment. Some of my colleagues disagree with me.

Senator JAVITS. Thank you, Mr. Chairman, and I shall have other questions later.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Chairman, I shall be very brief. Most of the questions that I had in mind have already been asked.

But, Mr. Martin, dealing further with this action being taken prematurely, as has been suggested, you have given your reasons for not wanting to wait until January, but as I recall from the press reports, the President asked you to come down to Texas to visit with him that weekend, and on the day after that invitation was extended, you took the action.

You told him you could not come until Monday, and then you took the action. Did you not have in mind that the President—or did you not feel that the President must have had in mind discussing these matters with you before you took action?

Mr. MARTIN. I would have liked to have had further discussion with the President in addition to the one that occurred on October 6. But as you know, the President had a gall bladder operation. If he had been in Washington, it would have been a lot easier. You will have to question others—I don't know about their arrangements—but I hoped to see the President on the 26th of November. It didn't develop that I could.

And this appointment happened to be set up for Monday. This is the coincidence of events, but in my judgment, it would have been too late, Monday.

Senator SPARKMAN. Well, I was under the impression that the request came from him on Thursday, December 2, the day before you took action.

Mr. MARTIN. It didn't come to me.

Senator SPARKMAN. Well——

Mr. MARTIN. You will have to question others on that, Senator. No request came to me.

Senator SPARKMAN. Well, I think I remember the press reports correctly, at the time, that you were requested to come down to Texas for that weekend, and you sent word back that you could not be there until Monday, and then on Friday——

Mr. MARTIN. I would never dream of sending word back to the President I could not be down at any time. I would never dream of such a thing.

Senator SPARKMAN. Well, I am sure that that was the press report at the time.

Mr. MARTIN. I am not responsible for the press or for anyone else. I am giving you what the——

Senator SPARKMAN. Well, I must confess that I did wonder why you couldn't hold up action at least long enough to sit down and talk with the group connected with our fiscal affairs, and I am pleased to hear you describe the informal arrangements that you have in meeting with them and talking with them from time to time. That has been going on for some time, has it not?

Mr. MARTIN. This started during Secretary Anderson's time. I have been with the Federal Reserve a long time, Senator, as you know, and in the early stages of my tenure there wasn't any way that I could directly talk to the President of the United States about these problems. We had, as you know, a very difficult time with Secretary Humphrey, when there was a disagreement, similar in nature, and during that period I had no access to explain my point of view. Subsequent to that, Secretary Anderson took over, and we arranged meetings that have been held in one form or another through the balance of the Eisenhower administration, through the entire period of the Kennedy administration, and through the Johnson administration.

Senator SPARKMAN. By the way, you referred to the Quadriad, but I am not sure that I got just who are its members.

Mr. MARTIN. The Quadriad has consisted of the Secretary of the Treasury, the Director of the Bureau of the Budget, the Chairman of the Council of Economic Advisers, and the Chairman of the Federal Reserve Board. Those are the four.

Senator SPARKMAN. Yes, sir. The thing that concerns me about this—I want to say that I respect the members of the Board of Gov-

ernors of the Federal Reserve System. I am sure we all do. It must be a very difficult position to occupy. But——

Mr. MARTIN. There are many times when it is not a happy position. This is one of them.

Senator SPARKMAN. I am sure that is true. But the thing that disturbs me is that it seems that this latest action is bound to increase the interest rate. I mean, in ordinary, everyday dealings. And I am thinking of the effect that it has upon the small businessman, upon the people who are home buyers and home builders, and upon the financial institutions that are set up to make mortgages, such as the savings and loan associations, lending agencies that will have to increase their rate of interest to the home buyer and the home builder.

Doesn't that, in turn, increase the cost of living, and doesn't that tend to push up the varied indexes that you seek to control?

Mr. MARTIN. Governor Balderston would like to answer that.

Senator SPARKMAN. All right.

Mr. BALDERSTON. Senator Sparkman, to me, higher prices and higher interest rates are a product of inflation, not the cause.

Now could I illustrate my point by referring to the supposed burden imposed by higher interest rates upon State and city governments?

The ratio of interest cost to total cost is for State governments only 2.1 percent; but—and here is the point that I think is often overlooked—every dollar paid out by the U.S. Government as interest is received by someone. And in the case of State governments, the offset in the form of interest received by pension and other trust funds is two-fifths as great as the interest paid out.

What I am saying is that for State governments, the interest payments are less than one and a half percent, if you take the net figure, of their total costs. But suppose the prices of the things and of the services bought by those State governments should rise, as they have been rising ever since I came on this Board in 1954. The cost to those State governments from the higher prices paid is far, far greater than the increase in interest costs alone.

In short, this little example, important as it is to all concerned with State and local governments, merely demonstrates how expensive to them is the cost of cheap money.

Senator SPARKMAN. But I am thinking of the consuming public, that pays for that costly money, as an individual. I realize that if you take the matter as a whole, the whole economy, it might be a different picture. What about the person that wants to buy a house? He has got to pay more for it now. And the person that buys the groceries, the individual needs, it seems to me this is an increase in price, increase in cost of living that runs to the individual, that should be taken into consideration.

Mr. BALDERSTON. I am very happy you raised that particular case, because of all the major industries in the country, the one that has suffered most from inflation in recent times is the construction industry.

Now suppose the cost of construction materials should go up, as it has gone up? Do I make my point?

Senator SPARKMAN. Yes; yes, I get that, but I had understood that your feeling and that of the majority of the Board was not that we had inflation already, to any fearful extent, but that fearing that it may come in the future.

Mr. BALDERSTON. Well, Senator Sparkman, since I came on this Board in 1954, the price deflator used for GNP, that is, for the economy as a whole, has risen 22 percent. And if you take the price deflators for State and local governments, the figure is 40 percent; for Federal Government, it is 35 percent.

Well, the last two of those are phony to the extent that there is no allowance made for improvements in productivity, but a 22 percent increase in prices between 1954 and 1964 means that inflation, the inflation threat is always with us. Inflation wears many guises: it may take the form of price; of land inflation in Florida in 1926; stock market inflation in 1929; and so forth.

Senator SPARKMAN. Thank you, Mr. Chairman. My time is up.

Chairman PATMAN. Governor Maisel, did you want to say something?

Mr. MAISEL. Well, I just wanted to comment on Governor Bolderston's point. I think we all agree that we must worry about inflation. However, the question might better be: If we had an 8-percent interest rate, how much less inflation would we have and at what cost?

In Germany and France they have had 7- and 8-percent interest rates, their inflation has been far greater than ours.

The related question is: How much unemployment would a high interest rate require in this country? As Governor Balderston pointed out, many of these figures are not very good or very accurate. There are built-in biases. Senator Proxmire has been chairman of your committee on this matter trying to get these numbers improved, so that we can have better information on which to work. However, I would hate to have the record show any belief that we could determine simply by changing interest rates whether or not prices would go up to the extent they have in the past. It is a far more complex problem than that.

I think many people would argue, for example, that one of the reasons prices rose during this period could have been an excess of unemployment. People would argue that prices were increased because we had to much unemployment during that period, and we weren't fully utilizing our resources. We weren't getting the total amount of production in the economy that we ought to. We weren't getting as much investment as possible in plant and equipment. While obviously I agree to some extent with Governor Balderston, I think we ought to be clear that this is a very complex matter in which there are many difficult relationships.

I certainly think we might all agree that if we knew an increase of the interest rate by 1 percent would stop prices from rising and if we knew how much production would be lost, it might be simple to agree that we would be better off raising interest rates by 1 percent. However, we have here a question of analysis and fact on which there is no agreement.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman. I am happy to say that up to the present the committee hasn't bogged down on getting into this serious question of the economic factors behind the decision of the Federal Reserve Board. And I am very pleased to notice that all of the members of the Board who have agreed on the vital importance of considering the economic factors still express themselves as

strongly in favor of the independence of the System. Am I correct in that observation?

I think this is very important. Some of the testimony that has come out, by Chairman Martin, emphasizes the care that was taken in using this independence. And I would say that great care was taken in using this independence. Although Governor Maisel, in a very fair way, has pointed out his difference of opinion, to coordinate with the Executive. I think this is an area that Congress well might look into. That is whether or not, as Mr. Martin has said, we might want to formalize the meeting of the Board.

I think the manner in which the Federal Reserve Board has conducted itself is quite exemplary. I think that the authors of the Federal Reserve Act back in 1913 would be mighty proud of the gentlemen we have before us; of the way they have exercised their judgment. And let me say that, far from decrying, as you imply, Governor Maisel, when you say that you are sorry these hearings have resulted, that internal conflicts will receive wide publicity, I think this is a further step forward. I do think that although we have set up the referee, as it were, and the referee has blown his whistle, and we have agreed that we are not going to kill the umpire—at least I hope we have agreed—that certainly we will want to investigate why the whistle was blown. Now the Congress can learn a great deal about this. Indeed, we can here.

There is a point, though. Governor Maisel said that he agreed with the independence of the System, but then later in this statement, he brought up, I think, the question of the definition of independence. He indicates that the weapon of independence is clearly a major bargaining force. However, because monetary and fiscal policies are necessarily interdependent, national goals may more easily be achieved if the ability to act leads to a coordinated program, rather than independent action.

Is there a disagreement, Governor, between you and the expressions of the definition of independence as expressed by Chairman Martin?

Mr. MAISEL. I am not certain that there is. I think, as I believe Chairman Martin indicated, that for the minority, there were two questions. One was the question of the reasons for the action. When it became clear that the majority felt that action was necessary, that we needed a tighter monetary posture than we had had previously, then the discussion within the Board shifted to this question of coordination and timing. As a result, a fair percentage of our discussion was concerned with these two matters.

I think the majority put a very different evaluation on a 1-week delay, or a 1-month delay, than the minority. This, as the chairman said, was a matter of judgment.

In his judgment, clearly, any delay was costly. To the point of view of the minority, delay was worthwhile. However, we felt that even if the majority were not willing to delay the imposition of tighter money, that it would be better off not to act through the discount rate change.

The Board had an announced policy, to raise the discount rate only as a matter of urgency.

Representative CURTIS. In other words, your disagreement lay in the fact that other factors could appear that were not known at the

time, rather than the fact that a judgment was made which happened to disagree with the other arms of Government. If you happened to agree that all the facts were in that you needed, you would have acted independently. Is that correct?

Mr. MAISEL. That's correct.

Representative CURTIS. Now, I hope that we haven't bogged down on this point. I hope it is clarified, because I know there are people—Chairman Patman, and possibly others—who disagree. I know in the press, there are many who are experts in this area who will, tomorrow, exhibit disagreement, but I hope that as we go forward with other witnesses, we may have this point clarified. I think it is important to pin this down.

Now, if I may, on the question of further facts to be considered, I will make the statement that I agree with Chairman Martin's point, if I understand it correctly, that the budget of 1967—that's the new money that will be requested or rather, new power, that the President will request from the Congress to spend—that this really does not have immediate bearing on this monetary policy.

The key issue, I would argue, is the expenditure rate of the Executive. The President already has power in the form of a $95 billion carryover, to spend previous appropriations from the Congress, which are unspent, plus—and I am talking about the administrative budget—what I would argue is $110 billion—some have said it is $119 billion—new power to spend from this session of Congress which has just adjourned, giving us a total of over $200 billion.

Now the President's expenditure rate, given to us last January, was $99.7 billion. He reiterated that rate as late as June of this year, when the Ways and Means Committee was considering the extension of, or rather the increase in, the Federal debt ceiling, and also considering the excise tax.

I requested personally, that the President send a letter to the Ways and Means Committee, reiterating this expenditure policy, which he did.

Now looking at the expenditure levels, and this is a key point that I regret to say the Members of Congress, and certainly the public, are missing, in relation to the great tax-cut bill of 1964, the issue was whether we were going to restrain Federal expenditures.

Those who argued as I did said we had to, or the tax cut would not be beneficial. Others argued, no, you have to continue increasing expenditures. The record is here for all to see. Fiscal year 1964, $97.7 billion. Fiscal 1965, $96.5 billion. And in the first month, July, of fiscal 1966, I was most pleased, $7.2 billion of expenditures.

I became alarmed in August when it became $9 billion, although seasonally it seemed that there was always an increase in August. Then when September came, and the figure was $9.5 billion, and September usually has a little fall-off in spending, I made a speech on the floor of the House saying that now we had a complete shift in expenditure policy. The figures in the Economic Indicators for November, I regret to say, don't show the October figure. I understand it is $8.7 billion, which though down some, still indicates a very high increased expenditure rate which is well over $110 billion annually, and our revenues are only about $97 billion, a little increase over what we had before.

Here's where the pressures come in: in the management of the Federal debt, and the impact that this will have in this area.

Having made these statements, Mr. Maisel, and directing my question really to you, why did you feel that anything further was needed as far as information was concerned, as far as expenditure policy was concerned? Or did you disagree that the budget itself, the request for new authority to spend for fiscal 1967 on up, has a bearing on this?

Chairman PATMAN. You may answer the question, although his time has expired.

Representative CURTIS. My time has expired, but if you would answer the question, please.

Mr. MAISEL. I think your point was very well taken. We have to be concerned with the actual estimates of the cash budget, and of expenditures, and of the national income budget. The figures that we had, based upon previous indications, did show a shift in this situation. The current quarters were the poorest quarters as far as their inflationary impact was concerned. Under our existing estimates, the Government's additions to demand would rise less rapidly than supply. I think what everybody was concerned about was would the President in January come in with a basically different expenditure program for Vietnam, for the first half of the 1966 calendar year, compared to the second half of the 1965 calendar year?

The 1967 budget was partly important. But I think that in most people's minds the critical question was what would the accurate figures be for the first half of the calendar year 1966, with respect to estimated expenditures and estimated receipts?

Our staff had done estimates of this, but they still remained tentative. They showed a situation in which, depending upon how you interpreted the various press statements, you might say either that we were going into a more deflationary impact as a result of fiscal considerations, or the opposite.

It was very, very closely balanced, but we were primarily concerned with the expenditure estimates, not the appropriations or the requests for appropriations.

Representative CURTIS. Thank you very much.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Thank you.

Chairman Martin, I am most interested in the question of timing and coordination in the exercise of the Federal Reserve's independence. I would like to ask you this question: In your discussions with the President and the other members of the Quadriad, prior to the action you took on December 3, did you at any point recommend or request the executive branch to pursue a noninflationary fiscal policy—that is to say, either to tax more, to spend less, or both of those—which recommendation would have made unnecessary the increase in the discount rate of December 3?

Mr. MARTIN. I don't know that it would have made it unnecessary, but let me make very clear that, as far as I know, no minutes are kept at these meetings, and all aspects of the problems that the country is facing in fiscal and monetary affairs are discussed very freely.

Representative REUSS. Yes. My question, though, was: Did you recommend to the President, or to——

Mr. MARTIN. I did not.

Representative REUSS. Let's make sure you understand my question.

Mr. MARTIN. Well, I understand your question. I do not go to those meetings as a rule to make recommendations.

Representative REUSS. Did you make recommendations as I have described?

Mr. MARTIN. I did not make any—oh, I discussed the matter generally, but I did not make any specific recommendation.

Representative REUSS. So you went ahead, then, and voted to increase the rediscount rate on December 3, without having taken a position in favor of fiscal methods of fighting inflation, and without, therefore, having had an opportunity to be turned down on that by the President and the other members of the Quadriad?

Mr. MARTIN. This is not the nature of those meetings. It is not for me to discuss. It is for the President to tell you how he conducts those meetings, not for me.

Representative REUSS. And just to make sure that you have answered my question, then neither at the meetings at which the President was present, or in any other way, at meetings or outside of meetings, did you recommend to any members of the executive branch that they adopt fiscal methods of fighting inflation, thus giving you greater leeway not to raise interest rates?

Mr. MARTIN. I have never gone to any of these meetings from the time that Secretary Anderson started them with specific recommendations, but I have discussed general policy, all aspects of it, to the extent that the President, who is the presiding officer, wishes.

Representative REUSS. Well, your answer to my question is no, is it?

Mr. MARTIN. My answer to your—I can't say no in a categoric sense, because we discussed all aspects of this problem, but not in terms of a recommendation of what ought to be done, except in my field. In my field, as I say, I discussed——

Representative REUSS. Monetary matters?

Mr. MARTIN. Monetary matters. This is my field. I don't try to run the Government.

Representative REUSS. But you didn't make any recommendations as to fiscal matters.

Mr. MARTIN. I urged every possible restraint. Now I did not make a specific recommendation, in fiscal policies.

Representative REUSS. Let me ask you this question: You have testified, a few minutes ago, that one of the reasons why you felt you should not wait until January to raise the rediscount rate, assuming it had to be raised at all, but instead, why you felt it had to be raised on December 3, was the sensitive market conditions of January and February. Did I hear you right?

Mr. MARTIN. It would be very difficult, in my judgment, to find a period in January and February when we could have done this, in view of the financing needs that I am sure the Treasury is going to have. But this was not my major reason. This was one of my reasons.

Representative REUSS. Just stick to this one reason that you have given. This one reason that we are referring to is a reason to help in the Treasury's debt management, is it not?

Mr. MARTIN. Exactly.

Representative REUSS. Well, you say you discussed the raising of the rediscount rate with Secretary Fowler, as close to the December 3 meeting as the very morning of that day, did you not?

Mr. MARTIN. That is correct.

Representative REUSS. And am I also correct in my understanding that Secretary Fowler urged you not to raise the discount rate at that time?

Mr. MARTIN. That is correct.

Representative REUSS. Well, then, you, to the extent that you adopted concern for the January-February debt management position of the Treasury, were in effect substituting your judgment for that of Secretary of the Treasury Fowler, were you not, in a matter which is his responsibility, not yours?

Mr. MARTIN. On that particular point, yes, but this was not the basic reason for our move. I would have liked to have moved—if I had been doing this on my own, I would have moved in late September or early October. We had to move when we did because of market developments that had nothing to do with January and February. If we had tried to counteract these market developments, and keep interest rates on Treasury obligations from rising during the period of Christmas and early in the new year, we would have had to supply reserves in greater amounts than we have done under any monetary policy heretofore.

And to me this would have gone beyond the realm of support for the market. This is a purely technical matter. But the other point is a subsidiary point, and to that extent, I was substituting my judgment for Secretary Fowler's there, but only as a subsidiary matter.

Representative REUSS. At the meeting of the Board on December 3, was there discussion of the effects of lowered unemployment on racial tensions in this country?

Let me spell out a bit what I mean. For some time, it used to be argued—including before this committee—that unemployment was mainly structural, and that not much could be done about the special problems of minority groups, for example, by general increases of demand.

Well, I think that that structuralist overemphasis has been pretty well dissipated by events of the last 2 or 3 years, when it has been demonstrated that when unemployment went down generally, it went down very much more for minority groups, such as Negroes.

With that background, I will repeat my question. Was the fact that Negro unemployment in this country is still in excess of 8 percent, as opposed to an overall 4.2 percent, discussed at the Federal Reserve Board's meeting with reference to the question of whether the interest rates should be raised at this time? To the best of your recollection?

Mr. MARTIN. I can't recall all of the things that were discussed at that specific meeting, but I want to say that the Open Market Committee, which consists of five of the presidents of the Reserve banks and the seven Board members, has been meeting periodically at 3-week and on some occasions at 2-week intervals, and all aspects of this have been discussed.

Representative REUSS. But you don't recall whether it was discussed at the December 3 meeting?

Mr. MARTIN. I don't recall. Every member of the Board—and they are all here except two, so they can speak for themselves—every member of the Board was given every opportunity to raise any point that he wanted to raise.

Representative REUSS. And the answer to my question as to whether you recall whether anything was said about this is "No"? Is that correct?

Mr. MARTIN. That is correct.

Representative REUSS. Another question. Would you consider Governor Maisel a great student of the balance of payments?

Mr. MARTIN. I have only got to know—as I have said, I am very delighted with Governor Maisel, and he has been here since April 1, and I haven't seen as much of him as I would like to see.

Representative REUSS. Well, just yes or no on whether you consider him a great student of the balance of payments.

Mr. MARTIN. I wouldn't answer that yes or no.

Representative REUSS. Now as to Governor Robertson, do you consider him a great student of the balance of payments?

Mr. MARTIN. Governor Robertson has performed yeoman service in the voluntary foreign credit restraint program.

Representative REUSS. Does that make him a great student of the balance of payments?

Mr. MARTIN. This is a judgment that I don't think I ought to be asked to pass on people.

Representative REUSS. You just made a judgment like that on yourself when you said that you were not a great student of the balance of payments a few minutes ago.

Mr. MARTIN. I am perfectly willing to make such a judgment on myself, but I am not willing to extend that to others.

Representative REUSS. Well, since you have ruled yourself out, does the present seven-member Federal Reserve Board include, in your judgment, a great student of the balance of payments?

Mr. MARTIN. I will answer this, having said that I wouldn't, by saying I am not sure that there is any member of the Federal Reserve Board that I would classify as a great student of the balance of payments.

Representative REUSS. Now changing the subject, why would it not have been possible to exercise some discretion at the rediscount window rather than raise the interest rate, and refuse credit, for example, to a bank which simply wanted to borrow because it could invest the money at a slightly higher rate in some other form of security? Why didn't you do that?

Mr. MARTIN. This is always a possibility, an administrative possibility, and to some extent, this is carried out by all of the banks in their handling of the discount window.

Representative REUSS. As a matter of fact, doesn't so-called regulation A of 1955, which sets forth your rediscount policy, explicitly exclude granting rediscounting privileges to a bank which wants to borrow simply to make a percentage point or so on the interest rate by investing it elsewhere?

Mr. MARTIN. I think that the officer in charge of the discount window is always trying to determine what the use of this is going to be, and I think that we have improved the administration of the discount window a great deal in the last 4 or 5 years. We now have a committee that is studying this, but we have no hidebound way of doing it.

Representative REUSS. Your answer to my question of whether regulation A—adopted in 1955, and still, so far as I know, governing your rediscount policies—prohibits the use of the rediscount window to enable a bank to borrow from the Fed simply to lend it elsewhere at a higher interest rate, your answer to that question is that it does or does not?

Mr. MARTIN. No, my answer to that question is I would have to read the regulation.

Representative REUSS. I see. Would you, after reading it, and at this point in the record, indicate for the record whether it does in fact prohibit such rediscounts?

Mr. MARTIN. I will be very glad to prepare a paper on that.

Representative REUSS. You don't have to prepare a paper. Just tell me whether it does or doesn't.

Mr. MARTIN. I would be very glad to tell you whether it does or doesn't.

(Regulation A, covering the foregoing, was subsequently furnished and made part of the record by Representative Reuss. It appears on p. 127.)

Representative REUSS. Thank you.

Chairman PATMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Governor Mitchell, in your statement, you referred to food prices having risen significantly, but because of supply conditions.

I would just like to make clear for the record that while food prices may have risen significantly, the farmer isn't getting the benefit of it, because notwithstanding the increase in meat prices recently, parity is still at 77, far under what it was 4 or 5 years ago.

Also, I think it ought to be pointed out that 19 cents per consumer dollar is all that goes for food, even with the increased prices, so I think that if anyone is getting the benefit of the increased prices, we had better make it clear that it is not the farmer.

Now you also made a statement that concerns me. You refer to "the lack of evidence that inflationary pressures are strong or accumulating." I have already referred to and placed in the record certain figures out of the Economic Indicators, prepared by the President's Council of Economic Advisers, not by me, which show that inflation is getting worse; and I stated at the beginning of this meeting the inflation figures for the last 5 years, and pointed out that during the first 9 months of this year, the amount of inflation is almost as much as it was during the entire previous 12 months. I also pointed out that nearly one-third of our increased gross national product consists of inflation.

Still you refer to the "fact" that in your judgment, there is no "evidence." Now I would like to ask you whether it is a case of whether in your judgment there is no evidence, or whether you are not willing to accept the evidence.

Mr. MITCHELL. Let me answer that in two ways. First, with respect to the evidence. You have got a poor thermometer. You are looking at the thermometer, and it is giving you an erroneous register. The Stigler Committee, which investigated the characteristics of the Consumer Price Index—3 years ago, I think it was, 3½ years—came to the conclusion that it concealed quality changes and concealment of these quality changes has meant that prices have appeared to rise, but they haven't risen if you take quality into account.

I recall a study made by Tillich at the University of Chicago, in which he took a constant product, like the automobile business, and he indicated that while the index showed that prices have risen something like 20 percent, in fact, they had declined something like 15 percent, quality considered, in the same interval.

Now the other point where the price changes is in their abrasiveness. You can have a lot of price changes, up and down, and some of them of fairly significant dimensions, because of bottlenecks of one sort or another. Now these are thoroughly characteristic and typical of the operation of a healthy, noninflationary economy. And what I was trying to do, in my testimony, was to look at the number of changes that have been taking place, and point out that in over half of the industrial groups, the prices for which we keep measurements, in half of these cases, there was no price movement at all, plus or minus 1 percent, and I think these are the two points in my paper which substantiate the judgment that today we are not getting the kind of price action that warrants monetary restraint of the character that the majority voted for.

Senator MILLER. Thank you.

Now I am very pleased when you brought out your reliance on the Stigler report. You have said that we have had a poor barometer. I would agree with you that there is a lot to be desired, but it is the best barometer we have, Governor, and furthermore, I point out to you that it is the barometer that is used in escalation clauses in labor-management contracts.

I understand that it is a uniform policy of the United Auto Workers of America to have such an escalation clause in its contracts, and I don't believe you would get very far with Walter Reuther if you suggested to him that they forget wage increases because of the Stigler report.

Now I would like to point out what was testified to in connection with the Joint Economic Committee's hearings on the Stigler report,[1] and I am reading from part 2, at page 588, the written statement furnished the committee by Mr. Ewan Clague. He was the expert who managed the Bureau of Labor Statistics. And what does he say?

He says, "The BLS is in no position to deny or affirm that there is currently an upward bias, and, least of all, to assign a numerical magnitude to it," and then in his direct testimony before the committee, at page 571, he says, "The balance of some of our downward biases and the efforts we make to factor out quality improvements indicate to us that this upward bias is relatively small, if any. I think I would not even want to concede there is any rise at all."

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[1] "The Price Statistics of the Federal Government," George J. Stigler, hearings before the Subcommittee on Economic Statistics of the Joint Economic Committee, 87th Cong., 1st sess., 1961.

In reading through the Stigler report, it is made abundantly clear that while there may be quality improvement, which is not taken into account, they do not take into account the increased cost of maintenance of the quality improvement, and also the downward bias which results from quality deterioration in price line goods, and the point I want to make is that I don't believe we are going to get very far if we are going to just say we have got a poor thermometer and ignore the facts of life in the increase in wage costs which are tied into that barometer.

Now, one other question of Mr. Martin.

Mr. Martin, I just want to make clear, lest some previous testimony may have cast some doubt. There is absolutely no disagreement, as far as you are concerned, with the policy of the administration of full employment with stable prices, is there?

Mr. MARTIN. None whatever.

Senator MILLER. But I detect that there is concern that the policy is not going to be achieved unless certain actions are taken. Is that not so?

Mr. MARTIN. That is correct, and these actions have been taken with the conviction on the part of the majority that they will be helpful in achieving this policy.

Senator MILLER. In other words, it would be a gross distortion to suggest that this was an attack on the policy itself, would it not?

Mr. MARTIN. No attack at all.

Senator MILLER. Yes, sir.

Now, in your statement, you referred to various factors that were taken into account, in arriving at the decision that was made. But you did not refer to, for example, the outflow of gold problem. I have had people suggest that because of the continued slippage in the purchasing power of our dollar, foreign creditors are more inclined recently to ask for gold in lieu of our dollars. Was this factor considered in your deliberations?

Mr. MARTIN. In a general way, yes, but the emphasis in this action was on the domestic economy. It is an implied matter, and I think it is very difficult to quantify what help this action may be in terms of our balance of payments. I make no exaggerated claims for what it will do in that area, but I am quite convinced that it will not be harmful.

Senator MILLER. I understand; but you did list the balance-of-payments problem as one of the factors that you considered?

Mr. MARTIN. Which was considered.

Senator MILLER. But you did not mention the outflow of gold problem?

Mr. MARTIN. Well, I consider that a part of the balance-of-payments problem.

Senator MILLER. Thank you.

Did you, as another factor, consider the war in Vietnam, and the anticipated increased expenditures relating thereto as one of the elements in your decision?

Mr. MARTIN. Unquestionably so.

Senator MILLER. You did not mention this, I don't believe, as one of the factors. I would like to point out that the distinguished columnist Richard Wilson, in the Washington Evening Star for Friday, December 3, has an article entitled "Administration at Moment of Truth,"

which mentions this factor, and I would like to ask consent to have this placed in the record.

Chairman PATMAN. Without objection, it is so ordered.

(The article follows:)

[From the Evening Star, Washington, D.C., Dec. 3, 1965]

ADMINISTRATION AT MOMENT OF TRUTH

What Adlai Stevenson called the moment of truth has now arrived in the Johnson administration. The reckoning has come.

The reckoning of how great the Vietnam war shall become, how great the cost of the Great Society, and how great the inflation resulting from both—all these accounts are now being cast up. The sum total is very large, whether measured in dollars, human values or life itself.

The real questions in Washington are not whether we shall negotiate in Vietnam, but how much additional force we shall apply; not whether we shall control inflation, but how; not whether the Great Society is good, but how we are to finance more of it and more war at the same time.

These are the reasons for the year-end conferences of President Johnson with his chief advisers in every field. The immensity of what has been started and now must be carried on imparts to these year-end conferences an urgency far beyond normal.

Nothing, it seems, can be contained within forecast limits, neither the war in Vietnam, nor the level of prices, nor the rate of general spending, nor even the size of such minor undertakings as Operation Head Start, the preschool training program.

Costs have bounded up $7 to $9 billion above the beginning of the year forecasts.

Instead of the $5 billion deficit forecast, we are likely to have more nearly a $10 billion deficit.

If the war effort in Vietnam has to be doubled in the next year, which is not beyond reality at all, the outlook will be changed even more drastically.

For Johnson, not yet fully recuperated from major surgery, it must be like a nightmare. The seeds he has sown are producing giants from the earth. When he speaks of hastening the pace of integration, he is confronted by demands for $100 billion to wipe out the ghettos of the cities. When he considered the world food problem, he is deluged by multibillion-dollar proposals without any compensating reduction in farm subsidies or foreign aid.

When he looks at his poverty program, he sees nothing but growing demands for more and more of the kind of programs which are already being badly administered.

Johnson wanted everything at once. He wanted to go to the moon quickly, settle the matter in Vietnam, abolish racial discrimination, eliminate poverty, care for the sick and old, educate all the young better than ever before, beautify the Nation, recreate the cities, reorder the economic life of whole sections of the Nation and have economic growth without inflation.

At the same time he wanted to be pennywise about Government expenses, turning off the lights in the White House, exhorting Cabinet members to cut nonessential costs and praising them for using small cars rather than big limousines in official business.

But now the more somber decisions of the deepening involvement in Asia overhang every plan for increasing the scope of the Great Society. Every day the war in Vietnam is more an American war, a "long, hard war" that ultimately may bring that state of limited national emergency that Johnson has wished to avoid, and did avoid in the round of decisions last summer.

What was deemed to be enough last summer is not enough this winter as no set of decisions before was ever found to be enough in the 10 years of the Vietnam conflict.

What will Johnson do? This is predictable. He will take additional steps in escalating the war but still largely within the confines of South Vietnam and without an all-out attack on North Vietnam.

He will seek to bring pressure, as in aluminum and copper, but in a different way for the stabilization of consumer prices. He will not be able to curb the increasing costs of social, education, and urban programs. He will go slower in the initiation of new programs.

If none of this is enough, as it may well not be, the harder decisions that Johnson avoided last summer may have to be taken.

Senator MILLER. Mr. Chairman, did you take into account the factor of the increased appropriations made by Congress over and above the $100 billion budget that was presented at the beginning of the year?

Mr. MARTIN. Not specifically, no; but this is all a part of the problem.

Senator MILLER. And Governor Maisel, in your comments, you spoke about commodity prices, nonfood prices. I take it, however, that you would not exclude the almost equal, if not more so, importance of noncommodity prices; namely, service prices.

Mr. MAISEL. The reason I excluded services specifically was partly for the reason that Governor Mitchell gave. We know, for example, that while doctors' rates have gone up among the fastest of all, the number of times we have to go to a doctor these days is decreasing. The speed with which we get out of the hospital is increasing. Quality raises particularly important questions of measurement in that part of the index.

The other point that has to be made clear is the question of what does monetary policy affect. I think most people—perhaps I shouldn't say "most people," but at least I—feel strongly that the reaction of service prices to monetary policy is not very great. These are the reasons that I used nonfood commodities rather than services in my testimony.

Senator MILLER. Although you recognize that these noncommodity prices are in the Consumer Price Index, and part of it?

Mr. MAISEL. Oh, yes, sir.

Senator MILLER. Thank you, sir.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Chairman Martin, this discussion hinges very largely on your interpretation and the contrary interpretation of the minority on the pressure of inflation or the prospect of inflation. You put less emphasis on our adverse balance of payments. You do say that we have had an increase in unit labor costs. I note that they are lower now than they were in October of 1964, and that looking at it with any perspective they seem to be quite stable, and I doubt if you or your fellow members would act on the basis of just 1 or 2 months.

You do give this a perspective, don't you?

Mr. MARTIN. Yes, sir.

Senator PROXMIRE. Well, then, when we look further at the degree of factory capacity, the level at which the economy is utilizing its capacity, we see that over the past year and a half or so, it has gone up very little from 87 to 88 percent, now 90 percent. The latest figure the staff could get for me was 90 percent. At any rate, this is quite stable. These two forces of plant capacity and unit labor costs are certainly two of the principal forces that would push prices up, if we have a cost-push inflation. Wouldn't you agree that these would hardly justify acting swiftly in December rather than waiting until January as some people in the administration would prefer, and as a substantial minority on the Board would seem to prefer?

Mr. MARTIN. This is another case of what you consider to be satisfactory evidence. In the judgment of the majority, the expectations here were such that if we waited until later to get clear evidence, we would have had little or no influence. We cannot ignore expectations

in this area, entirely. Now this capacity figure—90, 91 percent—is a very difficult figure, as you know. It means that a lot of plants are operating much closer to capacity than that. The pressures are here, and have been growing; we were not warranted in delaying any longer if we were to have any influence at all in restraining these pressures. This was, I think correctly, the position of the majority.

Senator PROXMIRE. Now we come to a very interesting and, I think, an extremely helpful qualitative analysis which Governor Maisel has given us this morning. Whether or not it is valid, of course, is a question. But he does point out that the elements in the price structure that would be affected by an increase in the interest rates do not seem to be under pressure and do not seem to have been rising. Food is the biggest element in the increase in inflation, and of course, as I understand it, the increase in interest rates is unlikely to stem that kind of inflation.

There were temporary reasons for the increase in food prices and in any event, it doesn't seem as if this is an effective way of stopping that kind of increase. Is that correct?

Mr. MARTIN. Well, I think it is debatable. It is arguable.

Senator PROXMIRE. Yes.

Mr. MARTIN. Let me try to put it to you this way, Senator, because I know you are trying to get at the heart of this. I think that the economic aspects are arguable. I have a point of view, I have some convictions on it, but they are arguable. I think the balance-of-payments aspects of this are arguable, but on the financial problem, which is primarily the Federal Reserve's concern, the money market problem, I think that the reasons were compelling for acting now rather than delaying. That's the sequence.

Senator PROXMIRE. I want to come to that in just a minute. Before I do, you say in your prepared statement, that over the first quarter of the year our deficit on so-called regular transactions was an annual rate of $1¾ billion. As you know, the Bernstein Committee, consisting of very eminent economists, the outstanding experts in the field of balance-of-payments statistics, unanimously recommended that instead of reporting statistics on regular transactions, we should use official transactions. The Joint Economic Committee unanimously recommended that both series be equally considered.

The latest official transactions statistics indicate that in the third quarter of this year we had a positive, a plus, a favorable balance of payments, of over a billion dollars, and the aggregate for the first three-quarters is close to $600 or $700 million negative, but apparently improving sharply.

Under these circumstances, don't you feel that the official transactions measurement should be given some weight?

Mr. MARTIN. I think it should be given some weight, and it was. The secretary of that committee was a Federal Reserve Board man, and performed I think, very usefully in it.

I have already disqualified myself to Mr. Reuss as a great authority on the balance of payments, but I think that it is part of the overall problem. I haven't argued for regular transactions or official transactions, or any other form of accounting. I have merely said that our performance is fair. I question whether it is good or not.

Senator PROXMIRE. Wouldn't you agree that the experts who were appointed to this committee headed by Mr. Bernstein are outstanding students and experts at least in the balance of payments statistical field? They were appointed for that reason; their recommendation was unanimous.

Mr. MARTIN. Well, as I understand that, the administration has said they will use both figures.

Senator PROXMIRE. Yes, now let me ask you: Is it not true that this increase, to the extent that it is fully reflected, in increased service costs in the national debt, if my mathematics are correct, that the service costs on the national debt are now $12 billion, with an average interst rate cost, or 4 percent? That means that each 1 percent cost is about $3 billion, one-half of 1 percent would be $1.5 billion. But this wouldn't be reflected until you accumulated over a 5-year period, because you have about a 5-year turnover in the national debt.

Am I clear? Do you see my point? Good.

So that I would say the maximum effect this year, if you sustain this for a year, and if there is a general one-half of 1 percent increase in national debt cost, would be around $300 million this year, $600 million the following year, et cetera. Is that a fair statement? As the maximum effect? And I would agree that it probably wouldn't be that great, but it could be that high.

Mr. MARTIN. It could be that high. Right.

Senator PROXMIRE. All right. Now in addition to this, there would be an additional cost to debtors, and this is, of course, debatable, again, but there would be an additional cost to debtors much more substantial in this country. Those who borrow money will have to pay more for it, several billion dollars.

Now, the New York Times yesterday had an interesting analysis, in which it said that the following areas of our economy will not be effected by the increase: No. 1, the cost of an unsecured cash loan from the bank on the corner, which in New York City tends to run between 8.5 and 12 percent, will not be increased.

In the second place, auto financing will not be increased.

In the third place, small loan companies, such as Household Finance, will not be increased. In the fourth place, probably, home mortgage rates are not expected to increase significantly. There might be a small increase, but very little.

Would you agree that this analysis is roughly correct?

Mr. MARTIN. No, I wouldn't agree to that analysis. I think it is too early to make a judgment of that sort.

Senator PROXMIRE. But on the basis of your experience, and nobody has more experience on the consequences of this kind of thing, would you feel that the principal effect would be in business borrowing for expansion or for purchasing equipment and expanding plant?

Mr. MARTIN. I would think that would be the principal effect.

Senator PROXMIRE. All right. Good.

Now is it not true that by business borrowing, and expanding plant, we in the future, we create, we increase our productive capacity, so that our capacity to meet demand in the future will be increased? Therefore, any dampening down now in the capacity of our future plant will result in more inflation in the future.

What I am getting at—this is a matter of timing, and I appreciate that. What I am getting at is this: If we could get at this element of consumer credit, which is, in my judgment, the most explosive element in our economy—as you know, it has gone up since 1954 from $28 to $81 billion, expanding at an enormous rate, the consumer who buys a car on time, who buys appliances on time, and so forth.

As I understand it, I am told by a member of your staff this morning that the specific authority for the President to change the terms of consumer credit—in other words, on buying a car from 36 to 30 months, has expired.

Now it would seem to me that Congress might very well consider the possibility of providing—this is at least one additional thought. This would have the advantage of not increasing the cost of servicing the national debt, of not increasing the cost to anybody who borrows money, but of working in a selective and limited way to the extent that it seems to be necessary, to get at inflation, where the pressures that in my simple judgment seem to be greatest, this is, in people getting overextended, and the natural tendency on the part of business to provide terms that are, perhaps, too generous.

Mr. MARTIN. This is the perennial discussion about selective and general controls. On your first point, you see, the problem of the banks is that a lot of the banks have been making term loans that in my judgment are not really good term loans and should have gone to the capital market, and the loan-deposit ratios of the banks have risen. If we are to maintain the stability that we currently have, which is vital to our competitive position in the world, it is important that we get a better flow of funds than we have been getting in the market, where you have had a rate like the prime rate standing as a boulder in the money stream, where the demands have been swirling around it in every direction.

Now I can agree with you that selective controls have a place. We do not have them at the present time. Regulation W was taken away from us by the Congress, and regulation X, which concerned real estate credit, was also taken away from us, some time ago.

I realize that you can have a problem—and the balance-of-payments problem is in that area—where you need every type of control, selective, and general.

But I don't believe in the present situation, Senator Proxmire, that we could have avoided—even if we had had selective controls in this area—complete elimination of the general control. I have never observed a situation in which selective controls have been able to work effectively without some general control also.

Senator PROXMIRE. Thank you. My time has expired, Mr. Chairman.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

Mr. Chairman, I think the record should be corrected or made clear with respect to a question that was asked earlier by Congressman Curtis of all five members of the panel with respect to their belief in the independence of Federal Reserve System.

I believe all five nodded their affirmative reply, but there would be nothing in the record to indicate that.

I ask unanimous consent that the record indicate that all five members nodded in the affirmative.

Chairman PATMAN. Would you read that question again, please?

Representative WIDNALL. Mr. Chairman, Mr. Curtis earlier asked a question of the panel with respect to their belief in the independence of the Federal Reserve System. I do not recall the exact nature of the question, but I am asking that the question, in answer, show on the record that all five members nodded their assent, their affirmative reply.

Chairman PATMAN. They shook their heads, but which way?

Mr. MARTIN. I will be very glad to renod, Mr. Chairman.

Representative WIDNALL. Well, for the record, would you each indicate by yes or no, your answer to Mr. Curtis' question?

Mr. MAISEL. Yes.

Mr. MITCHELL. Yes, sir.

Mr. MARTIN. Yes.

Mr. BALDERSTON. Yes, indeed.

Mr. SHEPARDSON. Yes, sir.

Representative WIDNALL. Thank you.

Mr. Maisel, you said an attempt to characterize the votes as based on a belief in hard money or easy money is not helpful either.

Each member clearly based his vote on how he believed the Board could best insure sound money and sound growth for the economy. Would you agree with that statement, Mr. Mitchell?

Mr. MITCHELL. Yes.

Representative WIDNALL. And all the way through? The other members, too?

I am pleased to see an objective view taken of that, because sometimes, as expressed in the press, decisions are interpreted in another way.

Mr. Maisel, I believe one of the factors that you said you considered in your decision to oppose the rate increase was the desire to wait and see the budget figure as submitted by the President. Don't you believe that at this time, the budget authority has sufficient information at hand to indicate to the Congress or to the members of monetary authorities what is in prospect for January?

Mr. MAISEL. Mr. Widnall; one: I am not sure that they do. Two: I think you have brought up a question that I believe Senator Javits or Representative Curtis raised earlier. As I understand it, it is the basic problem of this committee hearing, which is to look into the question of whether we have the proper amount of coordination in this matter.

Now, I am a novice in this matter, since, as you know, I have only been here since May 1. But I must say that in the 8 months that I have been in Washington, I have personally been shocked by the lack of coordination. I think if you told the average person who thought he knew what went on in Washington about the amount of coordination between the monetary and fiscal authorities in this area, he would be similarly shocked. I think Chairman Martin has correctly brought out the amount of informal coordination that takes place. Also, while there have been some staff studies of the quadriad, all I know is that I have never received any official information in any way of the analyses of the Treasury or the Budget Bureau or the Council of Economic

Advisers, with respect to a discount rate change at this time. I did not know whether or not they felt that the economy was approaching an inflationary danger nor if such dangers were arising whether they felt that they could best be met by monetary or fiscal policy.

When I came here, I explored informally some of the problems of coordination of information and analyses. I did not push far, because I recognized that this was primarily the chairman's responsibility which he was meeting in this informal manner. The reaction I received was that in the past, when attempts had been made to increase the amount of formal coordination, they had been rejected by the Federal Reserve. I received the impression that there was a distrust of systematic and routine coordination for fear that it would interfere with the Federal Reserve's independence.

Now, as I said, this entire matter has concerned me greatly ever since I have been here. It may simply be that I am ignorant. I have only been here 8 months. But I certainly have felt a lack of any type of formal coordination, and a lack of transmission of opinion on critical matters.

I have tried informally to get some opinions from other members of the quadriad and from members of their staffs. I have talked to them on a personal basis, but I have never seen any official statement of their point of view used by the Board in the course of our deliberations.

Now the situation may have been different in the past. I can only speak for the period since I have been here. I think this was the question that was raised earlier by Mr. Curtis and Mr. Javits. I think it is a matter that this committee should consider. What are the proper relationships among the various units in the Government responsible for the different parts of policy?

Representative WIDNALL. Mr. Maisel, I would like to develop that further later.

One of the factors in your decision to oppose the rate increase is a belief there is no real danger of inflation now?

Mr. MAISEL. I tried to make it clear that I could not give any judgment as to how real the danger was until I knew what the proposed expenditure and revenue figures were for the next half year. It seemed to me that this was the critical matter. I have gone through most of the projections made by independent authorities throughout the country. All basically show a balance. I have about four or five of them here with me, in my notebook. All indicate a rate of growth of around $40 to $46 billion in the GNP for next year.

This is also about the indicated rate of growth of the real potential of the economy, that is, its ability to produce goods. Almost all of these estimates that I have seen—and these include the work of our staff and others—show a balance. As I indicated, the two critical things that we didn't know yet were the amount of Federal expenditures, and secondly, would a projection of higher expenditures lead to a rapid change in private expectations which might cause these estimates to be low.

But pending knowledge of these two things, I did not feel that we were entering any different situation. In fact, I felt the opposite, that the price pressures had definitely been reduced. Partly as a result of the President's action in aluminum and copper, but also for

technical reasons. I think you have to assume that, as you move up toward full employment, certain industries reach their capacity. Since they are industries which have had low utilization in the past, their prices tend to rise very rapidly. We know very little, however, about what may happen to prices when these industries remain at capacity.

Representative WIDNALL. Was one of the factors in your decision to oppose the rate increase the fact that you knew the President and the Secretary of the Treasury were opposed to it?

Mr. MAISEL. Yes, sir. I am not clear whether I made it as clear in my testimony as possible, but I felt that it was very important for the country that in a wartime period we support the Commander in Chief, and not appear to attack him on a specific request. My own personal feeling was that this request from the President resulted from the fact that he was unclear himself as to what would happen by January. It was our responsibility to go along for now. However, if by January we could not come to an agreement, and if at that time I was convinced that inflation was possible, then I would have felt that our independence required us to move. I didn't feel that it was proper at this time.

Representative WIDNALL. Doesn't that amount to saying that the President and Secretary of the Treasury should determine our monetary policy?

Mr. MAISEL. No, sir, not at all. I feel very strongly that by putting the pressure on the rest of the Government, as Chairman Martin did, he was forcing them to make a choice. He was forcing them to decide whether they wanted a tighter fiscal policy or a tighter monetary policy. The President was in effect being given this choice, which I think was proper. However, I was concerned because I, at least, had no indication that the President had made a choice or even that he had the figures available to make a choice. I didn't want to be premature in forcing a decision upon the President which I believed was properly his to make.

Representative WIDNALL. Mr. Martin, on the vote on raising the maximum rates payable on time deposits, what was the vote on the Board?

Mr. MARTIN. 6 to 1, Mr. Widnall; 6 to 1. Governor Robertson dissented, and we put that in our release.

Representative WIDNALL. Thank you.

Mr. Mitchell, if the Federal Reserve Board would meet tomorrow to reconsider the action taken a week ago Friday, would you vote to allow the action to stand, or would you vote to reverse the action taken?

I am asking this question because I notice a lot of press comment saying, "If the Board's action is allowed to stand," end of quote.

Mr. MITCHELL. Well, I don't think it would be wise to reverse the action taken on the discount rate. Its effect could be neutralized with open-market policy, as much as or little as is deemed desirable in view of the prospects for the economy.

While I have the floor, could I say a word about communications?

I think Governor Maisel, who says he is a novice in this instance, doesn't fully recognize that avenues of communication do exist between the Federal Reserve, the Council of Economic Advisers, and the Treasury.

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It is most important for policymakers to have the benefit of good staff advice and good staff understanding. The staffs of the Treasury, the Federal Reserve, and the Council of Economic Advisers are in constant communication with one another. In fact, if they were in any more thorough communication, they wouldn't have time to do anything on their own. There is no lack of staff communication in this situation.

There are seven members of the Board of Governors, and not every one of them can go with the Chairman when he has a meeting with the President. In fact, none of us go. The Chairman has to take the burden—the responsibility, in my judgment—for handling much of the high-level communications that exist. While I voted against the decision of the majority on December 3, I want to make clear that I believe that the Chairman has done his very best to keep the avenue of high-level communications open at all times.

Representative WIDNALL. Thank you very much, Mr. Mitchell.

Just one more question of you, Mr. Maisel, and then my time is up.

If you were again to take up this matter, I will ask you the same question I asked Mr. Mitchell, would you vote to allow the action to stand, or would you vote to reverse the action taken?

Mr. MAISEL. As I made clear, Mr. Congressman, I believe that the action is irreversible for quite a period after it is taken. I think we have ratcheted up interest rates by moving the discount rate. Therefore, the market situation is such that it could not be reversed at the end of a week or 2 weeks or in any short period. There has to be a basic change in the economy before the action could be reversed.

Representative WIDNALL. Thank you very much.

Chairman PATMAN. Mr. Martin, before we decide on the next meeting, I would like for you to bring to our next meeting some information about CD's—certificates of deposit. There are, as I showed in the first chart, about $16.5 billion of CD's outstanding. You gave out a statement, I believe, about December 1, to the effect that 30 banks had about $12 billion of these deposits, and I wish you would bring the information as to the location of those banks. You need not identify them, but I want to know what cities these banks are in, and the amount of deposits that these large banks have in proportion to the total number of the CD's. Can you furnish that information?

Mr. MARTIN. I will get you all the information we have.

(See p. 199 for answer to Chairman Patman's request.)

Chairman PATMAN. Next, I want this information—I would like to have it from 1950. I know you have it, because I have asked it and put it in the record at different times, but I do not have the last 2 years. However, I wish you would furnish it since 1950; that is about the activities of the discount windows of the 12 Federal Reserve banks and their branches. I want to know the number of applications that have been made each year, and also the amount involved in the applications each year, broken down as to the 12 banks and the branches, 1950 up to date. Will you try to furnish that, please, sir?

Mr. MARTIN. I will do the best I can.

Chairman PATMAN. All right, sir.

(See p. 190 for information subsequently supplied relative to above.)

Chairman PATMAN. Now, then, when can we come back? Will 2:30 be all right?

All right with you, gentlemen?

Mr. MARTIN. That's all right with me.

I want to make clear that I have to be in New York on Thursday, and I intend to go away the end of this week, over Christmas. I just want to make that clear right now.

Chairman PATMAN. I don't think there is any problem presented there, Mr. Chairman, because the members have their own problems in that direction, too.

We will do the best we can. We appreciate your cooperation. We shall expect you here at 2:30 this afternoon. We will stand at recess until 2:30 this afternoon.

(Whereupon, at 1 p.m. the committee recessed until 2:30 p.m., the same day.)

AFTERNOON SESSION

Chairman PATMAN. The committee will please come to order.

We have a number of statements filed by people who would like to have them placed in the record.

I would like to have an understanding, if I may, that all statements will be filed with the staff director, Mr. Knowles, and the chairman will have the power to put those in the record that he believes are related to what we are doing at the appropriate place. If he is of the opinion that one should not be inserted he will confer with the ranking minority member and make a decision after consideration.

Is there any objection to that?

Senator JAVITS. Mr. Chairman, certainly there is no objection. I think that is very fair in view of the fact that if the minority feels the statement is being excluded that ought to be in, the minority itself can put it in, or read it in. So that I think every person is fully protected.

I would suggest, Mr. Chairman, and I now hand to the chairman a statement by the United States Savings & Loan League for consideration by the chairman in accordance with his understanding.

Chairman PATMAN. Thank you, sir. It will be included.

(Material referred to follows:)

UNITED STATES SAVINGS & LOAN LEAGUE,
Washington, D.C., December 9, 1965.

HON. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Longworth House Office Building,
Washington, D.C.

DEAR CHAIRMAN PATMAN: Attached is the text of the United States Savings & Loan League's statement criticizing last weekend's action in raising the ceiling on time deposits in banks from 4½ to 5½ percent. I know that as chairman of the Joint Economic Committee you are studying this development and its impact on the public interest and the entire financial community.

Actually, we consider this action as merely the latest in a long series of actions enlarging the powers of commercial banks and increasing their dominance of the financial community at the expense of the so-called nonbanking institutions such as savings and loan associations, savings banks, and credit unions.

The succession of increases permitted under regulation Q have encouraged banks over the past few years to very substantially increase the rate paid on time deposits. As a result, they have greatly increased the percentage of the total savings which they control. In the first half of 1965, time deposits in banks increased $10.4 billion, 22 percent above the first half of 1964. By contrast, savings and loan associations added $4.2 billion to savings in the first half of 1965, down 22 percent from last year.

While banks rates have been spiraling upward, dividends paid by savings and loan associations have been virtually stable. The average rate has increased only four one-hundredths of 1 percent, from 4.28 to 4.32 percent between mid-1963 and mid-1965.

The stabilized dividend rate and the slowdown in growth of the savings and loan business are the result of a combination of restrictive regulations by the Federal Home Loan Bank Board and a deliberate management policy of avoiding "growth for growth's sake." In view of conditions in the real estate market and the temporarily reduced role of housing in the national economy, a slower growth of our business was believed desirable from the point of view of overall economic policy and the national welfare.

While our business has gone through a period of moderation, the banks have been pushing ahead full steam. Record numbers of new banks have been chartered, new powers have been obtained or assumed, and banks have entered into a variety of nonbanking businesses. Banks have purchased mortgage companies, entered the accounting services business, acquired cerdit card plans, and engaged in equipment leasing.

In spite of the fact that certificates of deposit were the prime factor in the failure of several banks, the upward spiral in these instruments has been permitted unchallenged by the Federal banking agencies. Indeed, it seems clear that the concentration of CD's in big city banks was the deciding factor in last weekend's boost in regulation Q. The entire financial community is being placed in a turmoil because of irresponsible banking practices which went unchecked by the authorities.

The attached story from the American Banker of December 2, 1965, reports on the continued buildup of certificates of deposit, and the story from the Chicago Daily News, after the rate increase, quotes the head of the First National Bank of Chicago as saying, "If we didn't have the new ceiling on this type of deposits, we would have a problem."

We hope that the Congress will look into all of these matters so that steps can be taken to restore balance and to avoid future recurrences.

The savings and loan business is in very sound condition and we do not contend that the bank competition places our institutions per se in any jeopardy. We do feel that the siphoning of savings from our institutions into commercial banks will quickly reduce money available for mortgage lending and of a necessity increase the cost of borrowing. This is because savings and loans invest almost 100 percent of their savings in mortgages, whereas only a fraction of time deposits in banks find their way to the mortgage market.

We feel that the broad general allocation of credit is the prerogative of the Congress and the President and not that of a single banking agency on a 4-to-3 vote.

The issues involved touch the entire economy and greatly affect the public interest. We feel that the appropriate committees will want to carefully study this question and hear from all interested parties. In this connection, you can be assured of the full cooperation of the United States Savings & Loan League.

Sincerely,

STEPHEN SLIPHER, *Legislative Director.*

The following statement was issued today by Norman Strunk, executive vice president of the United States Savings & Loan League, in commenting on a Federal Reserve Board decision to increase interest rate ceilings on commercial bank certificates of deposit and other time money from 4½ to 5½ percent:

"The action of the Federal Reserve Board in boosting the ceiling on certificates of deposit to 5½ percent is nothing short of incredible. It will mean substantially higher interest rates throughout the economy and probably usher in an acute shortage of mortgage credit.

"One measure of the extremeness of this action is seen in the fact that only a week ago the Federal Home Loan Bank Board had proposed an investment bonus plan for long-term, lump-sum accounts in savings and loan associations with a rate ceiling of 4½ percent. Now the Federal Reserve has set the limit on commercial bank time money 1 full percent higher.

"For several months, the Federal Reserve has been warning against a buildup in certificates of deposit on the part of commercial banks, particularly a small group of large banks, on the grounds that these banks would face grave liquidity problems as these certificates expired. The issuance of huge sums of short-term certificates of deposit by a small number of big city commercial banks can

only be described as irresponsible banking practice. Now the Federal Reserve has decided to bail out the big banks from this liquidity squeeze under the guise of aiding the fight against inflation.

"As an independent body, the Federal Reserve could have moved earlier and thus more effectively against the threat of inflation. It also had the power to prevent the unhealthy increase in outstanding certificates of deposit. In each instance, it failed to act.

"We are unable to escape the conclusion that in making its decisions, the Federal Reserve is overly considerate of the welfare of the large commercial banks, and less concerned than it should be over the welfare of other businesses and the American people. The Federal Reserve is a creature of Congress, and we hope that Congress will take steps to correct this deficiency in 1966."

[From the American Banker, Dec. 2, 1965]

FRB Notes Increase in CD's Outstanding

WASHINGTON.—The Federal Reserve Board has reported an increase in the number of certificates of deposit outstanding to $16.4 billion as of November 17.

The figure, based on reports from 245 banks, was included in the Fed's quarterly survey of the maturity structure of negotiable time CD's outstanding in denominations of $100,000 or more.

At the time of the previous survey—in August—the Fed said that 249 banks reported $16 billion in outstanding CD's.

The report said that nearly three-fourths of outstanding CD's listed in the last survey—or about $12.2 billion—mature during a 4-month period ending March 1966.

It said the largest monthly total, $3.5 billion, will mature during December when corporate needs for funds for tax and dividend payments will be heavy.

The approximate average maturity of outstanding CD's on November 17 was 3.4 months compared to a 3.9-month average reported in the August survey.

[From the Chicago Daily News, Dec. 7, 1965]

Interest Rate Hike—Banks To Use Funds on CD's

(By Albert Jedlicka)

Chicago's two giant commercial banks moved quickly to raise their interest rates on short-term corporate savings following authorization of such action by the Federal Reserve Board.

The higher rates are expected to aid the large banks in Chicago in meeting the maturity of $1.238 billion in negotiable certificates of deposit in the next 6 months.

Approximately $956 million will fall due in the next 3 months.

Total holdings on November 17 were $1.407 billion.

"If we didn't have the new ceiling on this type of deposits, we'd have a problem," said Raymond H. Becker, executive vice president and cashier of the First National Bank of Chicago. "The new rates will enable the banks to attract new investment funds or to hold on to CD money."

The new ceiling of 5½ percent on an annual basis, which supplants the former top of 4½ percent, will make the banks more competitive for the investment dollar in the money market, notes Becker.

Terms also have been liberalized to the extent that the 5½ percent top applies to all CD's of 30 days or more. Formerly the banks were limited to paying 4 percent on CD's of up to 89 days, with the 4½ percent rate payable on certificates beyond 90 days.

Neither the Continental Illinois National Bank & Trust Co. nor the First National, which immediately boosted their CD interest ceiling, raised the rate the maximum allowed by the Fed.

Continental announced it will now pay 4.5 percent for 30 days; 4.55 percent for 60 days; 4.65 percent for 120 days, and 4.70 for 180 days.

Becker disclosed that the First National also will pay the 4.7 percent top for 180 days.

The banks have been selling the negotiable certificates in amounts of $500,000 and more.

Donald C. Miller, a vice president of Continental said the bank has issued CD's in denominations of as much as $5 to $10 million to large corporate investors.

Funds accumulated can be used as needed for taxes, dividends or payment of corporate debt obligations.

Some Loop bankers observed that the higher ceiling may have an impact on activity in personal or nonnegotiable CD's. Thus far, the major banks have not pushed this type of savings strongly.

As of October, the big banks held $162 million of personal CD's down from $167 million for the same month in 1964.

"We've been paying from 4⅛ to 4¼ percent on these nonnegotiables held in large amounts for the 3 to 6 months," said Becker. "We will cross the bridge in the future on whether to pay a higher rate on these CD's.

NATIONAL LEAGUE OF
INSURED SAVINGS ASSOCIATIONS,
Washington, D.C., December 10, 1965.

Hon. WRIGHT PATMAN,
Chairman, Committee on Banking and Currency,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: I am enclosing a copy of the national league's statement concerning the action of the Federal Reserve Board in authorizing the new 5½ percent rate ceiling on time deposits and certificates of deposit. You will note that National League President Harry P. Greep has termed the Board's action "irresponsible" because of its widespread adverse impact on the economy and, in particular, in the Nation's housing markets.

WILLIAM J. KERWIN,
Assistant Executive Director.

* * * * * * *

TEXT OF STATEMENT ON FEDERAL RESERVE ACTION ON REGULATION Q BY NATIONAL LEAGUE OF INSURED SAVINGS ASSOCIATIONS

In contrast to savings and loan associations, commercial banks enjoy numerous investment privileges which tend to increase their earnings capability. Banks, for example, enjoy the unique privilege of money creation; they hold substantial amounts of "free" money in the form of checking accounts available for investment purposes; and there is no limit on the range of commercial bank investments.

Savings and loan associations for all practical purposes are single-purpose lenders imprisoned by the mortgage market. Declining real estate activity affects the fortunes of the savings and loan business just as much as a boom in real estate—a point which was stressed in the 1962 fight over savings and loan taxation. Reduced real estate investment opportunities have during the past year caused savings and loan management to reevaluate policies and practices this year and the Federal Home Loan Bank Board to tighten its regulations further in the light of its evaluation of national objectives. The combination of interacting forces will result in a savings growth, for example, this year of about $8 billion as contrasted with $12 billion in 1964, for the savings and loan industry. The one-third savings and loan drop compares to a more than one-fifth increase in commercial bank time deposits. At this point it is almost impossible to predict 1966 performance but it seems perfectly apparent that net savings inflow will decline further and that the Federal home loan bank system will feel new pressure for advances, particularly if commercial banks raise their rates and siphon off funds from thrift institutions.

The national league believes that the time has come for the Congress to consider the possibility of broadening the investment powers of thrift institutions including passage of legislation such as the bill recently introduced, H.R. 8199, which would provide Federal associations with power to offer convenience checking accounts to their members.

Sincerely yours,

WILLIAM J. KERWIN,
Assistant Executive Director.

[From the Savings & Loan News, published by the National League of Insured Savings Associations]

WASHINGTON, December 6.—A savings and loan industry official warned today that the Federal Reserve Board's policy switch to higher interest rates may mean a reduction in funds available for home financing, higher rates on home mortgages, and possible curtailment of housing operations in 1966.

Harry P. Greep, president of the National League of Insured Savings Associations, said that the FRB action also "collides head on" with a 2-year effort by the Federal Home Loan Bank Board to hold down rates paid by savings and loan associations.

Greep pointed out that during the past year mortgage rates have been inching upward while the availability of savings funds for home financing has declined sharply. Savings associations—the Nation's prime source of home mortgage money—are expected to increase their savings deposits about $8 billion this year as compared with $12 billion in 1964. In part, this is due to higher rates paid recently by banks on certificates of deposit.

Greep, president of Atlantic Federal Savings & Loan Association of Fort Lauderdale, Fla., said that an increase in the reserve system's rediscount rate was anticipated by the savings and loan industry and plans were made accordingly.

But the national league president declared: "The Federal Reserve in effect has also granted commercial banks the power to commandeer the available supply of new savings by boosting the rate as high as 5½ percent as opposed to the previous ceiling of 4½ percent. In effect, the FRB has removed the rate ceiling on certificates of deposit and time savings certificates, and this could produce a massive shift in savings funds away from thrift institutions into commercial banks.

"To the extent that funds shift from thrift institutions to commercial banks, the available supply of funds for home financing will tighten and produce corresponding increases in mortgage rates simply because banks invest in mortgage loans in only a limited way.

"Recently, there have been indications that the decline in home construction has turned a corner and might even increase in 1966. The irresponsible action of the Federal Reserve on rate ceilings is likely to reduce new home construction, raise interest rates on home mortgage loans, increase downpayments and, in general, frustrate any move toward recovery in housing markets in 1966."

Although dividend rates paid by savings and loan associations are not specifically controlled by the Federal Home Loan Bank Board, the FHLBB over the years has exercised tacit control over rates through its regulatory machinery.

Greep said: "The Federal Reserve action again will hurt housing markets and may precipitate the kind of destructive competition for savings funds which occurred in the 1920's and led to the congressional enactment of rate controls on bank deposits. We urge the Federal Reserve Board to reconsider its action in the light of the serious public interest questions involved in sanctioning an almost unbelievable rate structure in the commercial banking industry."

Senator JAVITS. May I also, Mr. Chairman, suggest that those who have sent statements to our committee release them if they wish the public generally to know about it. It will be the understanding that these statements will be made a part of our record at the next session of the committee which might come tomorrow afternoon or on Wednesday.

Chairman PATMAN. Let us have this further understanding, that all statements heretofore filed and now on file and which will be filed between now and tomorrow at noon, will be made public as of tomorrow. Anyone filing a statement is privileged to release it to the press as of tomorrow if they desire.

Senator JAVITS. Very good.

Chairman PATMAN. Are you gentlemen ready to proceed?

Mr. MARTIN. We are. I would like to put in the record an answer to Mr. Reuss.

Chairman PATMAN. Mr. Reuss will be interrogating you later, Mr. Martin. I think that would be a good time to do it. I think it is my time to interrogate the witness now.

I want to ask you about the $16.5 billion in certificates of deposit. This is a relatively new innovation in banking, is it not, Mr. Martin?

Mr. MARTIN. Relatively new. Your request for statistics since 1950 on this—it will take a week or two for our division to complete that.

Chairman PATMAN. That is not on negotiable certificates of deposit, Mr. Martin. This is on the applications to the discount window.

Mr. MARTIN. I thought you wanted the other material, also.

Chairman PATMAN. I don't think they went that far back, did they? I don't think they have gone back more than 5 years to amount to anything.

Mr. MARTIN. I don't know——

Mr. MITCHELL. The certificates that are negotiable go back to February 1961. The certificates of deposit that are not negotiable have been in use for a long time.

Chairman PATMAN. Which ones did you say?

Mr. MITCHELL. The negotiable. That is the total you are looking at.

Chairman PATMAN. That is right.

Mr. MITCHELL. They go back 4 years.

Chairman PATMAN. Four years?

Mr. MITCHELL. Four years.

Chairman PATMAN. Those are the ones that disturb me. You stated there was considerable pressure brought to bear on you to do something about increasing the maximum allowable interest rates on these CD's at once, Mr. Martin. Who is bringing the most pressure?

Mr. MARTIN. There is no pressure brought on me. We have a Federal Advisory Council that meets with us. This matter was discussed but there has been no pressure that I know of.

Chairman PATMAN. I understood you to be quoted in the New York Times, or the Wall Street Journal, that the New York banks had called you a number of times about this, including Mr. Hayes, president of the New York Federal Reserve Bank.

Mr. MARTIN. That is incorrect.

Chairman PATMAN. You had no pressure from the New York banks?

Mr. MARTIN. The System discussed this from time to time, but I don't consider that pressure.

Chairman PATMAN. Did you have a request from Chicago—from bankers there—to do something about it at once?

Mr. MARTIN. We have had this matter called to our attention at almost every meeting of our committee.

Chairman PATMAN. All of them clamoring for an increase in the rates?

Mr. MARTIN. No; all of them raising the point that if market rates moved above the ceiling rates that they would be worried about being able to renew their certificates of deposit; that is all.

Chairman PATMAN. What?

Mr. MARTIN. They would be worried about being able to renew them.

Chairman PATMAN. That is the point I am getting at. Now a large part of these certificates are due the next 30 to 60 to 90 days, aren't they?

Mr. MARTIN. Many of them, that is right.

Chairman PATMAN. If they didn't get this rate increase they would be in difficulty, would they not? They would be withdrawn—not rolled over some way in the event they were unsuccessful in renewing

Mr. MARTIN. They might or might not, depending on the conditions in the market.

Chairman PATMAN. Have you not been studying how these could be rolled over someway in the event they were unsuccessful in renewing the certificates of deposits?

Mr. MARTIN. This is our business.

Chairman PATMAN. I did not ask you if this is your business. I asked you if you haven't made a study of it.

Mr. MARTIN. I don't know. It may be that we have studies at the Board that would be helpful.

Chairman PATMAN. Mr. Martin, you can't debate it that way. It is just recently that you have been alarmed about what would happen if these banks were unable to renew—roll over—these certificates of deposit. Were you alarmed to the extent that you had a study made to determine whether or not the banks could handle them some way, if they were not renewed?

Mr. MARTIN. Governor Mitchell, here, has made some comments in a talk on it; very effective comments. I think this is a very appropriate activity for us to engage in.

Chairman PATMAN. It seems, Mr. Martin, that you are not considering the matter from the public interest. Of course, you are looking at it from your viewpoint—the bank's viewpoint. I don't impugn your motives or anything like that, but you and the Board had in mind protecting these 30 banks or so that have these tremendous amounts of certificates of deposit that will be maturing in 30, 60, or 90 days. Unless the Board provided for a substantial increase in the maximum rate that could be paid on these CD's—as you did, from 4 to 5½ percent—many of the corporations holding these CD's would cash them in because otherwise they could get a better return even by investing in short-term Government bonds.

As I understand it, on the CD time deposits, the maximum rate was 4 percent but you raised it. Isn't that correct?

Mr. MARTIN. We lifted it to 5½ percent across the board.

Chairman PATMAN. That is right. Therefore, those large banks who are hurting are relieved because they can negotiate with these corporations and persuade them to roll them over at the higher 5½ percent rate.

Mr. MARTIN. That is the permissive rate.

Chairman PATMAN. That is right. The corporation holding 4½ percent CD's will now be offered up to 5½ percent. You said in your release this action was taken to help the small banks. How are you going to help the small banks by raising the time deposit rate to 5½ percent when I am sure you know, Mr. Martin, that the small banks can't compete with the big banks on something like this.

Mr. MARTIN. When this rate bumps against the ceiling it is almost impossible for the small bank to get funds to compete. Now that there is maximum latitude there is an opportunity for the small bank to meet its requirements.

Chairman PATMAN. That is before it reaches its 5 percent.

Mr. MARTIN. Before it reaches 5½ percent.

Chairman PATMAN. I mean 5½ percent. But announcements are being made all over the country; there was one in the paper yesterday about a bank offering 5½ percent. The small banks can't compete with that.

(Items illustrating above-mentioned action discussed by Chairman Patman follow:)

MIAMI NATIONAL BANK,
Miami, Fla., December 9, 1965.

Mr. J. O'HARA SMITH,
President, Occidental Savings & Loan Association,
Stanton, Calif.

DEAR MR. SMITH: We are pleased to inform you that Miami National Bank once again takes the initiative by offering purchasers of time certificates of deposit a full 5½ percent interest per annum, as permitted by the Federal Reserve Board.

Miami National Bank is actively seeking to acquire new savings and loan association investors as well as serving our old customers. May we suggest that you immediately consider taking advantage of this interest hike by purchasing a $10,000 certificate of deposit for a minimum period of 1 year, properly insured by the Federal Deposit Insurance Corporation, since we will not permit our total time deposits to exceed reasonable limits.

Please accept our heartiest wishes to you, your directors, officers, and staff for a most pleasant holiday and a prosperous and healthy new year.

Very truly yours,

VANCE FOSTER, *President.*

P.S.—I would appreciate hearing from you at your earliest convenience.

(An identical copy of the above letter was received by Mr. R. W. Elliott, president of the Southwest Savings & Loan Association, Abilene, Tex., and Mr. J. F. Bass III, president, Englewood Savings & Loan Association, Englewood, Fla.)

(The following advertisement appeared in the business and finance section of the Los Angeles Times, on Monday morning, December 13, 1965.)

SURETY NATIONAL BANK SAVINGS BONDS GIVE YOU MORE DOLLARS—COMPARE

Compare these rates available in the Nation with the 5½-percent rate you receive on the new Surety National Bank savings bonds.

[In percent]

Type of investment	Current rates	Surety savings bonds
Savings and loan associations	4.8 to 4.85	5½
Commercial banks (savings accounts)	4	5½
U.S. savings bonds	3¾	5½
U.S. securities (5-year maturity)	4³⁄₁₀	5½
Common stocks (average)	3	5½

Discount bonds (series A).—Buy at $19.03 to $761 per bond individually. Here's how your dollars grow—if you keep your $19.03 bond for 5 years, it's worth $25—a return of 31.4 percent profit.

Income bonds (series MI).—Multiples of $100, with a $1,000 minimum. Simple interest of 5½ percent per year is sent you monthly by check. Payments start the first month following date of your purchase.

Growth bonds (series MC).—Issued in multiples of $100. You pay face amount; interest is accumulated until maturity. Redeemable at face value, plus 5½

percent annual interest compounded quarterly. Held to maturity, they return 31.4 percent profit.

Income bonds (series SI).—Multiples of $100, with a $500 minimum. Your 5½ percent per year, compounded quarterly, is paid semiannually by check.

Now get the highest guaranteed interest rate available in the Nation—with our new savings bonds—5½ percent interest guaranteed from 90 days to 5 years and insured by the Federal Deposit Insurance Corporation. Come in today—or phone or write our savings bond department to get full details about these great new bonds, which guarantee higher interest rates than savings and loan associations. Now you can conduct all your financial transactions—more profitably in one place—at Surety National Bank. Bonds available only to individuals and nonprofit groups.

* * * * * * *

[From the American Banker, Dec. 15, 1965]

CALIFORNIA BANK POSTS Q LIMIT—5½ PERCENT ON "SAVINGS BONDS"

ENCINO, CALIF.—Surety National Bank Tuesday increased the rate on its various savings bonds to 5½ percent on minimums of $1,000 for deposits of 90 days and more, thus reaching the new Regulation Q ceiling.

O. L. Grossman, chairman and president, said "We have always paid the top rate on our savings bonds and we decided to continue."

He noted that the majority of bondholders are retired people and others "who leave their money with us forever." He said the bank sets a $25,000 maximum on individual holdings. Surety has $15 million in deposits, with $600,000 outstanding in savings bonds.

Mr. Grossman said "we have never cashed in a bond yet, and don't expect to, so we don't have the liquidity problems that we'd face with certificates of deposits in large amount."

He said a corporate CD would have to "give us a guarantee it would stay with us for a full year" before the bank would pay the 5½-percent rate on large deposits.

Several other small banks in California posted a 5-percent time deposit rate Monday, but there has been no change in the rates offered for the savings dollar by any of the State's giant retail banking chains.

Savings and loan associations in the State reportedly are holding off any announcement on rates for the first quarter of 1966, pending action by the big banks. The prevailing S. & L. rate is 4.85 percent, with some associations offering bonus dividends on 3-year money.

Another factor affecting California S. & L.'s is, of course, the rates paid by east coast banks. One estimate of total out-of-State holdings by associations here is 24 percent of savings.

Home Savings & Loan Association, Los Angeles, the Nation's largest S. & L. with $1.7 billion in savings shares, said its December directors' meeting is scheduled next week and the first-quarter rate will be set at that time. Spokesmen declined to say whether management will recommend any increase.

In Houston, Medical Center National Bank, a $15.8 million deposit institution, posted a 5-percent rate on its savings certificates, with a $1,000 minimum on 6-month money.

Other banks in the area said they were studying the move, but the larger Houston banks were expected to maintain present rates and seek large corporate deposits rather than consumer funds.

Texas National Bank of Commerce reported it is paying 4.75 percent on 6-month deposits of $500,000 and above. Texas-Commerce is the city's second largest bank with more than $700 million in deposits.

Most savings and loan associations in the area are at 4½ percent, with some suburban associations at slightly higher rates.

Rex Baker, president of the $57 million Southwestern Savings Association, said he does not anticipate a rate change unless there "is a substantial drain" of funds.

Mr. Baker, a member of the Texas Finance Commission, said he hopes the commission will introduce a regulation permitting State-chartered associations to pay a variable dividend, thus allowing them "to make contracts with savers similar to CD's."

In New York, most saving banks and savings and loan associations appeared to be waiting for Bowery Savings Bank, the Nation's largest mutual, to announce its first-quarter rate before making any moves.

Meanwhile, Manufacturers Hanover Trust Co. moved to match the consumer time deposit rates set earlier by First National City Bank and Bankers Trust Co.

Manufacturers posted a 4½-percent rate on 6-month income certificates in amounts of $10,000 or more, and a 4¼-percent rate on 60- to 179-day paper. The bank previously paid 4¼ percent on 6-month money and 4 percent on 90- to 179-day certificates.

MEDICAL CENTER NATIONAL BANK,
Houston, Tex., December 15, 1965.

SOUTHWEST SAVINGS & LOAN ASSOCIATION,
Abilene, Tex.

GENTLEMEN: Please be advised that we will pay 5 percent annual interest on certificates of deposit from $1,000 to $10,000 held for 6 months. Interest on these certificates will be paid quarterly.

These deposits are insured by FDIC to $10,000.

If you desire in the future to purchase certificates of deposit at 5 percent, we shall be most happy to issue them on an automatically renewable basis for additional periods of 90 days at each maturity.

The wording on the certificate is as follows:

"This certificate will be automatically renewed at the stated interest rate, if permitted by regulation, for an additional period of 90 days if not presented for redemption within 10 days after maturity. A like extension will be issued at each maturity date thereafter."

If you have funds available for investment at this yield, we shall be pleased to accept them.

Yours very truly,

LAWRENCE G. FRASER,
Vice President.

FIRST FEDERAL SAVINGS,
Everett, Wash., December 20, 1965.

Congressman WRIGHT PATMAN,
House Office Building,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: The recent action by the Federal Reserve Bank Board in raising the rediscount rates has already had its effect on the local lending market.

Interest rates at the banks is up from one-fourth to one-half percent. I have on my desk a letter from a large bank which offers 5 percent on certificates of deposit. Such action will of course draw money away from the savings and loan associations who loan for the purpose of buying or building homes to the commerical banks where it will be invested in either tax-exempt municipal bonds or high interest rate consumer loans.

Very truly yours,

ROBERT M. HUMPHREY.

MANUFACTURERS BANK,
Los Angeles, Calif., December 1965.

Re 5-percent certificates of deposit.

DEAR CUSTOMERS AND FRIENDS: Effective immediately, Manufacturers Bank is issuing certificates of deposit with an increased yield of 5 percent per annum on certificates of $10,000 or more. As you know, the Federal Deposit Insurance Corporation, of which we are a member, recently allowed this increase for funds held 91 days or more. We quickly wanted to make this increase available to our many customers and friends in the savings and loan industry.

We know that you will want to consider this high-yield opportunity to assure maximum return on your 1966 cash reserve. As of September 30, 1965, Manufacturers Bank published statement of condition deposits were $45 million, therefore you may purchase certificates of deposit up to $110,000 and have these funds qualified as part of your cash reserve requirement.

Simply make your check payable to Manufacturers Bank, and indicate a 3-, 6-, or 12-month certificate, and whether or not you would like interest paid quarterly.

If you have any questions please feel free to write or call collect. A postage-paid return envelope is enclosed for your convenience.

Our best wishes for progress and prosperity during the next year.

Cordially,

LEONARD WEIL, *President.*

ISLAND FEDERAL SAVINGS & LOAN ASSOCIATION OF HONOLULU,
Honolulu, Hawaii, December 22, 1965.

Hon. WRIGHT PATMAN,
U.S. House of Representatives,
Washington, D.C.

SIR: I am confirming the cablegram[1] which we sent you this morning as follows:

"American Security Bank of Honolulu announced yesterday 5-percent CD rate on 6-month certificate guaranteed interest payable quarterly from date of deposit. Large two-color ad today makes no mention, but news release states $400 minimum. Bank says higher rate is necessary to attract needed loan funds to Hawaii. We and other savings and loan associations also need a higher rate to attract needed mortgage funds to Hawaii and to stop withdrawals. Now impossible to hold back the banks. Request immediate lifting of rate controls here either by complete removal or by change of 'prevailing rate' to 5 percent or 5.5 percent.

"CLIFF KRUEGER, *President.*"

We enclose clippings of the ad and news story pertaining to the American Security Bank's announcement.

We earnestly believe that the problem is no longer to be laid at the feet of the Federal Reserve Board but that constructive action must be taken by the Federal Home Loan Bank Board in order to assist us. Raising of their de facto control to 4.75 percent may be of some assistance to associations east of the Mississippi River, but we in the West and Far West need assistance also. Hawaii is a capital-short area with a strong loan demand and a busy and active construction industry. This industry deserves financial support from savings and loan associations. We hope that the Federal Home Loan Bank Board will be responsive to our needs.

Cordially,

CLIFF W. KRUEGER, *President.*

[From the Honolulu Advertiser, Dec. 22, 1965]

AMERICAN SECURITY BANK UPS INTEREST

(By Emil A. Schneider)

American Security Bank announced last night that it is boosting its interest paid on savings certificates of deposit to a maximum of 5 percent, effective immediately.

The bank is the first of the seven banks in Hawaii to announce higher interest on this type of savings since authorization was granted by Federal bank regulatory agencies 2 weeks ago.

The authorization for higher rates has created fears in some circles, particularly on the mainland, that it might produce a rate war between banks and savings and loan associations in competition for the saver's dollars.

Related to these fears is concern that higher rates, especially if they spread to savings and loans, might help to force increases in interest rates on mortgage loans.

The 5 percent rate announced by American Security Bank will be higher than any paid by savings and loan associations here for savings. The prevailing S. & L. rate there is 4.75 percent, with one association paying 4.85 percent.

Banks previously had been limited to 4½ percent interest rates on certificates of deposit. A growing number of banks on the Mainland have announced higher rates recently but only a couple have gone to the new maximum of 5½ percent.

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[1] Cablegram in committee files.

The 5 percent rate to be paid by American Security Bank will be offered only on certificates of deposit of 6 months' maturity or longer. The minimum denomination will remain at $400 as in the past, a spokesman said. The bank has been paying 4½ percent interest on 6-month CD's.

The bank also announced increases on CD's of shorter maturities.

CD's of 30 days to less than 90 days maturity are being boosted from 4 to 4¼ percent interest, and those from 90 days to less than 6 months are being raised from 4¼ to 4½ percent rates.

William K. H. Mau, board chairman and chief executive officer of American Security, pointed out that the new rates apply both to newly issued CD's and to those that are renewed at the bank.

"Although this interest increase will invariably increase the interest cost to the bank." Mau said, "it is incumbent upon the American Security Bank to attract more local and mainland deposits to continue its participation in Hawaii's expanding economy.

"Recent published reports," he noted, "have already indicated a trend toward higher interest rates to be paid on time (savings) certificates of deposit by commercial banks nationally."

The authorization to pay higher rates on savings certificates by banks was announced December 5 by the Federal Reserve Board. At the same time the board increased the discount rate to 4½ percent for funds borrowed by member banks from Federal Reserve banks. This led to a boost to 5 percent on the "prime" interest rate charged by banks on business loans.

However, the maximum interest rate that banks can pay on regular passbook savings accounts remains unchanged at 4 percent. CD deposits, like passbook savings at banks, are insured for up to $10,000 by the Federal Deposit Insurance Corporation (FDIC).

LAWN SAVINGS & LOAN ASSOCIATION,
Chicago, Ill., December 20, 1965.

Hon. WRIGHT PATMAN,
Chairman of the House Banking and Currency Committee, House of Representatives, Washington, D.C.

DEAR CONGRESSMAN: This is the latest development on the banks "rating" plans on savings and loan association funds. We wonder how much of these transfer funds will be allocated by Exchange National into the home market, which is 90 percent financed by savings and loans.

Yours very truly,

HENRY KRUEGER, *President.*

[From the American Banker, Dec. 14, 1965]

MORE BANKS RAISE "CONSUMER" CD RATES; FUNDS DRAWING AS MUCH AS 5 PERCENT IN CALIFORNIA

(By James R. Hambelton)

NEW YORK.—A growing number of banks posted higher rates on savings Monday as the increases which began here last week spread across the Nation.

Banks in Detroit, St. Louis, and Los Angeles, among others, raised their rates on "consumer" deposit certificates, in some cases to as much as 5 percent for 6-month money in amounts down to $1.

At the same time, while savings and loan associations were considering competitive moves, the largest in Michigan, First Federal Savings of Detroit went to 4¼ percent, up from 4 percent on regular accounts and other S. & L.'s in the area were expected to follow suit. The belief is that a number of California S. & L.'s will go to 5 percent, up from the 4.85 percent many now are paying.

As banks lowered, the maturity and dollar amount of CD's which would be eligible for the new rates, the Federal Deposit Insurance Corporation was described as "giving some serious thought" to a new regulation that would place a minimum dollar amount on CD's.

Whether the FDIC will act, or whether it even has legal authority to impose such a dollar limit still is uncertain. The idea of such a regulation, however, would be to make CD's less competitive with passbook savings under the new rate structure. In lifting the CD ceiling the Federal Reserve Board deliberately left unchanged the 4 percent ceiling on passbook savings.

EFFECTIVE IMMEDIATELY

SAVINGS CERTIFICATES of 6 months or longer will pay you

EFFECTIVE IMMEDIATELY SAVINGS CERTIFICATES of 3 months to less than 6 months will pay you

4.50%

GUARANTEED INTEREST PER ANNUM
INTEREST STARTS FROM DATE OF DEPOSIT

EFFECTIVE IMMEDIATELY SAVINGS CERTIFICATES of 1 month to less than 3 months will pay you

4.25%

GUARANTEED INTEREST PER ANNUM
INTEREST STARTS FROM DATE OF DEPOSIT

REGULAR PASSBOOK SAVINGS ACCOUNTS will pay you

4%

GUARANTEED INTEREST PER ANNUM
COMPUTED MONTHLY—PAYABLE QUARTERLY
SAVINGS DEPOSITED BY THE 10TH OF THE MONTH EARN FROM THE 1ST

New interest rates applicable only on new and renewed savings certificates.

You get more for your money at

Hawaii's First Insured Bank

MEMBER FEDERAL DEPOSIT INSURANCE CORPORATION

Home Office: Kalakaua & Seaside / Downtown Office: King & Nuuanu
Liliha Office: Liliha St. at Vineyard / Kalihi Office: Opposite Kalihi Fire Station
Waipahu Office: Opposite Waipahu Hi School / Makiki Office: Beretania & Keeaumoku
Kaimuki Office: Koko Head Ave. off Waialae / Kapahulu Office: Kapahulu & Mokihana
Hilo Office: Waianuenue & Keawe

EXCHANGE NATIONAL BANK ANNOUNCES

CHICAGO TRIBUNE, SUNDAY, DECEMBER 19, 1965

5% ON SAVINGS CERTIFICATES

Now, Exchange National Bank pays 5% simple interest on Savings Certificates (a Time Deposit) when held to maturity... a new, bank-safe program for individuals, partnerships, corporations and non-profit organizations. This new program pays a guaranteed $5 for every $4 deposited... or 25% for a five-year maturity. Interest begins on date of purchase. Savings Certificates are offered in increments of $500, with a limit of $25,000 to any one individual, partnership or corporation.

SAMPLE GROWTH CHART

ISSUE PRICE	MATURITY VALUE
$ 500	$ 625
1,000	1,250
2,500	3,125
5,000	6,250
10,000	12,500
25,000	31,250

Savings Certificates also available on a discounted basis.

LIQUIDITY—Exchange National Bank Savings Certificates mature in five years and are completely negotiable. Or, if direct redemption is preferred, they may be redeemed at Exchange National Bank three months after date of issue, or within ten days after any subsequent three-month period, without prior notice. At such time, you will receive the amount indicated on your Savings Certificate redemption schedule.

COMPLETE BANK SAFETY—Exchange National Savings Certificates are backed by the full resources of The Exchange National Bank of Chicago, one of Chicago's leading banks... insured by the Federal Deposit Insurance Corporation.

IDEAL AS INVESTMENTS OR GIFTS—The same qualities that make Savings Certificates an outstanding investment—liquidity, safety and excellent return—make them outstanding gifts as well. They are ideal gifts for newlyweds, graduates, new grandchildren or charitable organizations... whomever you wish to honor.

Visit Your Exchange National Counselor Banker ... or use The Coupon:

Order Form—
Exchange National Savings Certificates

Customer Service Division
EXCHANGE NATIONAL BANK of CHICAGO
LaSalle and Adams Streets • Chicago, Illinois 60690
Telephone 332-5000; Area Code 312

Please issue Exchange National Savings Certificate(s) (a Time Deposit) in the following amount(s) (any multiple of $500) and in the name(s) indicated:

$______ Amount ______ NAME(S)

______ ADDRESS

$______ Amount ______ NAME(S)

______ ADDRESS

Enclosed is my check in the amount of $______

Signature______ (of purchaser) Date______

Address______ Telephone______

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But since the Board lowered the maturity ceiling for CD's to only 30 days, and with some banks willing to accept tiny amounts in the CD category, the distinction between passbook savings and CD money is rapidly disappearing, officials say. CD's, of course, originally were intended to tap corporate funds, but increasingly they are being used to compete for consumer savings.

Among banks which raised their rates were the Birmingham-Bloomfield Bank, Detroit, which began offering 4¾ percent for 1-year money and 4½ percent for 6-month money, in amounts of $1 and up in either category. A spokesman said the bank had been flooded with telephone calls and that many people said they would pull their money out of local S. & L.'s once they are paid their yearend dividends.

Also going to 4½ percent for 6-month CD's was First National Bank in St. Louis and Boatmen's National Bank. They had been paying 4¼ percent on this category. Both banks said they would pay 4¼ percent for 3- to 6-month money, also an increase of one-fourth of 1 percent.

In California, several small banks, including Independence Bank of Canoga Park, moved to 5 percent. Independence Bank is offering the rate for 90-day money in amounts of $1,000 or more, while Coast Bank in Long Beach went to 5 percent for 6-month money in any amount. At least three other small banks were said to be planning to adopt the 5-percent rate.

A spokesman for Independence Bank said the public reaction had been so great "that we have been doing nothing else but work on inquiries." The bank, which was founded January 2, 1963, has deposits of $9.5 million. An official said he doubted if the bank would have offered the new rate unless it had a ready use for it. He said it had $2.7 million in loan participations outstanding with an average yield of 7 percent. "We will take on all these loans ourselves when the money comes in," he explained.

Manufacturers Bank, Los Angeles, also said it would pay 5 percent, but for amounts of at least $10,000, held 91-days or longer.

Also in California, Litton Financial Corp., the big S. & L. holding company, said that on January 1 it would begin paying a one-half-percent bonus on 3-year money. Other S. & L. officials questioned how effective such a long term bonus would be and said they expected the prevailing rate on regular savings at California S. & L.'s might well go to 5 percent from the present 4.85 percent.

Under present regulations a S. & L. that moves above the prevailing rate in its area is cut off from further borrowings at its regional home loan bank but, as one S. & L. man put it, "This regulation may not be realistic under present circumstances."

The S. & L.'s in Detroit, however, do not run the risk of having their borrowing privileges curtailed, since the cutoff is in terms of the prevailing rate, or 4¼ percent, whichever is higher. The prevailing rate in Detroit is only 4 percent at present.

The Federal Home Loan Bank Board is giving consideration to revising the "prevailing rate" regulation, among others, to allow S. & L.'s to become more competitive with banks. But some S. & L. men insist that the basic problem is not restrictive rules, but the simple fact that only a handful of S. & L.'s can afford to pay 4½ percent.

[From Business Week, Dec. 18, 1965]

Rate Rise Sharpens Savings Battle

Fed's boost of interest ceiling on time deposits—and savings certificates—gives commercial banks a new edge; but Fed threatens to clamp down on any real war, and banks are wary.

The stage has been set—if the players want to use it—for another rate war over savings.

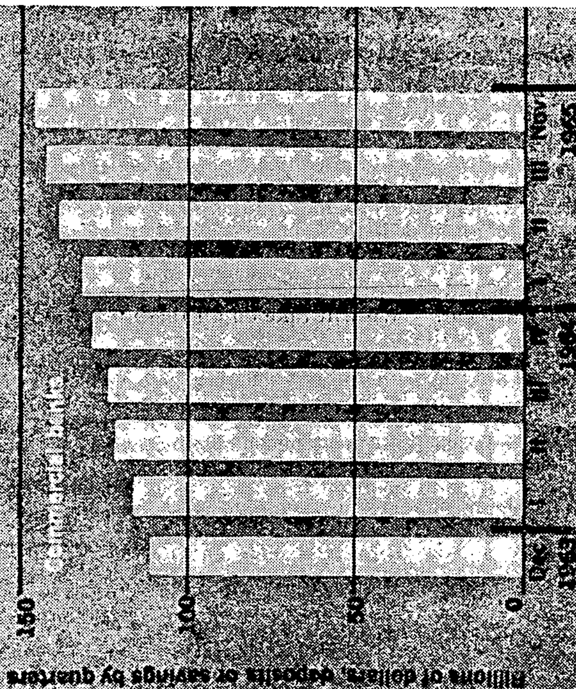
In the wake of the Federal Reserve Board's action raising to 5½ percent the ceiling on the rate commercial banks can pay for time deposits maturing in 30 days or more, both banks and savings and loan associations are taking tentative steps to increase their payments to savers.

Although they were not affected by the Fed's action, several eastern mutual savings banks have raised their rate to 4½ percent from 4¼ percent as a defensive measure. A few commercial banks around the country have seized the chance to get more competitive in their local areas by inching up the rates they pay on so-called savings certificates—a form of time deposit sold generally to small savers. In some cases, these rates are up to 5 percent.

In California, Lytton Financial Corp., an S. & L. holding company, says it plans to offer a bonus payment of one-half of 1 percent on large savings accounts left at its associations for 3 years or more.

Go-slow warnings: The Fed itself wants no part of such a savings war, and it is preaching restraint. It showed its concern by keeping the rate commercial banks can pay for individual savings accounts at 4 percent.

As it is, most banks and thrift institutions are showing prudence in their rate actions. As Norman Strunk, executive vice president of the U.S. Savings & Loan League, put it in cautioning S. & L.'s to go slow: "We don't want to


Commercial banks
have been running
out in front in the
savings race. Now
they may have a
chance to pull
even further ahead.
Billions of dollars, deposits or savings by quarters
150
100
50
0
Dec
1963
1965

get into a reckless war with the banks to see who can pay the most and run the fastest to insolvency."

Explosive: Still, the tinder is there for anyone to set off a fire. Commercial banks have surged ahead in the race for savings, and if they take steps now to increase their share of market, the other thrift institutions will have to battle back.

If so, there will be broad repercussions in each industry's operations. The impact would surely be felt in such arenas as the tax-exempt market (in which commercial banks have been the major influence over the past few years) and the mortgage market (in which thrift institutions dominate), and on Federal Reserve credit policy generally.

I. WEAPONS AT THE READY

For now, the commercial banks are increasing their lead in the savings competition. Since the beginning of 1964, time deposits at commercial banks have jumped 30 percent, compared with 20 percent gains for savings and loan associations and for mutual savings banks. This year, the S. & L.'s in particular have found it hard to gain ground.

For the most part, the commercial banks' gains can be attributed to their development of certificates of deposit, sold chiefly to institutional investors with idle or surplus cash. Certificates of deposit now run at about $16 billion for the big banks. This was the market that the Fed aimed at when it hiked the 4¼ percent ceiling on time deposits to 5½ percent.

The banks were bumping against that ceiling, and about $3.5 billion of CD money was due to mature this month. The Fed wanted to give the banks more elbow room, fearing that a runoff in these CD's to higher rate money market instruments would tighten credit at the banks—primarily the smaller banks that have to offer higher rates than large banks do to attract CD money.

Wide-open door: The Fed didn't touch the rate on savings deposits, but it left an opening wide enough for a 250-pound fullback for the banks to gain new savings: It set no limits—except the 5½-percent rate—on how much a bank could bring in through so-called savings certificates.

A savings certificate is a fixed-maturity time deposit. Unlike an individual savings account, which in practice can be withdrawn on presentation of a passbook, a holder of a time deposit agrees to leave his money with the bank for a fixed period—30 days or more. Technically, to get his money, he must give 30 days' written notice.

Thus, a savings certificate holder can't withdraw his money at his choosing with a passbook. Moreover, if he withdraws it before 30 days he loses his interest. In practice, some banks also have penalized holders of savings certificates who want their money before the maturity date—New York's First National City Bank, for instance, cuts its interest payment by 25 percent in such a case.

It's estimated that banks have issued well over $5 billion in savings certificates, as more and more banks get on the bandwagon.

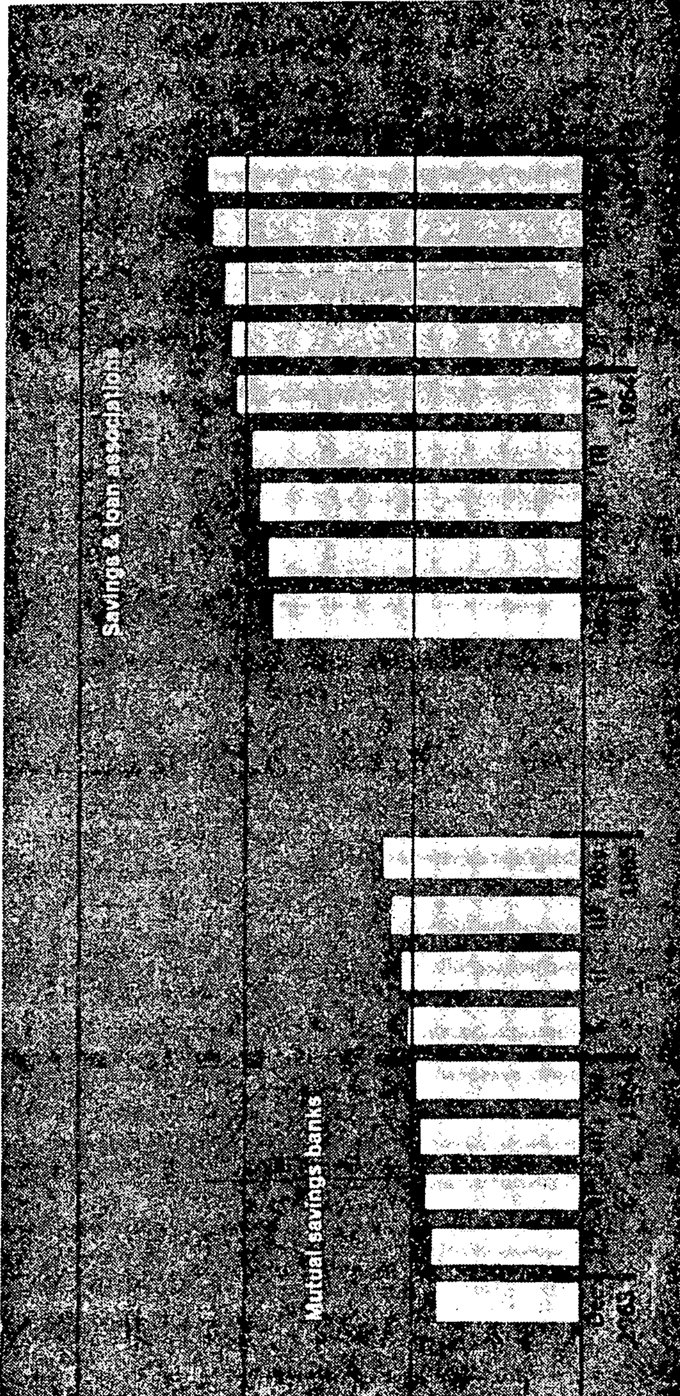
Variations: The commercial banks have set up all sorts of variations on the savings certificate. Franklin National Bank, the aggressive Long Island (N.Y.) bank that is now moving into New York City, offers 4½ percent on its certificates, sets the minimum holding period at 90 days and the minimum investment at only $25. First National City Bank, on the other hand, wants deposits of 180 days or longer, sets its minimum investment at $2,500. Chicago's Jefferson State Bank accepts only multiples of $500.

Atlanta's Citizens & Southern National Bank has four different types of certificates, aimed at different markets seeking income, growth, and so on. C. & S. now has over $176 million of certificates—$136 million of them purchased by individuals, the rest by nonprofit institutions.

James P. Furniss, its marketing vice president, believes the certificates divert money that might ordinarily go to S. & L.'s; but C. & S. has little evidence that money is being withdrawn from S. & L.'s for this purpose.

Questions: C. & S. people like other bankers, recognize that the higher rates on time deposits give new flexibility. Up to now, C. & S. has not used CD's extensively to attract deposits. It felt that with a 4½-percent ceiling on time deposits, a money shortage would mean a serious loss of funds from banks dependent on CD's.

The new 5½-percent ceiling does relieve the situation, but C. & S. still isn't sure how much more it should go into CD's—or how much more it should push savings certificates.


Savings & loan associations
Mutual savings banks

Key: Says Furniss: "The fact that the Fed held regular savings to 4 percent is a sign that it is not trying to encourage banks to raise rates."

If the banks do exercise self-restraint, then the savings war need not intensify. But the banks themselves don't know how strong will be the demand for credit—and the need for deposits—next year.

"The key to the situation," says Charles A. Wellman, president of First Charter Financial Corp., a Los Angeles-based S. & L. holding company, "is whether some of the larger banks begin to use certificates of deposit as a retail tool to attract accounts of the average small saver in the way some smaller banks are doing."

So far, most banks that have raised the rate for CD's have done so for the larger denominations; some giant banks are paying 4.7 percent for 90-day money. But several banks also have tinkered with the rates for savings certificates. New York's First National City Bank and Bankers Trust, for instance, increased their rates to 4½ percent from 4¼ percent.

S. & L. squeeze: The thrift institutions—particularly the S. & L.'s—will be hard hit if the banks move up rates on certificates; they obviously can't offer all of the one-stop banking services available at commercial banks.

S. & L. profits have been pinched between the higher rates they have to pay on savings and relatively soft mortgage rates, and they are looking for ways out.

The Federal Home Loan Bank Board has suggested that the S. & L.'s might set up a variable rate structure, paying more for larger accounts, and even reducing rates for smaller ones.

The proposal has met with some stiff opposition, but the Lytton "bonus" payment is another sign that some major S. & L.'s believe they need more flexibility in rates. Lytton says it will offer savers who keep a minimum of $1,000 with it for 3 years an annual interest of 5.35 percent, or a half percentage point over the prevailing S. & L. 4.85-percent rate in California.

Says Bart Lytton: "If we didn't think it made more sense than before, we wouldn't be initiating such a bonus."

II. HOLD THAT FIRE

In any moves, bankers and S. & L. men will keep an eye on Washington. All the major regulatory agencies are hoping that a war for savings can be averted. Fed Chairman William McC. Martin himself said last week he thought the banks would be quite "prudent." The first round of rate increases on CD's, officials feel, is in this spirit.

Warning: Before last week, big banks had no margin between CD costs and what they could get on their price rate. Now, they will try to get a little spread. Fed officials, however, say that any bank that goes all the way to 5½ percent on time deposits will be, in the words of one official, "subject to supervisory discipline" over its assets.

Bank examiners will question the prudence of investments made to cover higher rate CD's, and banks will be reminded that they have a special Internal Revenue Service exemption that permits them to invest in tax-exempt bonds and still deduct as business expense the interest they pay on CD's.

The threat now is that if tax exempts become the only investment that is economically feasible at a given interest rate on CD's, then IRS will take another look at this exemption.

Concern: The Fed is concerned about the saving certificate, but still is shying from regulation. Officials say the certificate has proved highly competitive in Atlanta, Philadelphia, and Long Island, but they feel the interest cost may help limit further growth.

Still, there is some thinking at the Fed as to what to do if the sale of certificates—or an expected switch from savings deposits to certificates—gets out of hand. One suggestion has been to ban the sale of small denominations that compete with thrift institutions. Another idea is to encourage S. & L.'s and mutual savings banks to come up with their own tool to increase savings. If that happens, the rate war could really become explosive.

Mr. MARTIN. I regret I don't know about the announcement. I don't think that there is any necessity for any of them going to 5½. This is a matter of judgment but this is permissive.

Chairman PATMAN. Do you have the discount window information I asked for—the applications that are made and the number by years?

Mr. MARTIN. I have checked with our Division of Bank Operations. They have given some similar statistics to you before but they will get in touch with the Reserve bank officers to update some of the statistics. They say it will take about a week or two for our Division to complete that.

Chairman PATMAN. Can't they do that by wire, Mr. Martin? I have gotten these figures from time to time. I just want them brought up to date. Now in the hearings on the Federal Reserve System before the House Committee on Banking and Currency, you submitted the information at my request for 1961, 1962, and 1963.

All I want is that information brought up to date, 1964 and up to now, 1965. That certainly could be secured by wire very easily and very quickly because it is not a technical matter, or one of judgment. It is available, I know, because you have furnished it to us in the past. If you will get that for us, I will appreciate it.

Mr. MARTIN. We will do the best we can but our Division is working very hard——

(See p. 190 for information requested by Chairman Patman and subsequently supplied by Federal Reserve Board.)

Chairman PATMAN. Now I want to turn to another matter and that is the amount of interest paid by all the people in the course of a year. My information from the Department of Commerce is that this amounted to $85 billion in 1964. My estimate is that at least $15 billion should be added to that amount which is covered up in the form of service charges, unlawful rates of interest, and other ways that are never disclosed. I think $15 billion would be a very fair estimate of that. This means that interest charges to the American people and businesses in the United States equal the national budget. Therefore, increases in the interest rate such as raising the discount rate—which is a wholesale charge and sets the floor under all other rates—is especially bad because the people will have to pay a multiple of this increase at the retail level. I estimate this will amount to an additional $25 billion in interest costs to the American people and businesses.

The effect, then, of increasing the discount rate from 4 to 4½ percent, will be, as I estimate it, a total interest charge in 1966 of $125 billion.

Of course, interest on the national debt—which is tremendous—will also increase as a result of your action. This interest now is $1 billion a month. That is $12 billion a year. It is terrific. So instead of your trying to find ways of increasing interest rates it occurs to me when we are about to get more involved in a war, we should figure out ways to keep interest rates low to finance this war and our domestic needs as we did in World War II.

Now, I have a feeling that we ought to consider if other ways of doing the same thing that you want to do are available. If it is necessary, possibly through raising bank reserve requirements—which, of course, can be done. This way, of course, the banks will lose some profits. If you raise the reserve requirements you can do exactly the same thing you have done by raising the discount rate, and by doing

it this way interest charges would be increased to the business people or businesses.

Mr. MARTIN. If we raise the reserve requirements the banks will start selling some of the securities they now hold.

Chairman PATMAN. That is right. The Fed can buy all the Government bonds they offer. You can protect the Government bond market. You have an obligation to do it. You are charged under the law to protect that market at 4¼ percent. You have not done it. The market now is as high as 4.66 on a yield basis, in some cases.

Mr. MARTIN. Any time we want to be an engine of inflation we can be that.

Chairman PATMAN. That is a phrase you use as an excuse. You know, you have raised interest rates time and time again using the excuse of inflation. That excuse has finally worn out. Also, you use the excuse of the balance of payments. Now it, too, is worn out. I think you ought to try to use something else.

Mr. MARTIN. In the post-Korean war economy we certainly had some inflation.

Chairman PATMAN. My time has almost expired. Let me just say this: that it is instructive to read what President Wilson and various Members of Congress had to say about the Federal Reserve System, when the legislation concerning its creation was under discussion. The main thrust of the following quotes from President Wilson, Carter Glass, Alben Barkley, Senator Norris, and others is that in creating the Federal Reserve System they wanted a system that would serve in the interest of all the people and not be dominated or controlled by the private commercial banking industry.

(Additional information submitted by Chairman Patman follows:)

FLOOR REMARKS IN HOUSE AND SENATE ON FEDERAL RESERVE ACT OF 1913, 63D CONGRESS, 1ST AND 2D SESSIONS

[Members and dates as indicated]

QUOTATIONS IN HOUSE OF REPRESENTATIVES

Page 4643, Mr. Glass (Democrat, of Virginia) quoting President Wilson: From Mr. Glass' speech introducing H.R. 7837, the Federal Reserve Act of 1913, September 10, 1913.

"And the control of the system of banking and issue which our new laws are to set up must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative."

Page 4645, Mr. Glass (Democrat, of Virginia): September 10, 1913.

"The danger which the banking community professes to see is not the real danger which I apprehend. The bankers seem to fear that men of their craft will be excluded; but the real peril of the provision is the possibility of too many bankers being included."

Page 4663. Mr. Korbly (Democrat, of Indiana): From Mr. Korbly's speech urging support for the Glass bill, September 10, 1913.

"We have created these 12 banks, partly in control of bankers, in conjunction with Government officers, and then we have practically put these 12 banks under the control of the Federal Reserve Board, which is altogether a Government office, and we propose that this Board shall see to it that the prescriptions of Congress shall be obeyed."

Page 4664, Mr. Murdock (Progressive, of Kansas): Appealing for support of the Glass bill, September 10, 1913.

"The measure places the central conventional control of Reserve banks in the hands of the Government, a proposition which the bankers themselves very strenuously opposed until a guardian advisory committee of bankers was added to the central governmental board.

"This addition weakened the original proposition, but as the amended governmental control stands, even though it prove feebly formal, it carries the promise of the ultimate actual control by the Government, and this promise alone warrants a supporting vote of the whole measure."

Page 4673–4, Mr. Phelan (Democrat, of Massachusetts): Speech urging support for a Federal Reserve System, September 10, 1913.

"The supreme oversight and control of the whole system, however, is vested in a board representing the public. Thus the bill renders unto the bankers what is the bankers', but positively and definitely secures to the public what belongs to the public."

Page 4731, Mr. Borland (Democrat, of Missouri): Calling for bipartisan support for the Glass bill. September 11, 1913.

"Either the control of credits and money must be turned over to the banker or it must be retained in the hands of the people of the United States and their representatives. The Glass bill does not make the National Reserve Board a corporation. It is simply a board of public officials similar to the Interstate Commerce Commission or any other governmental agency through which the people exercise administrative control."

Page 4763, Mr. Quin (Democrat, of Mississippi): Speech blasting the opponents of the Glass bill. September 11, 1913.

"I want to say to you, gentlemen, that the people want the Government to control the banks under this bill, but the special privilege crowd are all exceedingly anxious that the banking fraternity should control the Board. I stand for the rights of the people of this country, and I am voting for them to control through the President and the Senate, for the people in the final analysis are financially responsible for every dollar of this currency."

Page 4768, Mr. Seldomridge (Democrat, of Colorado): From speech supporting a Federal Reserve System. September 11, 1913.

"We have reached the parting of the ways in this legislation. We must either give the power to regulate our financial system to private and special interests or else we must confine it exclusively to governmental supervision and discretion. The Democratic Party will never permit this great function to be exercised through other than governmental agencies. On this declaration it stands fearless and unafraid."

Page 4789, Mr. Barkley (Democrat, of Kentucky): Speech supporting the Glass Federal Reserve bill. September 12, 1913.

"Mr. Chairman, we hear much criticism from the Republican side of this House and from some of the larger bankers of the country because it provides for a Federal Reserve Board, to be appointed by the President of the United States. Those who have criticized this provision of the bill upon this floor and elsewhere claim to fear that by reason of the fact that this Board shall be appointed by the President, it will therefore be a political board and may use its great powers for political purposes.

"There is not a governmental function with which we have to do today that is not a political function. There is not an act of Congress, nor an order of the executive department, nor a decision of the courts, from the smallest to the highest, that is not a political function, for the real definition of 'politics' itself is 'the science of government,' and the definition of the word 'political' is simply 'pertaining to or having to do with the science of government.' It is therefore impossible for any function of the Government to be performed that is not a political function."

"Mr. HAYES. Mr. Chairman, will the gentleman yield[

"The CHAIRMAN. Does the gentleman yield?

"Mr. BARKEY. Yes.

"Mr. HAYES. I would like to ask the gentleman if he claims that all of the powers of the Government are exercised as a matter of partisan politics?"

"Mr. BARKLEY. No, sir; I do not. And that is where the gentleman fails to distinguish between the terms 'political' and 'partisan.'

"Mr. HAYES. I would like for the gentleman to distinguish between 'partisan' and 'political.'

"Mr. BARKLEY. I appreciate that difference. That is where the critics make their mistake. They take it for granted they are the same, which is largely true of the so-called Republican Party." * * *

* * * * * * *

"Mr. BARKLEY. The President does not control the action of the Reserve Board after they are appointed any more than he controls the action of the Interstate Commerce Commission after he appoints its members."

Page 4800, Mr. Helvering (Democrat, of Kansas): Supporting a Federal Reserve System. September 12, 1913.

"The issue and control of money is too intimately connected with the welfare of every inhabitant of the United States to leave it in private hands, and while the banker is a most important cog in the economic life of the Nation, yet his powers are so great and his opportunities for good or evil so many that it is absolutely necessary that he should be the servant of the Government in dealing with the people instead of a separate and independent entity."

Page 4805, Mr. Collier (Democrat, of Mississippi): Urging united support for the Glass bill. September 12, 1913.

"One of the most serious objections to the Aldrich plan of currency reform was that it contemplated placing this control in the hands of the bankers themselves. I would never agree to support such a proposition. I would never be willing to place this power, this control, in the hands of the bankers or the lawyers or the merchants or any other set of men. Human nature is too strong in the best of us to permit such power to be vested in private hands. This power should properly be placed under the control of the Government itself—under the control of a government placed into power by the ballots of the American people and responsive to the will of that people."

Page 4821, Mr. Gray (Democrat, of Indiana): Urging Government control over monetary policy. September 12, 1913.

"I believe that the issue of money and its control and distribution is a vital public function which should be exercised only by the people themselves through the instrumentality of Government."

Page 4854, Mr. Wilson (Democrat, of Florida): From floor debate, urging Democratic Members to support the Glass bill. September 12, 1913.

"Objection is made by the opposition to this bill, claiming it would give the President too much power in appointing the Federal Reserve Board. The bill provides these appointments shall be made with the advice and consent of the Senate. They also claim this Board would be under political control. Political control is governmental control. Who constitutes the Government in this country? The people. Do you want to deny the people the right to govern themselves?"

Page 1459, Mr. Underwood (Democrat, of Alabama): Majority leader urging final passage of Glass-Owen Reserve bill. December 22, 1913.

"The rock on which our friends on the Republican side have broken when they attempted to pass their monetary legislation through this House in the last 16 years has been the fact that they have attempted to put the control of the system that they advocated in the hands of the men who loan the money and not in the hands of the representatives of the people who borrow the money."

Page 5038, Mr. Gray (Democrat, of Indiana): Supporting a Federal Reserve System. September 16, 1913.

"Money is the most vital of all public agencies, and as such vital public agency it should be held in the full and complete control of the public, all the people—its issue, volume, and its distribution, to insure its availability to all the people equally and impartially for their use. Such a public function should never rest in the control of private or selfish interests, to be made the subject of monopoly and concentration into the hands of a few. The provisions of the Glass bill place such control where it properly belongs—in the Government—to be administered by the sworn and chosen representatives of the people.

"The unrestricted power to issue money carries with it the power to control the volume of currency, and thereby the power to fix prices of all products, commodities, services, and property, and of all values as measured in money. To surrender this power to private control would be to surrender the most potent and vital authority of the Government—the control of money and the virtual control of the welfare of the people.

"Give me the absolute power to control the volume of money and I will control the destinies of this Nation more fully and completely than the exercise of arbitrary power by a czar * * *.

"This House is under political control, the Senate is under political control, the Executive is under political control * * *.

"Political control means the rule of the people, and it has terrors only for those who are afraid of and recoil from the rule of the people."

Page 5107, Mr. Brown (Democrat, of West Virginia): Urging final passage of Glass bill. September 17, 1913.

"Under the proposed system, however, the appointees on the Federal Reserve Board must be confirmed by the Senate, and the majority of the Board must retire when a new President is elected. In this way the people have the power to ratify or reverse the policy of any administration at the end of every 4 years."

QUOTATIONS IN SENATE

Page 179, Mr. Reed (Democrat, of Missouri): Urging passage of Federal Reserve Glass-Owen bill. December 4, 1913.

"The banks have contended that they are entitled to be represented upon the Federal Reserve Board. I utterly deny it. They are on one side of the table; the Government of the United States, representing the people of the country, is upon the other. The bankers represent those who demand, who ask rights from the Government. They come to the Federal Reserve Board making their demands and proffering their requests. No man should sit upon that Board unless he represents the people of the United States—the people of the United States alone—for it is their money and their credit which is to be granted."

Page 538, Mr. Weeks (Republican, of Massachusetts): Urging a Federal Reserve System. December 9, 1913.

"* * * *'And the control of the system of banking and of issue which our new laws are to set up must be public, not private, must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.'"

Page 783, Mr. Hollis (Democrat, of New Hampshire): Supporting Glass-Owen Federal Reserve bill. December 12, 1913.

"But the Federal Reserve Board should represent the Government solely. They should control broad questions of policy concerning which individual interests might tend to favoritism and abuse."

Pages 1071–1072, Mr. Borah (Republican, of Idaho): Urging an effective Government-run Federal Reserve System. December 22, 1913.

"It cannot adjust itself to an industrial life grounded in inequality; it cannot be fitted to monopoly; though strong enough to destroy, it can never be powerful enough to regulate monopoly. These things we ought to realize and cease our efforts to adjust our Government to the centralizing, monopolizing tendencies of business and compel business to adjust itself to the fundamental principles of democracy. This Government should assert its power and exert its prerogatives, and nowhere is it more essential and vital that it do so than in the complete regulation and control of the money and currency of its people. Everything that performs the functions of money, whether technically money or not, should come under this control."

Page 1136, Mr. Norris (Republican, of Nebraska): Urging Government control over the Federal Reserve System. December 18, 1913.

"I did believe, and do believe, that the banking and currency system and the banks organized under the system ought to be under Government control."

ARTHUR S. LINK, WILSON: "THE NEW FREEDOM" (PRINCETON UNIVERSITY PRESS 1956), PP. 211–212

"Since 1910 Wilson had been slowly evolving in his own mind two basic assumptions that he felt should govern banking and currency reform. The first was that concentration of credit and money in Wall Street had reached the proportions of monopoly, and that economic freedom could not exist so long as a 'money trust' had the power to 'chill and check and destroy genuine economic freedom.'

"Thus in 1913 the President supported the regional reserve concept as a means of destroying the 'money trust' in spite of all the pressure that men like House and Warburg could bring in behalf of a central bank. 'Through the measure proposed,' he told a reporter in explaining the Glass bill, 'I believe we will correct the evil we are most bent upon correcting—that of the present concentration of reserve and control at the discretion of a single group of bankers or by a locality of banking interests.* * *'

"Wilson's second basic assumption had also apparently taken firm shape in his mind by the time the discussions over the Glass bill had reached their climax in June 1913. It was that banking was so much a public business that the Government must share with private bankers in making fundamental fi-

nancial decisions. He supported the Federal Reserve bill, he told a reporter, because 'it provides * * * for public instead of private control, thus making the banks what they should be—the servants and not the masters of business * * *. With Government control, there is created a force which, while it will not attempt to run the business of the banks, will be clothed with some authority to prevent injustice from the banks to the general public. Under the proposed plan, recognition is given to the interests of the people, and there is established the principle of some other controls of credit than arbitrary control by the banks * * *. This is a great principle. So long as it is observed, the details themselves are matters of relatively minor importance." [1]

"[1] Interview given by the President to J. C. O'Laughlin of the Chicago Tribune about June 20, 1913, and enclosed in J. C. O'Laughlin to J. P. Tumulty, June 26, 1913, Wilson papers. This interview was apparently never published. I have transposed certain sentences for the sake of clarity."

(Mr. PATMAN. Marriner S. Eccles, a member of the Federal Reserve Board, in testifying on the Banking Act of 1935 (hearings before the Committee on Banking and Currency, House of Representatives, on H.R. 5357, 74th Cong., 1st sess., 1935, pp. 181–183), was highly critical of allowing nonmembers of the Federal Reserve Board to be official members of the Open Market Committee. Mr. Eccles pointed out that open market operations are the most important instrument of control over the volume and cost of credit, and that this activity should be conducted exclusively by the appointed member of the Federal Reserve Board, and not be controlled by commercial banking interests directly or indirectly.)

* * * * * * *

2. OPEN-MARKET OPERATIONS

From the longtime point of view the recommendations dealing with changes in the machinery for determining and carrying out the open-market policies of the Federal Reserve System are essential. Open-market operations are the most important single instrument of control over the volume and the cost of credit in this country. When I say credit in this connection I mean money, because by far the largest part of money in use by the people of this country is in the form of bank credit, or bank deposits. When the Federal Reserve banks buy bills or securities in the open market, they increase the volume of the people's money and lower its cost; and when they sell in the open market, they decrease the volume of money and increase its cost. Authority over these operations, which affect the welfare of the people as a whole, must be vested in a body representing the national interest.

Under existing law open-market operations must be initiated by a committee consising of representatives of the 12 Federal Reserve banks, that is, by persons representing primarily local interests. They must be submitted for approval or disapproval to the Federal Reserve Board, and after they have been approved by the Federal Reserve Board, the boards of directors of the Federal Reserve banks have the power to decide whether or not they wish to participate in the operations. We have, therefore, on this vital matter a setup by which the body which initiates the policies is not in a position to ratify them; and the body which ratifies them is not in a position to initiate them or to insist on their being carried out after they are ratified; and still a third group has the power to nullify policies that have been initiated and ratified by the other two bodies. In this matter, therefore, which requires prompt and immediate action and the responsibility for which should be centralized so as to be inescapable, the existing law requires the participation of 12 governors, 8 members of the Federal Reserve Board, and 108 directors scattered all over the country before a policy can be put into operation.

It requires no further explanation to show that the existing machinery is better adapted to delay and obstruction than it is to effective operation, and that it results in a diffusion of responsibility which prevents the necessary feeling of complete authority and responsibility by a small group of men who can be held accountable by the Congress and the Nation for the conduct of this matter that is of national importance.

The proposal in the bill is to set up a committee of five, three of whom shall be members of the Federal Reserve Board and two Governors of Federal Reserve banks. This proposal would have the advantage of creating a small committee with undivided responsibility. It is not clear, however, that this arrangement is the best that can be devised for the desired purpose. The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of monetary policies, would under this proposal have to delegate its principal function to a committee, on which members of the Board would have a bare majority, while governors of the banks would have two out of five members.

From the point of view of the Board the disadvantages of this arrangement are that a minority of the Board could adopt a policy that would be opposed to one favored by the majority. It would even be possible for one member of the Board by joining with the two Governors to adopt a policy that would be objectionable to the seven other members of the Board.

The placing of this authority in such a committee would also have the disadvantage of giving one important power, the power of open market operations, to the open market committee, while other fundamental powers are vested in the Board. These powers could be utilized to nullify the actions of the open market committee. For example, the committee might adopt a policy of easing credit, while the Federal Reserve Board would be in a position to tighten credit, either by raising discount and bill rates or by increasing member-bank reserve requirements. Also the Board, through its power of prescribing regulations for open market operations, could conceivably interfere with the carrying out of the policies of the committee. While it is not contemplated that such extreme situations would occur, it does not seem desirable to amend the law in a manner that might result in such unreasonable developments.

Upon further study it would appear that the best way in which to handle this proposal would be to place the responsibility for open market operations in the Federal Reserve Board as a whole and to provide for a committee of five Governors of Federal Reserve banks to advise with the Board in this matter. The Board should be required to obtain the views of this committee of Governors before adopting a policy for open market operations, discount rates, or changes in reserve requirements.

Such an arrangement would result in the power to initiate open market operations by either a committee of the Governors or by the Board, but would place the ultimate responsibility upon the Federal Reserve Board, which is created for that purpose. In this connection I should like to quote President Woodrow Wilson, who in his address to the joint session of Congress on June 23, 1913, said:

"The control of the system of banking and of issue * * * must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative."

Chairman PATMAN. Senator Javits?

Senator JAVITS. Mr. Martin, I am interested in one aspect of your testimony. You will need your statement for this.

In your statement you say:

For the first time since 1957 it seems likely that we may soon reach our interim goal of pushing unusual employment down to if not below 4 percent of the labor force.

Later you say:

As long as unemployment of manpower and plant capacity was greater than could be considered acceptable or normal, we had every reason to lean on the side of monetary stimulus.

Do you consider a 4 percent unemployment rate acceptable and normal and is that the basis for your decision?

Mr. MARTIN. I have never known, Senator, exactly what the right level ought to be. We naturally want as low a level as it is possible to have. I don't know how much frictional unemployment there is. This is a longstanding debate among experts. Our unemployment figures are not quite comparable to the unemployment figures that the

British have, for example, in many technical details. But we accepted a number of years ago that it looked like the frictional level that would be acceptable, not desirable but acceptable, in terms of moving toward full employment, would be in the neighborhood of 4 percent.

Senator JAVITS. I have heard the Chairman of the Council of Economic Advisers address himself to that same question and he used the figure 3 percent. Is there a difference between the Executive and the Federal Reserve Board on the normalcy of that figure?

Mr. MARTIN. We have never addressed ourselves to a definitive discussion of the 3 or 4 or 5 percent.

Senator JAVITS. You speak in your statement of the three reasons for doing what you did as being "to assure the continuance of our economic expansion, maintenance of generally stable price and restoration of reasonable equilibrium in our national payments."

In making your decision, are you willing to accept the 4 percent unemployment rate in order to get stable prices? And would you say that is the rationale of your decision?

Mr. MARTIN. I don't want to accept either rationale. We are struggling now with what I call the economics of full employment. It is my belief that we will make more progress toward full employment by the course that the Board is presently pursuing. If I didn't believe that I wouldn't have taken this action. I believe that the flow of funds that will be generated in this way under these conditions will make it possible perhaps for the unemployment rate to fall significantly below 4 percent.

Senator JAVITS. What do you call full employment? How do you define full employment?

Mr. MARTIN. I don't know. It is a very, very difficult concept to define. I have wrestled with it since 1946. I think there is going to be structural unemployment from time to time, pockets of it that have to be attacked outside of aggregate demand. This argument over structural unemployment and cyclical unemployment has been going on for a number of years and the Board position, at least I have always taken this position, has been that we have to tackle both of them. But what is the most effective way to eliminate those I don't know.

Senator JAVITS. In making this decision did you assume that we were at the state of full employment, whatever you define it to be?

Mr. MARTIN. That we were approaching a state of full employment and that progress toward full employment would be endangered if we did not take this action.

Senator JAVITS. Do you challenge Chairman Patman's estimate that the consumer is going to pay $25 million more per year in interest by virtue of this rate rise?

Mr. MARTIN. I am not in a position to challenge it because I don't know at this juncture.

Senator JAVITS. Do you approve it?

Mr. MARTIN. I don't ever approve anybody paying more.

Senator JAVITS. I am sorry. I did not mean to stick you with any such question. I am talking about the evaluation which Chairman Patman has made; do you think it is a fair evaluation?

Mr. MARTIN. I would have some question of it.

Senator JAVITS. You would have some question?

Mr. MARTIN. Would have some question. I would have to study this considerably further.

Senator JAVITS. Would you be good enough to study it and submit for the record the analysis of the Board of what this is going to cost payers of interest for credit? Just exactly as Chairman Patman made an estimate, let us know. In other words, we have to juxtapose this. You say to us, juxtapose this to the cost of inflation. We say to you what are we going to juxtapose? What is your estimate of what it is going to cost?

Mr. BALDERSTON. Senator Javits, may I ask a question?

Senator JAVITS. Certainly. That is the privilege of every witness before a congressional committee.

Mr. BALDERSTON. Is it not likely, sir, that there are more savers in this country than there are borrowers?

The problem of double counting comes in because the same citizens are owners of Government bonds, and of policies with insurance companies, and also possess savings accounts and pension rights. If you take out the double counting it is my belief that there are more savers than there are borrowers.

Senator JAVITS. Chairman Martin, I make the request of you to include any countervailing fact that you choose. I know there are over 80 million savings bank depositors and life insurance policyholders and likely they may get an increased interest and the double counting which Mr. Balderston speaks of, you tell us that in the memo. I think we are entitled to know what you want us to juxtapose in cost "A" and saving "B," to wit, inflation, redistribution of this increased interest rate, and so on.

I think we are entitled to know your best judgment in dollars and cents as to what that is going to mean. I make that request. You tell us whatever you feel you can but I do think we ought to have something.

Mr. MARTIN. I will be glad to do the best we can. I think the point that Governor Balderston has made, that interest is a wage to the savers as well as a cost to the borrowers, is right.

Senator JAVITS. Give us the figure, or what you think of the chairman's figure, and give us an countervailing aspect you wish.

(See p. 66 for response to above discussion later received from Federal Reserve Board.)

Senator JAVITS. I have just one other question, Mr. Chairman, and I would like to compliment the Chair and the witnesses. I think this hearing has been extraordinarily helpful and will be for the country.

We almost omitted questioning you on the balance of payments and yet the Board stated that restoration of reasonable equilibrium in our international payments was one of the reasons for your action. Now what benefits do you foresee from the increased discount rate in terms of reducing our net private capital outflows or from any other influence that you see on the balance of payments as, for example, investment in the United States because of a higher interest rate? And when I ask you that question I ask you to bear in mind in answering it that there are certain major countries which have lower bank rates than ours, to wit, Italy, France, and West Germany. There are a number that have rates equal to or above ours: Belgium, Canada, Japan, Netherlands, Sweden, and the United Kingdom.

Again, my question—I wanted to give you my thinking on this—what benefits do you foresee from the increased discount rate in terms of our balance of payments or the narrower question, reducing our net private capital outflow.

Mr. MARTIN. I was careful this morning not to make any exaggerated claim as a result of this move but as I have frequently testified before this committee and other committees, I don't think that the way the world is constituted today that we can be an isolationist in interest rates any more than we can be in politics.

Some people say, well, of course, our foreign friends will just up the interest rates to compensate for any narrowing of the gap that occurs as a result of this move. I have serious questions about that. I think that our foreign friends have been finding it easier to use monetary policy than to use fiscal policy which they should be using to damp down their inflation at the present time. This has been a hazard that they have been wrestling with.

Now, I believe that in terms of confidence in the Western World that the move that we are making, the move that we have taken on this front is going to be a plus in terms of developing equilibrium between the various countries in the Western World and this country in our balance of payments.

I don't believe it is going to close the gap. I think we need our voluntary foreign credit restraint program; and the Federal Reserve Board under the expert administration of Governor Robertson who, unfortunately, could not be here today has been doing everything in its power to support the President's program in this direction on the voluntary basis and will continue to do so.

I believe this buttresses that program in the sense that unless our foreign friends just go hog wild on the use of interest rates, to the point where it is not really contributing much to their internal economies, that this is going to be a step toward bringing about equilibrium.

Senator JAVITS. Equilibrium in the sense it will bring money back in the United States for investment?

Mr. MARTIN. That is correct.

Senator JAVITS. Rather than having American money going abroad and even some foreign money staying abroad, is that the idea?

Mr. MARTIN. That is right.

Senator JAVITS. Have you any estimate of that in money?

Mr. MARTIN. No. I mentioned in my prepared statement today the leakage factor that has contributed to direct investment abroad. The opportunities here for taking money from the Eurodollar market if it is really needed for investment purposes in this country are now much more real than they have been for a long time.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. Mr. Chairman, why would not the foreign countries raise up their rate of interest to match ours to overcome it and haven't they done that in the past?

Mr. MARTIN. In some instances they have, Senator. I think some of our foreign friends, and I speak particularly of the central bankers, realize the limitations on this. Take a country like Germany—and I am not trying to make any invidious comparisons, that is one of the

difficulties of this type of hearing, I don't want to attack the policy of a foreign government—but they have found that it is easier to use interest rates than it is to use fiscal policy and therefore they have attempted to slow their inflation by interest rates rather than by fiscal policy to the point where some of my associates in the central banking area wonder if they have not reached the point of diminishing returns. Therefore, I seriously question, although I can't guarantee this at all, whether they are going to follow the policy of upping interest rates at this juncture.

Senator SPARKMAN. You do not think we have reached the point of diminishing returns? This may be it?

Mr. MARTIN. This may be or it may not. Time will tell, Senator.

Senator SPARKMAN. I just read a letter that was addressed to each member of this committee by the U.S. Savings & Loan League. (See p. 91). I touched on this this morning. A great part of my legislative activities has been in the field of housing and I can not help but feel that this will have a very adverse effect upon housing, badly as it is needed in this country, as a result of increased interest rates.

You spoke this morning of coordinating your action with the people in the handling of fiscal affairs for the Government. Was there any coordination, for instance, with the Home Loan Bank Board?

Mr. MARTIN. No, I think we were somewhat deficient in that area. You must realize that this was a difficult timing operation. We had a divided Federal Reserve Board. There was not any assurance of exactly what moves we were going to make. It is a difficult area.

Senator SPARKMAN. Of course the savings and loan associations use practically all of their savings in home mortgages. You are aware of that. One difficulty they have had over the past several years, speaking from the standpoint of the Home Loan Bank Board, has been holding down the rate of dividend payments. They have felt very keenly the competition of commercial banks in the interest that they were able to pay on deposits. I hardly see how they can compete with this now at all. I noticed some statistics given in that letter to the effect that their savings are down during the past year, certainly have not kept pace with the rise.

The increased savings are down. I wonder if we are not going to run into some terrific headaches in that field.

Mr. MARTIN. Senator, this was taken into acount. This is the reason we did not move the savings deposit rate up. We moved the rate up on certificates of deposit, time deposits, but not on savings. We kept the savings rate at 4 percent in order to minimize the competitive impact between the mutual savings banks and the savings and loan people and the savings departments of the commercial banks.

Now, if you were talking about pure theory, and I personally have testified on this a number of times, I think the time is not too far off when it might be wise not to have any ceiling in that area at all. That would allow free competition. When you get into these binds, these ceilings, these limitations, it eventually causes you trouble, in my judgment.

While I would not want to see banks permitted to pay interest on demand deposits at this juncture, I think the time may not be too far off when we would be wiser in terms of the flow of funds not to have this ceiling at all. We may never have considered it as fully as we ought to, but we took this competitive impact into consideration and

we decided not to raise the 4-percent limitation on savings deposits for the very reason that you are stating.

Senator SPARKMAN. But there is no ceiling or there is no floor on certificates of deposit, take them as small or as big as they come.

Mr. MARTIN. That is correct.

Senator SPARKMAN. I notice in a new item that in the large Chicago banks out of $1,200 million held there in certificates of deposit, only $162 million were of the smaller type. In other words, over 85 percent of the money was in large certificates of deposit. Do you think that might be true throughout the country?

Mr. MARTIN. I think the tendency is that way, yes, sir.

Senator SPARKMAN. So the typical savings and loan association is still competing with the certificates of deposit right down to the smallest amounts?

Mr. MARTIN. They are. I would hope that prudence and caution in the industry would take care of this.

As I say, our intention here was not to put any additional strains on them and although in theory we could have extended this to savings deposits, and there are a good many people who say the saver should get a higher rate, we decided to take that risk rather than to risk the impact of the competitive problem that you are talking about at this level.

Senator SPARKMAN. Of course the savings and loan would have to, they will have to move in some way to compete with this increased interest rate. And when they pay more for the savings that come to them it means they have to lift the interest rates on the mortgages because there has to be an operating differential.

Mr. MARTIN. They have to make a profit.

Senator SPARKMAN. They have to make a profit. It seems to me the net effect to the homebuyers of the country is an increased cost for homes. I am just mentioning that one phase of it.

By the way, I notice in a Wall Street Journal article today in which it is projecting building outlays for 1966, it says the overall building outlay is gaining 6 percent. But there is this rather sober thought in there: The only major private area showing prospects of slow growth next year, the report said, is private housing.

Mr. MARTIN. We all have our theories about the reason for this. Nobody deplores more than I do the fact that the housing starts have not been participating in this upward trend that we have had in everything else.

My own explanation in theory has to do with population statistics. I don't know whether this is an answer or not. I do think there has been a decline after the war years in the population strata of family formation that is coming to an end here. If I were projecting, which I try to avoid doing, I would think we may not be very far off, a year or so, before you will have these housing starts starting up because of population changes in formation.

Senator SPARKMAN. Certainly I can see a lot in there because we have to watch, we project the family formations by the baby crop which comes along.

Mr. MARTIN. That is right.

Senator SPARKMAN. I believe that is all, Mr. Chairman.

Chairman PATMAN: Mr. Curtis?

Representative CURTIS. Just on this one point for information: I note that Robert C. Weaver, head of Housing and Home Finance

Agency, in an article appearing in the New York Times on December 9, expressed doubts that the discount rate would spur a rise in home prices, and he goes into the various reasons.

I would like to pick up where I left off, when I was trying to direct attention to the area of the Federal debt. And, Mr. Chairman, I would like to put in the record at this point, if I may, my supplemental views on the increase in the public debt which appears in a document put out by the Committee on Ways and Means of this year, entitled, "Legislative History of H.R. 8464, 89th Congress, a Bill To Provide a Temporary Increase in the Public Debt Limit."

Chairman PATMAN. Without objection, it is so ordered.

(Document referred to follows:)

SUPPLEMENTAL VIEWS OF THOMAS B. CURTIS ON THE INCREASE IN THE PUBLIC DEBT

The administration's request to increase the debt ceiling from $324 to $329 billion is predicated upon maintaining an expenditure level of $99.7 billion for fiscal 1966 as set forth in the budget submitted to the Congress in January.

This is an increase in expenditures from the previous fiscal year of over $2.5 billion. It is my judgment that this is too great an increase in relation to our anticipated revenues of $94.4 billion and in light of world peace conditions, our accumulated deficit balances in international payments and the size of the present Federal debt.

I am happy to state that the difference of opinion I am expressing is one of judgment bottomed upon an agreed economic and fiscal theory that balanced Federal budgets are an important fiscal goal and that deficit financing is a regrettable and not-to-be-sought-after goal. It is important to hammer this point home because there are many spokesmen in the present administration and certainly among the academic economic communty who do not agree with this theory. They should continue to be heard by the Congress and the public, as I am certain they will insure that they will be, but so should those who adhere to the fiscal policy which actually is being followed by the administration be heard.

It is ironic that I should have to make this statement, yet there is an altogether too large number in the Congress and among the general public who have come to believe that the theories of deficit financing are the theories that are actually being pursued by the Federal Government, particularly in the enactment of the 1964 Federal income tax rate reduction legislation. We all need to be reminded that the 1964 income tax rate reduction legislation was carried out in context of Federal expenditure restraint, not expenditure ease. A policy of expenditure ease would have led to an expenditure level of $104 billion in fiscal 1964 and a further increase in fiscal 1965, instead of $97.7 billion in 1964 and an anticipated level of $97 for fiscal 1965.

The present proposed legislation to reduce the rates to ultimately remove certain of the selected excise taxes amounting to $4 to $5 billion annual revenue is also in context with Federal expenditure restraint, keeping in sight a balanced budget in the immediately foreseeable future.

I am pleased that the Ways and Means Committee cut the administration request to increase the debt ceiling from $329 to $328 billion. This means that if the administration preserves, as it should, the flexibility necessary for efficient debt management, the projected expenditure level of $99.7 billion will be reduced to $98.7 billion. This is certainly in accord with the administration's desires and in line with what the administration has been able to do in the past 2 years since it adopted the basic policy of expenditure restraint.

However, it is my judgment that in the present economic climate of great economic activity, even $98.7 billion is too high a Federal governmental expenditure level. If we could hold to a $97 billion level I believe we would see a balanced budget by fiscal 1967. Nothing could do more good, actually and psychologically, in solving our balance of international payments problems or strengthening the U.S. position internationally if this were achieved. The administration could throw out the window, all the temporizing measures it has been employing to stave off the impending dangers resulting from our international imbalances if this were done; namely, interest equalization taxes, cutting tourist allowances, and urging "voluntary" restraints on the private sector.

Certain administration personnel and spokesmen who are resisting the President's policy of expenditure restraint from time to time advise the Congress and the public that the Federal debt is of no serious economic consequence. They say that increasing, not decreasing, Federal expenditures financed by further deficits is the key to continuing prosperity and, I presume, international economic strength. As argument to support their contentions they point out that the Federal debt is a smaller ratio to gross national product than it was in 1946. This is true and certainly the ratio of debt to gross national product is an important guidepost in determining how much Federal debt our society can sustain.

But 1946 is the worst possible year in decades to pick as an optimum and standard for comparison. It is the year following the heaviest sustained deficit financing this country has ever undertaken (a necessary undertaking, I submit, to finance our efforts in World War II). The guideposts to use are the peacetime periods when this country had the most rapid sustainable economic growth. Comparison of recent ratios with these periods reveals that the ratio of Federal debt to GNP rarely in the past has attained a level as high as 20 percent. Far from being complacement about the ratio of 50 percent which we suffer today, we should be asking why have we not been able to get this ratio closer to 20 percent 20 years after the end of World War II. We should also observe that two-thirds of the reduction in this ratio since 1946 was the result of the heavy inflation which immediately followed the close of the war, hardly a course of action to emulate for future ratio reductions.

The question of major importance that faces our Nation is: How much resiliency will we have if a new war or a major economic downturn should require us to engage in heavy deficit financing, starting from a ratio of 50 percent instead of from 20 percent? Furthermore, we should relate some of our present immobility in dealing with our international balance-of-payments problems to the lack of flexibility which is inherent in the high ratio of 50 percent which we have.

The Treasury Department uses a rule of thumb to estimate Federal yearly tax revenues of $1 of revenue per every $6 of GNP. This seems like a pretty good guidepost in itself to observe in determining what an optimum ratio of Federal debt to GNP might be.

I have been urging for a number of years that there be a public dialog on the subject of the Federal debt. I have done my best to move the debate from the stupid position of those who predicate their views on the belief that debt is bad. Debt is far from bad. It is one of the most effective tools an economy possesses, but like any tool it can be misused and abused by individuals, by business and certainly by governments. I have decried the inability of advocates of deficit financing to distinguish between good and bad debt—debt that is productive and debt that is counterproductive.

I shall vote against the present bill with mixed emotions. I am greatly pleased and encouraged by the administration's past actions and future promises. I am greatly pleased with the action of the Ways and Means Committee in cutting the figure by $1 billion—from $329 to $328 billion—in the realization that this debt ceiling legislation is an effective, though cumbersome and by no means the best, way Congress can express its judgment on the great issue of expenditure levels and balanced budgets.

However, I think it is still necessary to be on record that in the present economic climate this is not enough. I am greatly afraid that the recommendations of the minority members of the Joint Economic Committee to hold Federal expenditure levels to a $95 billion ceiling for fiscal 1964–65 were more sound than the levels of $97 and $98 billion which the Republicans on the Ways and Means Committee recommended to pave the way for the 1964 income tax rate reduction bill. I think that if we could hold to an expenditure level of $97 billion this coming fiscal year instead of the projected $99.7 billion, particularly if the cutback were primarily in the foreign aid programs to permit the private sector to move forward in assisting the development of the underdeveloped countries, we would be much closer to being back on fairly firm economic ground.

Representative CURTIS. Incidentally, and I think very important, one of the basic issues before the Ways and Means Committee is what the expenditure level would be.

As I pointed out, the administration reiterated in late May and on into June an expenditure figure of $99.7 billion for fiscal 1966. They based their request for $329 billion debt ceiling on this expenditure level.

I tried to get a $2 billion cut in that amount. One billion dollars was accepted, so the debt ceiling was $328 billion, predicated on an expenditure level of $98.7 billion, with the administration stating that they hoped to stick to that.

I only bring this up to demonstrate, if possible, the impact of the real change in the administration's expenditure policy exhibited in August of this year and certainly repeated even more so in September when the monthly expenditure rate went up to $9.5 billion, which would certainly, if that were the rate for the full year, put them up to around $115 billion.

What I am directing attention to is the problem that the debt managers are going to face with this kind of excess of expenditures over revenue. All the revenue anticipations have gone up only $1½ to $2 billion, certainly in no way compensating for this increased spending. You have already testified to the problem that you have experienced in your Open Market Committee.

What about this problem of the fact that we have a ceiling of 4¼ percent on the interest on long-term bonds that can be offered? What could the Federal Reserve System do in this area of debt management if nothing were done in the area where you have taken action?

This would relate to Mr. Maisel's point, where he felt we ought to lean more heavily on restricting the Federal purse of Government securities to curb or to effect monetary policy in that way.

Would you comment on that?

Mr. MARTIN. I think my record is well known. I personally think that we would now have lower interest rates, if we didn't have the 4¼ percent ceiling. But this is a difficult thing to prove. We were not able to get the ceiling——

Representative CURTIS. Assuming we have this lowered, Mr. Martin. You could buy the bonds long-term at 4¼.

Mr. MARTIN. I have already stated, of course, we could just create inflation endlessly.

Representative CURTIS. You are saying what I expected. This is the point I wanted to make, so that Mr. Maisel could comment. If this is so, or if you contest it, that would be interesting but how can the Federal Reserve Board exercise a more restrictive policy in the purchasing of Government bonds? Indeed, it would have to loosen up under this kind of situation where we are going to have to do more financing, not less.

Would you comment?

Mr. MAISEL. Yes, sir.

If I understand you correctly, my point would be I was talking about the possibility before the discount rate increase. In other words, before the discount rate increased there was a possibility that the Government would choose to run a tighter fiscal policy.

My own point of view was that I preferred a tighter fiscal policy and leaving the discount rate where it was. If that path had been chosen, although it was not clear, the 4¼ percent ceiling may well have been one that could have been lived with.

This was a matter of judgment. We would have had seasonal pressures in our favor. This last quarter of the calendar year is the quarter when the Government's seasonal demands on the money market are the highest by far.

Representative CURTIS. That is because of revenue, not because of expenditures. The expenditure levels are pretty constant.

Mr. MAISEL. I agree to that. There is still the fact that the Government goes into the money market for a much larger amount in the fourth quarter of the calendar year than any other period.

In this year it was a particularly large amount that the Government borrowed because of the way Government financing worked out. The amount of demand in the money market in the fourth quarter of the year was unusually high. The argument I was making was that a coordinated policy would have offered the administration a choice of trying to keep down the creation of debt. In addition it would then have been managing the debt around a lower peg in the market. In effect, the discount rate is a peg in the market. It is like any other peg. When you move up to a 4½-percent discount rate, you find many problems in lowering the money market rate from that new height. Each time the discount rate moves, you are moving a peg around which the money market operates.

I think everybody recognizes that once having moved that peg we are in an entirely different situation. I probably agree with Mr. Martin that now we are in for a difficult situation in the coming months because of the conflict between the way the law is written and the way in which the peg is set. They are in definite conflict and if they remain that way Government borrowing costs are going to be very high in the next year.

Representative CURTIS. Let me zero in on this a bit, the facts on the expenditure levels. I am reading from page 35 of the Economic Indicators, November 1965, the Federal finance section, and it gives us these monthly figures. There wasn't any question after the August figures were in and after the September figures were in, what the expenditure policy of the administration was. If I am not mistaken. I think Secretary Fowler and Director of the Budget Schultze said their expenditures were going to go up to around $110 billion.

Now in that context, Mr. Maisel, I would think that you would be in full accord here that we certainly could not ask the Federal Reserve System to help Treasury even more in marketing these bonds. As Mr. Martin has expressed it, I guess you do agree with his observation that if we take on more through the Fed, we in effect are creating a monetary inflationary system.

Wouldn't you agree?

Mr. MAISEL. Mr. Chairman, I am not certain I have the right figures. I have asked the staff to check. I believe that in the third quarter of the calendar year 1965 the cash deficit of the Treasury was $3.9 billion.

Representative CURTIS. Let me interrupt to say I am not referring to the cash budget. I am talking about the administrative budget expenditures because these are what fluctuate. Hopefully we balance our trust fund and I think we do a fair job of it. I am referring to the administrative budget, which is the one that does fluctuate. It is the administrative budget that shows these figures that I have just read, at a rate of around $112 billion beginning fiscal 1966 when they had anticipated $99.7 billion. As a matter of fact, when they had accepted the figure that Congress implied of $98.7 billion by setting the debt ceiling at $328 billion instead of $329 billion. So, let us not get these various budgets confused.

I have referred to the budget as a five-shell game. It is hard enough to follow the pea under three shells. Stick to the one shell which is the administrative budget, which is the one that fluctuates.

Mr. MAISEL. Yes, sir. But I will ask the staff to correct me if I am wrong, it is my understanding that the demand on the money market is a question of the cash budget, not the administrative budget. In other words, the figures I am reading here if I am reading them correctly, say that the third quarter of the year the Treasury had a cash deficit of $3.9 billion. They either had to use up existing funds or go into the market to finance that $3.9 billion deficit.

In the fourth quarter of the year, the quarter in which these pressures have been the greatest, the cash deficit was $6.1 billion. Now the projected figures for the next two quarters, which are the ones I was talking about, are for another but much smaller cash deficit in the first quarter of the calendar year 1966 and a large surplus for the cash budget in the second quarter of 1966. This is what I referred to as the seasonal problems in the market. It is based the way the revenues and expenditures are phased.

In the fall of the year we run a large deficit and in the spring of the year we run a surplus because that is when collections are higher.

Now if I am not incorrect, it is these facts that are a measure of the Treasury's pressure upon the money markets.

Representative CURTIS. I see my time has expired. I will come back later. The only observation I would make is that I am directing attention to the expenditure policy set by the administration. I think the figures that I read relate to that expenditure policy.

Senator SPARKMAN (presiding). Mr. Reuss?

Representative REUSS. Mr. Martin, this morning I raised the question whether the Federal Reserve Regulation A of 1955, which is still in effect, did not empower Federal Reserve banks to close the discount window so to speak, to banks that were asking for a rediscount, principally for the purpose of profiting from rate differentials. I now have outfitted myself with a copy of that 1955 regulation. I find that in section 200(e) it is set forth that—

> In considering a request for credit accommodation, each Federal Reserve bank * * * considers whether the bank is borrowing principally for the purpose of * * * profiting from rate differentials.

I am reading correctly.

In fact, you do have that power, do you not?

Mr. MARTIN. You are reading correctly and I think it might be well to put regulation A in the record.

Representative REUSS. I ask unanimous consent that we put regulation A in the record.

Senator SPARKMAN. Without objection that may be done.

Mr. MARTIN. The reason I did not give you a direct answer on this is that it is a problem of administration.

Representative REUSS. Entirely reasonable. I just wanted to get it in the record.

Mr. MARTIN. Right.

(The regulation referred to follows:)

BOARD OF GOVERNORS
of the
FEDERAL RESERVE SYSTEM

ADVANCES AND DISCOUNTS BY FEDERAL RESERVE BANKS

REGULATION A

(12 CFR 201)

This regulation as printed herewith is in the form as revised effective February 15, 1955

In announcing the following revision of Regulation A, the Board of Governors stated:

> **"While this revision of Regulation A makes certain changes in the language of the Regulation itself, the most important change is the revision of the foreword (General Principles) to Regulation A. The revised foreword is designed merely to restate and clarify certain guiding principles which are observed by the Federal Reserve Banks in making advances and discounts in accordance with the applicable provisions of the Federal Reserve Act and of Regulation A. The revision is not intended to further restrict or restrain access by member banks to the credit facilities of the Federal Reserve Banks."**

INQUIRIES REGARDING THIS REGULATION

Any inquiry relating to this regulation should be addressed to the Federal Reserve Bank of the district in which the inquiry arises.

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(This text corresponds to the Code of Federal Regulations, Title 12, Chapter II, Part 201, cited as 12 CFR 201)

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REGULATION A

(12 CFR 201)

Revised effective February 15, 1955

SECTION 201.0—FOREWORD: GENERAL PRINCIPLES

(*a*) A principal function of the Federal Reserve Banks under the law is to provide credit assistance to member banks, through advances and discounts, in order to accommodate commerce, industry, and agriculture. This function is administered in the light of the basic objective which underlies all Federal Reserve credit policy, i.e., the advancement of the public interest by contributing to the greatest extent possible to economic stability and growth.

(*b*) The Federal Reserve System promotes this objective largely by influencing the availability and cost of credit through action affecting the volume and cost of reserves available to the member banks. Through open market operations and through changes in reserve requirements of member banks, the Federal Reserve may release or absorb reserve funds in accordance with the credit and monetary needs of the economy as a whole. An individual member bank may also obtain reserves by borrowing from its Federal Reserve Bank at a discount rate which is raised or lowered from time to time to adjust to the credit and economic situation. The effects of borrowing from the Federal Reserve Banks by individual member banks are not localized, as such borrowing adds to the supply of reserves of the banking system as a whole. Therefore, use of the borrowing facility by member banks has an important bearing on the effectiveness of System credit policy.

(*c*) Access to the Federal Reserve discount facilities is granted as a privilege of membership in the Federal Reserve System in the light of the following general guiding principles.*

(*d*) Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. Under ordinary conditions, the continuous use of Federal Reserve credit by a member bank over a considerable period of time is not regarded as appropriate.

* These principles arise out of statutory and regulatory requirements. See especially paragraph 8 of section 4 of the Federal Reserve Act set forth at p. 11 of the Appendix to this Regulation.

(*e*) In considering a request for credit accommodation, each Federal Reserve Bank gives due regard to the purpose of the credit and to its probable effects upon the maintenance of sound credit conditions, both as to the individual institution and the economy generally. It keeps informed of and takes into account the general character and amount of the loans and investments of the member bank. It considers whether the bank is borrowing principally for the purpose of obtaining a tax advantage or profiting from rate differentials and whether the bank is extending an undue amount of credit for the speculative carrying of or trading in securities, real estate, or commodities, or otherwise.

(*f*) Applications for Federal Reserve credit accommodation are considered by a Federal Reserve Bank in the light of its best judgment in conformity with the foregoing principles and with the provisions of the Federal Reserve Act and this part.

SECTION 201.1—INTRODUCTION

This part is based upon and issued pursuant to various provisions of the Federal Reserve Act. The part is applicable to the following forms of borrowing from a Federal Reserve Bank: (a) advances to member banks on their own notes secured (1) by direct obligations of the United States, by paper eligible for discount or purchase by Federal Reserve Banks, or by obligations of certain corporations owned by the United States, or (2) by other security which is satisfactory to the Federal Reserve Bank; (b) discounts for member banks of commercial, agricultural and industrial paper and bankers' acceptances; and (c) discounts for Federal Intermediate Credit banks.

SECTION 201.2—ADVANCES TO MEMBER BANKS

(*a*) **Advances on Government obligations.**—Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding fifteen days[1] on the promissory note of such member bank secured (1) by the deposit or pledge of bonds, notes, certificates of indebtedness, or Treasury bills of the United States, or (2) by the deposit or pledge of debentures or other such obligations of Federal Intermediate Credit banks having maturities of not exceeding six months from the date of the advance.[2]

[1] Under the last paragraph of section 13 of the Federal Reserve Act, a Federal Reserve Bank has authority to make advances for periods not exceeding ninety days to individuals, partnerships, and corporations (including member and nonmember banks) on their promissory notes secured by direct obligations of the United States. However, advances to member banks on the security of direct obligations of the United States are normally for short periods of not exceeding fifteen days; and it is not the practice to make advances to others than member banks except in unusual or exigent circumstances.

[2] Such advances may also be made on notes secured by the deposit or pledge of Federal Farm Mortgage Corporation bonds issued under the Federal Farm Mortgage Corporation Act.

(*b*) **Advances on eligible paper.**—(1) Any Federal Reserve Bank may make advances, under authority of section 13 of the Federal Reserve Act, to any of its member banks for periods not exceeding ninety days[3] on the promissory note of such member bank secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for discount by Federal Reserve Banks under the provisions of this part or for purchase by such banks under the provisions of the Federal Reserve Act.

(2) In the event notes which evidence loans made pursuant to a commodity loan program of the Commodity Credit Corporation and which comply with the maturity requirements of §201.3(a) have been deposited in a pool of notes operated by the Commodity Credit Corporation, the certificate of interest issued by the Commodity Credit Corporation which evidences the deposit of such notes may be accepted as security for an advance made to a member bank under this paragraph.

(*c*) **Advances on other security under section 10(b) of the Federal Reserve Act.**—Any Federal Reserve Bank may make advances, under authority of section 10(b) of the Federal Reserve Act, to any of its member banks upon the latter's promissory note secured to the satisfaction of such Federal Reserve Bank regardless of whether the collateral offered as security conforms to eligibility requirements under other provisions of this part. The rate on advances made under the provisions of this paragraph shall in no event be less than one-half of 1 per cent per annum higher than the highest rate applicable to discounts for member banks under the provisions of sections 13 and 13a of the Federal Reserve Act in effect at such Federal Reserve Bank. Such an advance must be evidenced by the promissory note of such member bank payable either (1) on a definite date not more than four months after the date of such advance, or (2) at the option of the holder on or before a definite date not more than four months after the date of such advance.

SECTION 201.3—DISCOUNT OF NOTES, DRAFTS AND BILLS FOR MEMBER BANKS[4]

(*a*) **Commercial, agricultural and industrial paper.**—Any Federal Reserve Bank may discount for any of its member banks, under authority of sections 13 and 13a of the Federal Reserve Act, any note, draft, or bill of exchange which meets the following requirements:

[3] However, borrowings by member banks are generally for short periods.

[4] Even though paper is not eligible for discount by a Federal Reserve Bank for a member bank under the provisions of this part, it may be used as security for an advance by a Federal Reserve Bank to a member bank under the terms and conditions of paragraph (c) of §201.2 if it constitutes security satisfactory to the Federal Reserve Bank.

(1) It must be a negotiable note, draft, or bill of exchange, bearing the endorsement of a member bank, which has been issued or drawn, or the proceeds of which have been used or are to be used, in producing, purchasing, carrying or marketing goods[5] in one or more of the steps of the process of production, manufacture, or distribution, or in meeting current operating expenses of a commercial, agricultural or industrial business, or for the purpose of carrying or trading in direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States);

(2) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for permanent or fixed investments of any kind, such as land, buildings or machinery, or for any other fixed capital purpose;

(3) It must not be a note, draft, or bill of exchange the proceeds of which have been used or are to be used for transactions of a purely speculative character or issued or drawn for the purpose of carrying or trading in stocks, bonds or other investment securities except direct obligations of the United States (i.e., bonds, notes, Treasury bills or certificates of indebtedness of the United States); and

(4) It must have a maturity at the time of discount of not exceeding ninety days, exclusive of days of grace, except that agricultural paper as defined in this section may have a maturity of not exceeding nine months, exclusive of days of grace; but this requirement is not applicable with respect to bills of exchange payable at sight or on demand of the kind described in paragraph (b) of this section.

(*b*) **Bills of exchange payable at sight or on demand.**—Any Federal Reserve Bank may discount for any of its member banks, under authority of section 13 of the Federal Reserve Act, negotiable bills of exchange payable at sight or on demand which (1) bear the endorsement of a member bank, (2) grow out of the domestic shipment or the exportation of nonperishable, readily marketable staples,[6] and (3) are secured by bills of lading or other shipping documents conveying or securing title to such staples. All such bills of exchange shall be forwarded promptly for collection, and demand for payment

[5] As used in this part the word "goods" shall be construed to include goods, wares, merchandise, or agricultural products, including livestock.

[6] A readily marketable staple within the meaning of this part means an article of commerce, agriculture, or industry of such uses as to make it the subject of constant dealings in ready markets with such frequent quotations of price as to make (a) the price easily and definitely ascertainable and (b) the staple itself easy to realize upon by sale at any time.

shall be made promptly, unless the drawer instructs that they be held until arrival of such staples at their destination, in which event they must be presented for payment within a reasonable time after notice of such arrival has been received. In no event shall any such bill be held by or for the account of a Federal Reserve Bank for a period in excess of ninety days.

(*c*) **Bankers' acceptances.**—Any Federal Reserve Bank may discount for any of its member banks a banker's acceptance[7] which bears the endorsement of a member bank and (1) which grows out of transactions involving the importation or exportation of goods, the shipment of goods within the United States, or the storage of readily marketable staples,[8] as such transactions are more fully described in §203.1(a) (1), (2), and (3),[9] respectively, of this subchapter or (2) which has been drawn by a bank or banker in a foreign country or dependency or insular possession of the United States for the purpose of furnishing dollar exchange as provided in §203.2 of this subchapter: *Provided,* That any such acceptance shall have a maturity at the time of discount of not more than ninety days' sight, exclusive of days of grace, except that an acceptance drawn for agricultural purposes and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than six months' sight, exclusive of days of grace:[10] *And provided further,* That acceptances for any one customer in excess of

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[7] A banker's acceptance within the meaning of this part is a draft or bill of exchange, whether payable in the United States or abroad and whether payable in dollars or some other money, accepted by a bank or trust company or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits.

[8] In the case of an acceptance growing out of the storage of readily marketable staples, the bill must be secured at the time of acceptance by a warehouse, terminal, or other similar receipt, conveying security title to such staples, issued by a party independent of the customer or issued by a grain elevator or warehouse company duly bonded and licensed and regularly inspected by State or Federal authorities with whom all receipts for such staples and all transfers thereof are registered and without whose consent no staples may be withdrawn; and the acceptor must remain secured throughout the life of the acceptance. If the goods are withdrawn from storage before maturity of the acceptance or retirement of the credit, a trust receipt or other similar document covering the goods may be substituted in lieu of the original document, provided that such substitution is conditioned upon a reasonably prompt liquidation of the credit; and, to this end, it should be required, when the original document is released, either that the proceeds of the goods will be applied within a specified time toward a liquidation of the acceptance credit or that a new document, similar to the original one, will be resubstituted within a specified time.

[9] The bill itself should be drawn so as to evidence the character of the underlying transaction, but if it is not so drawn evidence of eligibility may consist of a stamp or certificate affixed by the acceptor in form satisfactory to the Federal Reserve Bank.

[10] No acceptance discounted by a Federal Reserve Bank should have a maturity in excess of the usual or customary period of credit required to finance the underlying transaction or of the period reasonably necessary to finance such transaction; and no acceptance growing out of the storage of readily marketable staples should have a maturity in excess of the time ordinarily necessary to effect a reasonably prompt sale, shipment, or distribution into the process of manufacture or consumption.

ten per cent of the capital and surplus of the accepting bank must remain actually secured throughout the life of the acceptance.[11]

(*d*) **Construction loans.**—In addition to paper of the kinds specified above, any Federal Reserve Bank may discount for any of its member banks, under authority of section 24 of the Federal Reserve Act, a negotiable note which (1) represents a loan made to finance the construction of a residential or a farm building whether or not secured by lien upon real estate, (2) is endorsed by such member bank, (3) is accompanied by a valid and binding agreement, entered into by a person[12] acceptable to the discounting Federal Reserve Bank, requiring such person to advance the full amount of the loan upon the completion of the construction of such residential or farm building, and (4) matures not more than six months from the date such loan was made and not more than ninety days from the date of such discount by such Federal Reserve Bank, exclusive of days of grace.

(*e*) **Agricultural paper.**—Agricultural paper, within the meaning of this part, is a negotiable note, draft, or bill of exchange issued or drawn, or the proceeds of which have been or are to be used, for agricultural purposes, including the production of agricultural products the marketing of agricultural products by the growers thereof, or the carrying of agricultural products by the growers thereof pending orderly marketing, and the breeding, raising, fattening, or marketing of livestock.

(*f*) **Paper of cooperative marketing associations.**—Notes, drafts, bills of exchange, or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products are deemed to have been issued or drawn for an agricultural purpose within the meaning of the foregoing definition of "agricultural paper", if the proceeds thereof have been or are to be used by such association in making advances to any members thereof for an agricultural purpose, in making payments to any members thereof on account of agricultural products delivered by such members to the association, or to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members. In addition, any other paper of

[11] In the case of the acceptances of member banks this security must consist of shipping documents, warehouse receipts, or other such documents, or some other actual security growing out of the same transaction as the acceptance, such as documentary drafts, trade acceptances, terminal receipts, or trust receipts which have been issued under such circumstances, and which cover goods of such a character, as to insure at all times a continuance of an effective and lawful lien in favor of the accepting bank, other trust receipts not being considered such actual security if they permit the customer to have access to or control over the goods.

[12] Such person may be the member bank offering the note for discount or any other individual, partnership, association or corporation.

such associations which complies with the applicable requirements of this part may be discounted. Paper of cooperative marketing associations the proceeds of which have been or are to be used (1) to defray the expenses of organizing such associations, or (2) for the acquisition of warehouses, for the purchase or improvement of real estate, or for any other permanent or fixed investment of any kind, is not eligible for discount, even though such warehouses or other property is to be used exclusively in connection with the ordinary operations of the association.

(*g*) **Factors' paper.**—Notes, drafts, and bills of exchange of factors issued as such for the purpose of making advances exclusively to producers of staple agricultural products in their raw state are eligible for discount with maturities not in excess of ninety days, exclusive of days of grace.

(*h*) **Collateral securing discounted paper.**—Any note, draft, or bill of exchange eligible for discount is not rendered ineligible because it is secured by the pledge of goods or collateral of any nature, including paper ineligible for discount.

(*i*) **Determination of eligibility.**—(1) A Federal Reserve Bank shall take such steps as may be necessary to satisfy itself as to the eligibility of any paper offered for discount. Compliance of paper with the provisions of paragraph (a)(2) of this section may be evidenced by a statement which adequately reflects the borrower's financial worth and evidences a reasonable excess of quick assets over current liabilities, or such compliance may be evidenced in any other manner satisfactory to the Federal Reserve Bank.

(2) The requirement of this section that a note be negotiable shall not be applicable with respect to any note evidencing a loan which is made pursuant to a commodity loan program of the Commodity Credit Corporation and which is subject to a commitment to purchase by the Commodity Credit Corporation or with respect to any note evidencing a loan which is in whole or in part the subject of a guarantee or commitment made pursuant to section 301 of the Defense Production Act of 1950 as amended.

(*j*) **Limitations.**—(1) The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, endorser, drawer, or guarantor, discounted for any member bank shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national bank under the terms of section 5200 of the Revised Statutes of the United States, as amended.*

* Section 5200 of the Revised Statutes of the United States is printed in the Appendix to this Regulation (page 17).

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(2) The law forbids a Federal Reserve Bank to discount for any State member bank notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State member bank in an amount greater than that which could be borrowed lawfully from such State member bank were it a national bank.

SECTION 201.4--GENERAL REQUIREMENTS AS TO ADVANCES AND DISCOUNTS

(*a*) **Applications for advances or discounts.**—(1) Every application by a member bank for an advance to such bank or for the discount of paper must contain a certificate of such bank, in form to be prescribed by the Federal Reserve Bank, that the security offered for the advance or the paper offered for discount, as the case may be, has not been acquired from a nonmember bank (otherwise than in accordance with §201.5) or, if so acquired, that the applying member bank has received permission from the Board of Governors of the Federal Reserve System to obtain advances from the Federal Reserve Bank on security so acquired or to discount with the Federal Reserve Bank paper acquired from nonmember banks.

(2) Every such application shall also contain a notation by the member bank as to whether it has on file a statement which adequately reflects the financial worth of a party primarily liable on the paper offered as security for an advance or for discount or of the person from whom the member bank acquired such paper if such person is legally liable thereon.

(3) Every application of a State member bank for the discount of paper must contain a certificate or guaranty to the effect that the borrower is not liable and will not be permitted to become liable to such bank for borrowed money during the time his paper is under discount with the Federal Reserve Bank in an amount greater than that which could be borrowed lawfully from such State bank were it a national bank.

(*b*) **Financial statements.**—In order to determine whether security offered for an advance or paper offered for discount is eligible and acceptable, any Federal Reserve Bank may require that there be filed with it statements, or certified copies thereof, which adequately reflect the financial worth (1) of one or more parties to any obligation offered as security for an advance or to any note, draft, or bill of exchange offered for discount and (2) of any corporations or firms affiliated with or subsidiary to such party or parties. A Federal Reserve Bank may in any case require such other information as it deems necessary.

(*c*) **Other information.**—Each Federal Reserve Bank is required by law to keep itself informed of the general character and amount of

the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances or discounts, the Federal Reserve Bank is required to give consideration to such information. Each Federal Reserve Bank may require such information from its member banks as it may deem necessary in order to determine whether such undue use of bank credit is being made and whether the granting of any requested credit accommodation would be consistent with the general principles applicable to extensions of credit under this part.

(*d*) **Amount of collateral.**—In connection with any advance or discount under this part, a Federal Reserve Bank may require such collateral as it may deem advisable or necessary; but it is expected that the Federal Reserve Bank in determining the amount of collateral will give due regard to the public welfare and the general effects that its action may have on the position of the member bank, on its depositors, and on the community; and in general a Federal Reserve Bank should limit the amount of collateral it requires to the minimum consistent with safety.

SECTION 201.5—PAPER ACQUIRED FROM NONMEMBER BANKS

(*a*) **Prohibition upon acceptance of nonmember bank paper.**—Except with the permission of the Board of Governors of the Federal Reserve System, no Federal Reserve Bank shall accept as security for an advance or discount any assets acquired by a member bank from, or bearing the signature or endorsement of, a nonmember bank, except assets otherwise eligible which were purchased by the offering bank on the open market or otherwise acquired in good faith and not for the purpose of obtaining credit for a nonmember bank.

(*b*) **Applications for permission.**—An application for permission to use as security for advances assets acquired from nonmember banks or to discount paper acquired from nonmember banks shall be made by the member bank which desires to offer such assets as security or such paper for discount and shall state fully the facts which give rise to such application and the reasons why the applying member bank desires such permission. Such application shall be addressed to the Board of Governors of the Federal Reserve System but shall be submitted by the member bank to the Federal Reserve Bank of the district, which will forward it promptly to the Board of Governors of the Federal Reserve System with its recommendation.

(*c*) **Paper acquired from Federal Intermediate Credit banks.**—The Board of Governors of the Federal Reserve System hereby grants permission to Federal Reserve Banks to make advances to member banks upon the security of paper or assets bearing the signature or endorsement of, or acquired from, Federal Intermediate Credit banks or to discount for member banks paper bearing such a signature or endorsement or so acquired, if otherwise eligible under the law and this part.

SECTION 201.6—DISCOUNTS FOR FEDERAL INTERMEDIATE CREDIT BANKS

(*a*) **Kinds and maturity of paper.**—Any Federal Reserve Bank, under authority of section 13a of the Federal Reserve Act, may, with the permission of the Board of Governors, discount for any Federal Intermediate Credit bank (1) agricultural paper as defined in §201.3, or (2) notes payable to such Federal Intermediate Credit bank covering loans or advances made by it pursuant to the provisions of section 202(a) of Title II of the Federal Farm Loan Act, which are secured by notes, drafts, or bills of exchange eligible for discount by Federal Reserve Banks. Any paper discounted for a Federal Intermediate Credit bank must bear the endorsement of such bank and must have a maturity at the time of discount of not more than nine months, exclusive of days of grace.

(*b*) **Limitations.**—No Federal Reserve Bank shall discount for any Federal Intermediate Credit bank any paper which bears the endorsement of any nonmember State bank or trust company which is eligible for membership in the Federal Reserve System under the terms of section 9 of the Federal Reserve Act. In acting upon applications for the discount of paper for Federal Intermediate Credit banks, each Federal Reserve Bank shall give preference to the demands of its own member banks and shall have due regard to the probable future needs of its own member banks.

APPENDIX

STATUTORY PROVISIONS

Section 4 of the Federal Reserve Act reads in part as follows:

"Said board of directors shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and may, subject to the provisions of law and the orders of the Board of Governors of the Federal Reserve System, extend to each member bank such discounts, advancements, and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks, the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture. The Board of Governors of the Federal Reserve System may prescribe regulations further defining within the limitations of this Act the conditions under which discounts, advancements, and the accommodations may be extended to member banks. Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accommodations, the Federal reserve bank shall give consideration to such information. The chairman of the Federal reserve bank shall report to the Board of Governors of the Federal Reserve System any such undue use of bank credit by any member bank, together with his recommendation. Whenever, in the judgment of the Board of Governors of the Federal Reserve System, any member bank is making such undue use of bank credit, the Board may, in its discretion, after reasonable notice and an opportunity for a hearing, suspend such bank from the use of the credit facilities of the Federal Reserve System and may terminate such suspension or may renew it from time to time."

Section 9 of the Federal Reserve Act reads in part as follows:

"*Provided, however,* That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than that which could be borrowed lawfully from such State bank or trust company were it a national banking association. The Federal reserve bank, as a condition of the discount

of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank."

Section 10(b) of the Federal Reserve Act reads as follows:

"Sec. 10(b). Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Each such note shall bear interest at a rate not less than one-half of 1 per centum per annum higher than the highest discount rate in effect at such Federal Reserve bank on the date of such note."

Section 13 of the Federal Reserve Act reads in part as follows:

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Board of Governors of the Federal Reserve System to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount, and the notes, drafts, and bills of exchange of factors issued as such making advances exclusively to producers of staple agricultural products in their raw state shall be eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States.* Notes, drafts, and bills admitted to discount under the terms of this

* Or Treasury bills or certificates of indebtedness. See act approved June 17, 1929 (46 Stat., 19), amending sec. 5 of Second Liberty Bond Act, approved Sept. 24, 1917 (40 Stat., 290).

paragraph must have a maturity at the time of discount of not more than 90 days, exclusive of grace.

* * * * *

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, and subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, any Federal reserve bank may discount or purchase bills of exchange payable at sight or on demand which grow out of the domestic shipment or the exportation of nonperishable, readily marketable agricultural and other staples and are secured by bills of lading or other shipping documents conveying or securing title to such staples: *Provided,* That all such bills of exchange shall be forwarded promptly for collection, and demand for payment shall be made with reasonable promptness after the arrival of such staples at their destination: *Provided further,* That no such bill shall in any event be held by or for the account of a Federal reserve bank for a period in excess of ninety days. In discounting such bills Federal reserve banks may compute the interest to be deducted on the basis of the estimated life of each bill and adjust the discount after payment of such bills to conform to the actual life thereof.

"The aggregate of notes, drafts, and bills upon which any person, copartnership, association, or corporation is liable as maker, acceptor, indorser, drawer, or guarantor, rediscounted for any member bank, shall at no time exceed the amount for which such person, copartnership, association, or corporation may lawfully become liable to a national banking association under the terms of section 5200 of the Revised Statutes, as amended: *Provided, however,* That nothing in this paragraph shall be construed to change the character or class of paper now eligible for rediscount by Federal reserve banks.

"Any Federal reserve bank may discount acceptances of the kinds hereinafter described, which have a maturity at the time of discount of not more than 90 days' sight, exclusive of days of grace, and which are indorsed by at least one member bank: *Provided,* That such acceptances if drawn for an agricultural purpose and secured at the time of acceptance by warehouse receipts or other such documents conveying or securing title covering readily marketable staples may be discounted with a maturity at the time of discount of not more than six months' sight exclusive of days of grace.

"Any member bank may accept drafts or bills of exchange

drawn upon it having not more than six months' sight to run, exclusive of days of grace, which grow out of transactions involving the importation or exportation of goods; or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. * * * * *

"Any Federal reserve bank may make advances for periods not exceeding fifteen days to its member banks on their promissory notes secured by the deposit or pledge of bonds, notes, certificates of indebtedness, or Treasury bills of the United States, or by the deposit or pledge of debentures or other such obligations of Federal intermediate credit banks which are eligible for purchase by Federal reserve banks under section 13(a) of this Act, or by the deposit or pledge of Federal Farm Mortgage Corporation bonds issued under the Federal Farm Mortgage Corporation Act, or by the deposit or pledge of bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and any Federal reserve bank may make advances for periods not exceeding ninety days to its member banks on their promissory notes secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act. All such advances shall be made at rates to be established by such Federal reserve banks, such rates to be subject to the review and determination of the Board of Governors of the Federal Reserve System. If any member bank to which any such advance has been made shall, during the life or continuance of such advance, and despite an official warning of the reserve bank of the district or of the Board of Governors of the Federal Reserve System to the contrary, increase its outstanding loans secured by collateral in the form of stocks, bonds, debentures, or other such obligations, or loans made to members of any organized stock exchange, investment house, or dealer in securities, upon any obligation, note, or bill, secured or unsecured, for the purpose of purchasing and/or carrying stocks, bonds, or other investment securities (except obligations of the United States) such advance shall be deemed immediately due and payable, and such member bank shall be ineligible as a borrower at the reserve bank of the district under the provisions of this paragraph for such period as the Board of Governors of the Federal Reserve System shall determine: *Provided,* That no temporary carrying or clearance loans

made solely for the purpose of facilitating the purchase or delivery of securities offered for public subscription shall be included in the loans referred to in this paragraph.

* * * * *

"The discount and rediscount and the purchase and sale by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Board of Governors of the Federal Reserve System.

* * * * *

"Any member bank may accept drafts or bills of exchange drawn upon it having not more than three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Board of Governors of the Federal Reserve System by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. Such drafts or bills may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Board of Governors of the Federal Reserve System: * * * *

"Subject to such limitations, restrictions and regulations as the Board of Governors of the Federal Reserve System may prescribe, any Federal reserve bank may make advances to any individual, partnership or corporation on the promissory notes of such individual, partnership or corporation secured by direct obligations of the United States. Such advances shall be made for periods not exceeding 90 days and shall bear interest at rates fixed from time to time by the Federal reserve bank, subject to the review and determination of the Board of Governors of the Federal Reserve System."

Section 13a of the Federal Reserve Act as amended reads in part as follows:

"Upon the indorsement of any of its member banks, which shall be deemed a waiver of demand, notice, and protest by such bank as to its own indorsement exclusively, any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, discount notes, drafts, and bills of exchange issued or drawn for an agricultural purpose, or based upon live stock, and having a maturity,

at the time of discount, exclusive of days of grace, not exceeding nine months, * * * *

"That any Federal reserve bank may, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, rediscount such notes, drafts, and bills for any Federal Intermediate Credit Bank, except that no Federal reserve bank shall rediscount for a Federal Intermediate Credit Bank any such note or obligation which bears the indorsement of a nonmember State bank or trust company which is eligible for membership in the Federal reserve system in accordance with section 9 of this Act. Any Federal reserve bank may also, subject to regulations and limitations to be prescribed by the Board of Governors of the Federal Reserve System, discount notes payable to and bearing the indorsement of any Federal intermediate credit bank, covering loans or advances made by such bank pursuant to the provisions of section 202(a) of Title II of the Federal Farm Loan Act, as amended (U.S.C., title 12, ch. 8, sec. 1031), which have maturities at the time of discount of not more than nine months, exclusive of days of grace, and which are secured by notes, drafts, or bills of exchange eligible for rediscount by Federal reserve banks.

* * * * *

"Notes, drafts, bills of exchange or acceptances issued or drawn by cooperative marketing associations composed of producers of agricultural products shall be deemed to have been issued or drawn for an agricultural purpose, within the meaning of this section, if the proceeds thereof have been or are to be advanced by such association to any members thereof for an agricultural purpose, or have been or are to be used by such association in making payments to any members thereof on account of agricultural products delivered by such members to the association, or if such proceeds have been or are to be used by such association to meet expenditures incurred or to be incurred by the association in connection with the grading, processing, packing, preparation for market, or marketing of any agricultural product handled by such association for any of its members: *Provided,* That the express enumeration in this paragraph of certain classes of paper of cooperative marketing associations as eligible for rediscount shall not be construed as rendering ineligible any other class of paper of such associations which is now eligible for rediscount.

"The Board of Governors of the Federal Reserve System may, by regulation, limit to a percentage of the assets of a Federal reserve bank the amount of notes, drafts, acceptances, or bills

having a maturity in excess of three months, but not exceeding six months, exclusive of days of grace, which may be discounted by such bank, and the amount of notes, drafts, bills, or acceptances having a maturity in excess of six months, but not exceeding nine months, which may be rediscounted by such bank."

Section 19 of the Federal Reserve Act reads in part as follows:

"* * * No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Board of Governors of the Federal Reserve System."

Section 24 of the Federal Reserve Act reads in part as follows:

"Loans made to finance the construction of industrial or commercial buildings and having maturities of not to exceed eighteen months where there is a valid and binding agreement entered into by a financially responsible lender to advance the full amount of the bank's loan upon the completion of the buildings and loans made to finance the construction of residential or farm buildings and having maturities of not to exceed nine months, shall not be considered as loans secured by real estate within the meaning of this section but shall be classed as ordinary commercial loans whether or not secured by a mortgage or similar lien on the real estate upon which the building or buildings are being constructed: *Provided,* That no national banking association shall invest in, or be liable on, any such loans in an aggregate amount in excess of 100 per centum of its actually paid-in and unimpaired capital plus 100 per centum of its unimpaired surplus fund. Notes representing loans made under this section to finance the construction of residential or farm buildings and having maturities of not to exceed nine months shall be eligible for discount as commercial paper within the terms of the second paragraph of section 13 of this Act if accompanied by a valid and binding agreement to advance the full amount of the loan upon the completion of the building entered into by an individual, partnership, association, or corporation acceptable to the discounting bank."

Section 5200 of the Revised Statutes of the United States reads as follows:

"Sec. 5200. The total obligations to any national banking association of any person, copartnership, association, or corporation shall at no time exceed 10 per centum of the amount of the capital stock of such association actually paid in and unimpaired and 10

per centum of its unimpaired surplus fund. The term 'obligations' shall mean the direct liability of the maker or acceptor of paper discounted with or sold to such association and the liability of the indorser, drawer, or guarantor who obtains a loan from or discounts paper with or sells paper under his guaranty to such association and shall include in the case of obligations of a copartnership or association the obligations of the several members thereof and shall include in the case of obligations of a corporation all obligations of all subsidiaries thereof in which such corporation owns or controls a majority interest. Such limitation of 10 per centum shall be subject to the following exceptions:

"(1) Obligations in the form of drafts or bills of exchange drawn in good faith against actually existing values shall not be subject under this section to any limitation based upon such capital and surplus.

"(2) Obligations arising out of the discount of commercial or business paper actually owned by the person, copartnership, association, or corporation negotiating the same shall not be subject under this section to any limitation based upon such capital and surplus.

"(3) Obligations drawn in good faith against actually existing values and secured by goods or commodities in process of shipment shall not be subject under this section to any limitation based upon such capital and surplus.

"(4) Obligations as indorser or guarantor of notes, other than commercial or business paper excepted under (2) hereof, having a maturity of not more than six months, and owned by the person, corporation, association, or copartnership indorsing and negotiating the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

"(5) Obligations in the form of banker's acceptances of other banks of the kind described in section 13 of the Federal Reserve Act shall not be subject under this section to any limitation based upon such capital and surplus.

"(6) Obligations of any person, copartnership, association or corporation, in the form of notes or drafts secured by shipping documents, warehouse receipts or other such documents transferring or securing title covering readily marketable nonperishable staples when such property is fully covered by insurance, if it is customary to insure such staples, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus

when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such obligation, and to an additional increase of limitation of 5 per centum of such capital and surplus in addition to such 25 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 120 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 30 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 125 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 35 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 130 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 40 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 135 per centum of the face amount of such additional obligation, and to a further additional increase of limitation of 5 per centum of such capital and surplus in addition to such 45 per centum of such capital and surplus when the market value of such staples securing such additional obligation is not at any time less than 140 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association or corporation arising from the same transections and/or secured by the identical staples for more than ten months. Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents, warehouse receipts, or other such documents transferring or securing title covering refrigerated or frozen readily marketable staples when such property is fully covered by insurance, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus when the market value of such staples securing such obligation is not at any time less than 115 per centum of the face amount of such additional obligation, but this exception shall not apply to obligations of any one person, copartnership, association, or corporation arising from the same

transactions and/or secured by the identical staples for more than six months.

"(7) Obligations of any person, copartnership, association, or corporation in the form of notes or drafts secured by shipping documents or instruments transferring or securing title covering livestock or giving a lien on livestock when the market value of the livestock securing the obligation is not at any time less than 115 per centum of the face amount of the notes covered by such documents shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus. Obligations arising out of the discount by dealers in dairy cattle of paper given in payment for dairy cattle, which bear a full recourse endorsement or unconditional guarantee of the seller and are secured by the cattle being sold, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

"(8) Obligations of any person, copartnership, association, or corporation secured by not less than a like amount of bonds or notes of the United States issued since April 24, 1917, or certificates of indebtedness of the United States, Treasury bills of the United States, or obligations fully guaranteed both as to principal and interest by the United States, shall (except to the extent permitted by rules and regulations prescribed by the Comptroller of the Currency, with the approval of the Secretary of the Treasury) be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

"(9) Obligations representing loans to any national banking association or to any banking institution organized under the laws of any State, or to any receiver, conservator, or superintendent of banks, or to any other agent, in charge of the business and property of any such association or banking institution, when such loans are approved by the Comptroller of the Currency, shall not be subject under this section to any limitation based upon such capital and surplus.

"(10) Obligations shall not be subject under this section to any limitation based upon such capital and surplus to the extent that such obligations are secured or covered by guaranties, or by commitments or agreements to take over or to purchase, made by any Federal Reserve bank or by the United States or any department, bureau, board, commission, or establishment of the United States, including any corporation wholly owned directly or indi-

rectly by the United States: *Provided,* That such guaranties agreements, or commitments are unconditional and must be performed by payment of cash or its equivalent within sixty days after demand. The Comptroller of the Currency is hereby authorized to define the terms herein used if and when he may deem it necssary.

"(11) Obligations of a local public agency (as defined in section 110 (h) of the Housing Act of 1949) or of a public housing agency (as defined in the United States Housing Act of 1937, as amended) which have a maturity of not more than eighteen months shall not be subject under this section to any limitation, if such obligations are secured by an agreement between the obligor agency and the Housing and Home Finance Administrator or the Public Housing Administration in which the agency agrees to borrow from the Administrator or Administration, and the Administrator or Administration agrees to lend to the agency, prior to the maturity of such obligations, monies in an amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity, which monies under the terms of said agreement are required to be used for that purpose.

"(12) Obligations insured by the Secretary of Agriculture pursuant to the Bankhead-Jones Farm Tenant Act, as amended, or the Act of August 28, 1937, as amended (relating to the conservation of water resources), shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus.

"(13) Obligations as endorser or guarantor of negotiable or nonnegotiable installment consumer paper which carries a full recourse endorsement or unconditional guarantee by the person, copartnership, association, or corporation transferring the same, shall be subject under this section to a limitation of 15 per centum of such capital and surplus in addition to such 10 per centum of such capital and surplus: *Provided, however,* That if the bank's files or the knowledge of its officers of the financial condition of each maker of such obligations is reasonably adequate, and upon certification by an officer of the bank designated for that purpose by the board of directors of the bank, that the responsibility of each maker of such obligations has been evaluated and the bank is relying primarily upon each such maker for the payment of such obligations, the limitations of this section as to the obligations of each such maker shall be the sole applicable loan limitation: *Provided further,* That such certification shall be in writing and shall be retained as part of the records of such bank."

Representative REUSS. Let me ask you, Mr. Martin, is it not a fact the borrowing at the rediscount window by member banks is at any one time, including the present time, very, very small in relation to the total lending power of the banking system?

Mr. MARTIN. It has been very small in recent years and over the period of the Federal Reserve history there has been a tendency for banks to feel that there was something wrong about borrowing at the discount window.

Representative REUSS. The so-called reluctance thesis.

Mr. MARTIN. That is right. We have tried to discourage this somewhat because we want the discount window to be as useful as possible.

Representative REUSS. It is a fact, is it not, that at present and for the last year the amount of borrowed reserves from the Federal through the rediscount window by the banking system has been a very tiny fraction of their total lending power, something like one-twentieth of 1 percent? Does that figure seem about right?

Mr. MARTIN. A very modest amount, and this has been because we have pursued an easy money policy.

Representative REUSS. Is it not an accurate statement, then, that your action in raising the rediscount rate from 4 to 4½ percent on December 3 was largely symbolic and largely relating to the interest rate rather than anything that could have a tremendously meaningful direct effect?

I say this because of, one, your ability to slam the rediscount window shut and, two, the fact that it is such a tiny portion of the total lending capacity of the banks.

Mr. MARTIN. It could become larger. Let me just go back to my statement and make the point again, "Let none of us overlook the fundamental difference between a change in interest rates imposed by a central bank contrary to the trend of basic economic forces, and a change permitted by the central bank in line with those forces."

Representative REUSS. You would agree that it was largely a symbolic action?

Mr. MARTIN. Well, it was a little bit more than symbolic because it was getting in line with the market.

Representative REUSS. And in fact within hours after you raised the rediscount rate the banks throughout the country, at least the larger banks, increased their lending rates to their customers by amounts roughly reflecting your action, did they not?

Mr. MARTIN. The prime rate; that is right.

Representative REUSS. Now let me look at something else with you. It is a fact, is it not, that negotiable time certificates of deposit, CD's as they are called, have gone up enormously in the last 4 years but particularly enormously in the year immediately preceding, and in fact they have gone up by about $4 billion in the last year? Is that correct?

Mr. MARTIN. That is correct. On Mr. Patman's earlier question, without bringing it up to date, I have here the table that shows that for all districts the certificates of deposit amount to $16,367 million. The big bulk of them, almost half, are in New York.

Representative REUSS. Yes. Now I know that you abhor the idea of being an engine of inflation, but I am going to put it to you that unwittingly you and the Fed are maybe being a small engine of in-

flation as follows: This new thing under the sun, a certificate of deposit, is held very largely in large amounts and these CD's are issued very largely, 80 or 90 percent, by some 20 or 30 of the biggest banks in the country. Is that not so?

Mr. MARTIN. By the larger banks for the most part, yes.

Representative REUSS. Yes. And is it not so that whereas an ordinary bank deposit made by a corporation, which does not pay any interest, leads to a credit expansion on the part of the bank in the ratio of about 6 to 1, that a negotiable time certificate of deposit leads to a staggering credit expansion by the banking system potentially of 25 to 1 because of the present reserve requirement on time deposits of 4 percent. Is that not so?

Mr. MARTIN. On the basis of reserve requirements, yes. But this gets back into what constitutes the money supply. Here I have repeatedly said——

Representative REUSS. Can we discuss that at some other time? I am just talking about reserve requirements.

Mr. MARTIN. This is directly related to it. That is the only reason to go ahead to discuss it. It is in my judgment directly related because what constitutes a money supply is a part of this. The accepted definition we have mostly used has been just currency and demand deposits.

Representative REUSS. I have tried to throw in time deposits and I have been sympathetic to it. There is no argument there.

Mr. MARTIN. Right.

Representative REUSS. Getting back to the lending capacity of banks, is it not a fact that when the amount of outstanding negotiable CD's increased this year by $4 billion, since they are classified as time deposits, and since the current reserve requirement ratio on time deposits remains at 4 percent, that banks could expand credit in a ratio of 25 to 1.

Is that not so?

Mr. MARTIN. Would you like Governor Mitchell to answer that?

Representative REUSS. He has telegraphed his answer by shaking his head, but I will hear him.

Mr. MITCHELL. You did not get the reason. You only got the answer.

Well, I think the point is that the banks in putting out negotiable CD's are buying savings instead of creating funds. If the savings and loan association, for example, got $16 billion worth of CD's these would be savings, no one would argue about that.

Representative REUSS. They can only lend $16 billion.

Mr. MITCHELL. They can only lend $16 billion. The same is true with respect to banks as far as time accounts are concerned.

Representative REUSS. As far as what?

Mr. MITCHELL. As far as time accounts or CD's are concerned. The banks' disadvantage over the savings and loan associations is that they must put up a 4-percent reserve. Whereas the savings and loan associations borrow savings and have no legal reserve requirement whatever.

Representative REUSS. When the banking system which in 1960 had zero certificates of deposit acquires as of now $16 billion of certificates of deposit, what is the difference in the ability to extend credit on the part of those banks which have acquired it?

Don't they get a 25 to 1 of volatile, high-powered dollar?

Mr. MITCHELL. No. Look at it this way. The economy in the last 2 years has generated about $70 billion of new funds of which something on the order of $6 billion is from monetary creation. The rest is savings. The time deposit total is mainly savings, not new monetary creation. The monetary creation is reflected in the additions to demand deposits which have the expandable characteristics that you referred to.

Representative REUSS. Mr. Maisel, you perhaps can educate me on this.

Mr. MAISEL. All I can say is that this is a debate which goes back to the 1920's. You will find it in the books throughout this period. I think that we won't get too far trying to solve the debate. It comes down to the question of whether an individual bank can create deposits or whether the banking system can create deposits.

Representative REUSS. I was talking about the system.

Mr. MAISEL. I think what the debate between Governor Mitchell and you really revolves around is the question of how high-powered these deposits are. For example, many have argued that the banks have been issuing too much credit. Governor Mitchell does not agree because he feels that the banks haven't been issuing credit, they have been collecting more savings. Therefore he does not agree with you.

On the other hand, I would guess Chairman Martin might well agree with you. He believes that the banks have been issuing too much credit. He is concerned with the assets they have bought with these savings deposits.

I think what you have to decide here is what happens when banks increase time deposits. Some define money as currency and demand deposits. Others define money as currency, demand deposits, and time deposits. Others are concerned because bank assets have increased rapidly. They don't differentiate between loans based on demand deposits and those based on time deposits. I think that you have called attention to a basic disagreement among the members of the Board. However, this disagreement does not go along the same line as does that with respect to the discount rate.

Representative REUSS. I love Chairman Martin as much as I do Governor Mitchell. I am perfectly ready to hear him on this. When the banking system gets an extra billion dollars of certificates of deposits and having in mind the 4-percent reserve requirement for time deposits, of which the certificate of deposit is an example, what happens to the credit-creating capacity of the banking system? Is it just like a savings and loan association? Do they only get a billion dollars they can put out?

Mr. MARTIN. If it is bona fide savings, yes.

This is the problem: I think Governor Maisel has pointed it up and I think Governor Mitchell has pointed it up. I don't like to quote a man who is dead now, but I had this same discussion with Lord Keynes a good many years ago before he died. He told me that people look at this money supply and they think they understand it and they spend a lifetime on it and they are not sure.

It is a very complicated problem, what constitutes the money supply as such. That is the reason I put it in terms of the money supply.

Representative REUSS. Why do you have any reserve requirement on time deposits?

Mr. MARTIN. This has been a debatable point and we have discussed whether we should take it off entirely. There have been many briefs filed on this. A number of years ago the American Bankers Association did quite a study on reserve requirements and they advocated eliminating that.

Representative REUSS. Since you haven't followed their advice and have retained the reserve requirement, this indicates some vestigial feeling that this does have something to do with the credit-creating capacity of the banking system. That being so, why do you not raise, as you can under present law, the reserve requirement on this particular novel CD instrument? Why don't you raise the reserve requirement from 4 to 6 percent and thus take an important anti-inflationary step?

Mr. MARTIN. Well, we could. Let Mr. Mitchell give you that.

Mr. MITCHELL. Let me try again, Mr. Reuss.

What enables banks to expand deposits is excess reserves. If they attract deposits and reserves in the same proportion, their increased lending capacity is similarly confined. But if they attract more reserves than they need to cover their deposits then they can expand their deposits by making additional loans or investments. This is the way in which the banking system achieves the expansibility you refer to. Now the argument that Governor Maisel referred to is this: If the Federal Reserve System had as its objective the expansion of the money supply or the demand deposit component of the money supply by 4 percent a year, and in doing so found that some demand deposits were being transferred into time deposits, the precise measurement of its policy posture would be difficult. This is because there are at least two other major sources of time deposits other than demand deposits. One is other financial intermediaries such as savings and loan associations and the other is the money and capital market. Corporations who have previously held their funds in Treasury securities can sell securities and convert their holdings into CD's and then banks with the expansion of their time deposits can buy securities or make loans. So you can have a rise in time deposits which only moderately and, I believe, to a fairly small extent, reflects monetary creation.

Representative REUSS. Are you prepared to assign a coefficient to that small extent?

Mr. MITCHELL. Some econometric studies indicate as much as 25 to 35 percent of the change in time accounts in certain periods.

Representative REUSS. My time is up but I would like you, Chairman Martin, if you would, to file with our committee an answer to the question I presented, which is: Why, if the 4-percent reserve requirement on time deposits is meaningless, do you not at least lower it or ask Congress for its abolition; and if it is not meaningless why don't you now take what would seem to some of us to be a proper anti-inflationary step by raising it at least within your present legal limits of 4 to 6 percent? Because my time is up and because my question is complicated, I will ask to file it.

Mr. MARTIN. We will file a paper on it. It is not meaningless. It has to be integrated with monetary policy.

(Data subsequently supplied by the Federal Reserve Board relating to the above discussion appears on p. 590 of volume 2 of these hearings.)

Chairman PATMAN. Senator Miller?

Senator MILLER. Governor Maisel, you characterized yourself as a "fiscal conservative" this morning. Do you classify yourself as a monetary conservative, too?

Mr. MAISEL. Perhaps. I am not as certain of that.

Senator MILLER. I was wondering why you apparently laid such great stress on the fact that it appears during the next year we are going to have $40 to $45 billion increase in our gross national product.

Mr. MAISEL. I was attempting to explain how I felt inflations occurred. In other words, I feel that the goal of monetary policy is to attempt to maintain the economy's demand within the normal limits set by the ability of the economy to increase production. What I was saying was that as long as I believe that the increase in demand next year would not outrun the increase in potential production based upon a growing labor supply, the increase in capacity, and the growth in productivity, then it was not incumbent upon the Board to use monetary policy to attempt to hold back demand.

Senator MILLER. I am very glad to get this pointed out because I have always been taught that what we should pay attention to for this purpose is not GNP but true economic growth and that there is an old economic principle that when our money supply increases more in a year than our true economic growth, then we are going to have inflation. But I, frankly, have never heard the philosophy that when we increase our money supply no more than our increase in GNP we don't have to worry about inflation.

Do you subscribe to the idea that we can increase our monetary supply in the same amount as our increase in GNP without any worry about inflation? Is that your point?

Mr. MAISEL. No, sir; it is not. The rate at which we have been increasing our money supply has been far less than the rate of increase in GNP.

If anybody were to argue that we could increase them at the same rate, then we would have no monetary explanation as to why prices have been going up. Increases in the money supply have been far below the rate of increase in the GNP.

Senator MILLER. I understand that, but at the same time, Mr. Maisel, it has been considerably in excess of our true economic growth. That is why we have had inflation.

Mr. MAISEL. No, sir; I don't believe the figures would work out that way.

Senator MILLER. You give me the figures that you contend represent the increase in the money supply.

Mr. MAISEL. Yes, sir. I have the figures right here for the last 3 years. For 1964 the money supply increased at a rate of 4.3 percent.

Senator MILLER. Can you give it to us in dollars?

Mr. MAISEL. I will find that. I have simply the rate of increase, 3.8 percent in 1963, 3 percent in 1964, and 4.2 percent thus far this year.

Senator MILLER. I think it would be helpful and more meaningful if we had the amount of dollars, billions of dollars. Frankly, I have seen the figure $25 billion increase in our money supply.

Mr. MITCHELL. Five or six billion dollars a year.

Senator MILLER. I understood that included increased currency, demand deposits and time deposits.

Mr. MAISEL. We saw from our earlier discussion a problem exists on how to define the money supply. However, here are the figures for the normal definition—currency plus private demand deposits.

In December 1961, it was $143.3 billion; in December 1962, it was $147.3; in December 1963, it was $153.1; in 1964, it was $159.7. So that I think the figures Governor Mitchell gave you were approximately right. That would average about $5.5 billion a year increase.

Senator MILLER. Then we are not on the same ground in the definition of money supply. What I was talking about is money supply to include additional currency, demand deposits and time deposits.

Mr. MAISEL. That is correct. To get on common ground we would have to agree on the argument that Governor Mitchell had with Congressman Reuss. Congressman Reuss wanted to include at least some part of the time deposits in the money supply and Governor Mitchell indicated he felt that to do so would be an error.

Senator MILLER. The point is, if you do include it, it seems to me what you should be looking at is not increase in GNP but true economic growth. They are certainly not in the same ballpark at all. Last year our increase in GNP, as I recall, was somewhere around $38 billion. After taking out the inflation we had around $27 billion of real dollar increase in GNP. If you take the $25 billion increase in the money supply, using the coverage that you referred to, we shouldn't have had any inflation. Since we had $11 billion of inflation we know that the real dollar increase in GNP is not the same as true economic growth.

It seemed to me that perhaps we ought to pay a little more attention to our true economic growth and a little less attention to increase in GNP.

I would like to ask Chairman Martin this question: I know that perhaps an increase in the cost of borrowing money for mortgages and plant expansion might tend to dampen down plant expansion. Would it be your opinion that an increase in the inflation, which would naturally balloon up into an increased cost in the plant itself, and probably be accompanied by increased wages, would not tend to dampen down plant expansion, too?

Mr. MARTIN. I think it would.

Senator MILLER. I share that opinion very strongly.

Also, while it is recognizable that there was some improvement in our balance-of-payments deficit problem as against last year, since you told me that you embraced in that concept the outflow-of-gold problem, I am sure you took into account the fact that we had an outflow of gold, as I understand it, of $1.3 billion during just the first 8 months of this year which was as much as the previous 3 years put together.

I take it you took that into account, too?

Mr. MARTIN. Yes.

Senator MILLER. So that while we might have had an improvement in the balance-of-payments deficit it looks like we were pretty far backward on the outflow-of-gold problem, did we not?

Mr. MARTIN. That is correct.

Senator MILLER. If you went into this with Congressman Reuss, Mr. Mitchell—please forgive me but you did make the suggestion that you could—the Board could neutralize the interest rate increase by activities of the open market committee.

Would you explain what you had in mind when you made that statement?

Mr. MITCHELL. Instead of providing funds in a volume which would validate a level of rate such as we have today, and which is consistent with the discount rate, 4½ percent, we could have provided a larger volume of reserves which would have resulted in the decline from present interest rate levels.

Senator MILLER. Would you explain the mechanics?

Mr. MITCHELL. The mechanics of Federal Reserve operation——

Senator MILLER. Of the open market operation.

Mr. MITCHELL. The open market operation supplies reserves through the purchase of securities and provides them in sufficient volume to take care of seasonal needs, knots in the market, and for economic growth.

Now this particular period of a year is one in which there are a great many knots in the money market because of the dividend date, December 10, and tax date, December 15. So the System is in process of providing very large reserves through the purchase of securities. By providing more than is needed for their purposes would weaken the structure of interest rates.

Senator MILLER. May I ask Chairman Martin whether it is his feeling that there may be some action such as this by the open market committee to offset the impact of the increase in the interest rate?

Mr. MARTIN. If you will look at our statement announcing this we took cognizance of the problems of the market. Certainly the System tends to deal as responsibly as it can with the market. Again I want to reiterate, I hope you don't think I am captious on this, that I think it is very bad for us in open hearings to be forecasting or predicting what is going to happen to the course of interest rates unless we expect to alter the market operation entirely by discussion. I think that the reason that the Congress has given us the authority as presently put there is for that purpose. I don't want to get myself today in a position of forecasting outside of this statement that we have made. We have another meeting of the Federal Open Market Committee tomorrow. We meet every 3 weeks, and monetary policy is the most flexible instrument that the Government has. We can change policy. One of the reasons I am against prediction is that we ought to guard against being tied to a preconception. We ought to keep an open mind on these things.

Senator MILLER. I accept that restraint.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I would like to come back, Chairman Martin, very briefly to the point I was trying to make this morning. Isn't it true that action by Congress to give the President the powers he used to have but which have now lapsed—and now which I understand he can only use in the event he declares an emergency or we declare war against North Vietnam—to limit consumer credit terms would mean we would have an alternative weapon, an optionable weapon, which could have a strong effect on restraining demand as

decisively as you want to make it, depending on how stringent you want to make the terms or limit them.

In other words, it could have the same effect in dampening down inflation as an increase in the interest rates would have and there would be no increase in the cost of national debt, no increase in the cost of borrowers and, most important of all by far is that there would not be an inhibition on business investing in plant and equipment and thereby supplying the production that could prevent a future inflation.

Selective credit controls, also, would not inhibit building educational facilities which also increases efficiency of the labor supply and therefore have a tendency to keep down prices. Increased interest rates directly discourage school building.

Mr. MARTIN. I will simply add to what I said this morning, Senator, that selective controls have a real purpose under certain conditions. We had them during the war period and, on the whole—I was not there so I am not speaking as one who was party to it—I think they handled regulation "W" and regulation "X" very well.

From talking to people who administered them, I know they had a great many problems. They are not easy to administer.

Senator PROXMIRE. I am sure they did. I am not suggesting that there will be anything compulsory about it. What I am saying is that this should be an optional weapon which in view of present circumstances might be made available by Congress as a standby option.

Mr. MARTIN. It ought to be considered. If we get to a wartime situation certainly it should be considered. The point that I want to make is, and this is not criticism of the Congress, the Board suggested during the Korean situation that we be left this authority on a standby basis. The Banking and Currency Committee took it away from us. I am not criticizing them for it. I am not fighting an old battle but I say on a standby basis I think it would have been wiser to have left us with this authority.

Senator PROXMIRE. Am I mistaken when I understand you did not ask for it back or that you opposed it?

Mr. MARTIN. We have not asked to get it back. That was a long time ago. We have not proposed any legislation along those lines.

Senator PROXMIRE. You have neither opposed or proposed it?

Mr. MARTIN. At this juncture, yes. But it certainly should be considered.

Senator PROXMIRE. Senator Miller briefly referred to this, but I would like to explore it—I am not asking for any prediction, of course, and I recognize you are very wise in resisting that kind of answer—but in your statement you say the following: "The Federal Reserve faced a choice between attempting to check or reverse the rise in interest rates by accelerating the rate at which it was providing reserves to the banking system," or as an option, "raising the time deposit rate ceiling to allow the economy to use more efficiently the funds already available and raising the discount rate to bring it more in line with existing market rates."

Now this suggests that the impact of the increase in the rediscount rate can be quite moderate, in fact can be almost negligible provided the Federal Reserve Board continues to follow the policy as it has in the past.

I am not asking what you are going to do but I am asking whether I have a proper understanding—and you are expert in these money matters and I am not. Does this statement mean if conditions remain the same and if the Fed should continue to expand the money supply at about the same rate as before, if this is done, won't this minimize the stabilizing effect of the interest rate increases and doesn't this mean you are driving monetary policy in opposite directions. You are rising the discount rate but at the same time you are increasing the monetary reserves.

Mr. MARTIN. A visual picture I have is of a car going at maybe 60 or 70 miles an hour and slows down to 50 miles an hour, which is by no means stopping, in getting toward the same objective. Again I simply go back to the statement that the Board made—because it is up to the open market committee and the Board to determine policy—but I read it here:

> The action contemplates, however, the continued provision of additional reserves to the banking system in amounts sufficient to meet seasonal pressures as well as the credit needs of an expanding economy without promoting inflationary excesses, primarily through the Federal Reserve's day in and day out purchases of Government securities in the open market.

Senator PROXMIRE. It seems to me this is a very crucial point because both you and Governor Mitchell and perhaps others have said here today that the position is irreversible. I think Governor Maisel made the same statement. On the other hand, you have sufficient flexibility here so that while the discount rate may be irreversible it is possible for you so to operate the open market policy that you prevent any substantial increase in interest rates if the objective facts were to persuade you that is a wise policy.

I am not asking what you are going to do. I say you could do that without being frozen into a position of high interest rates, in other words.

Mr. MARTIN. We have flexibility, and the whole basis of the statement which I made was that monetary policy is the most flexible instrument that the Government has.

Senator PROXMIRE. Let me ask you a questiton—and I don't mean this to be at all impertinent—but it is a question which has troubled me. I want to put it hypothetically after I indicate why I am asking it. It was reported in the papers that in the event the President should appoint another member of the Board—when a place is vacant—who disagreed with your position and if you in this sense should lose control of the Board that you would resign.

Now having made that statement, and I am not asking about any confirmation or denial of it, do you think that part of the independence of the Federal Reserve Board depends upon having a chairman who must insist that he has a workable majority on the Board in general for his philosophy and his position?

Mr. MARTIN. I don't want to refer to any statements that have been made. I have tried to avoid this problem. I don't know what the situation is. I will cross that bridge when I get to it. I can assure you that the one thing that is of vital importance to me as an individual, and this has nothing to do with my associates, and I hope this does not sound sloppy or silly, but it happens to be my concept of my personal integrity. If I felt that I could not discharge my responsi-

bilities in consonance with my personal integrity I would feel bound to resign.

This has nothing to do with future policy or anything else. But that is as far as I can go on this particular problem.

As I said this morning—again I don't intend to sound sloppy at all—at some point these things become matters of conscience, responsibility, and integrity.

Senator PROXMIRE. I appreciate that. I have the greatest admiration for your integrity as well as for your ability. You see, the thing that troubles me a great deal is the authority that the appointment power gives the President of the United States under these circumstances and the fact that every member of the Board has a right of course and a duty to discharge his duty as he sees it.

Whether this means any member, however, should take the position that unless he maintains his position of power he should resign is something else. That is an additional authority which would seem to me to somewhat diminish the authority which the act gives the President in his appointive discretion.

Mr. MARTIN. I appreciate the spirit in which you ask this question. I would only respond and I think I should respond as I have to it. I don't consider it impertinent at all. As you know, Chairman Patman has been a good friend of mine through the years. We don't agree but we have never had any discourtesy between us. He has asked for my resignation on three or four occasions this year. I have not accepted that in any ill temper. I would only say when I made my talk in June and there was some discussion about this that I was asked if I intended to resign and I made the comment that when and if I decided to resign I will let you know promptly.

Senator PROXMIRE. May I ask a question I have asked before but I would like to have you bring it up to date if you could? As you know, I have pointed out that Philip Bell, a professor of Haverford, and Dr. Gemmill, who has worked with the Federal Reserve Board, have both made studies which to them indicated that interest rate differentials are a relatively minor factor in the flow of funds abroad, in the balance of payments.

I have been pressing to see if we can get an up-to-date and more comprehensive study by the Board. I wonder if you have any knowledge of any such study which would show that interest rate differentials, this increase in the interest rate at this time might be a reasonably decisive factor in the flow of funds, in the balance of payments.

Mr. MARTIN. No, I have no study. I think that those men you referred to are very competent and intelligent men. I think that we will have to use the current experience to see whether there is any additional light thrown on this. I would think that it is very difficult to make this sort of judgmental analysis.

One of the difficulties that all of us are confronted with, and goodness knows I have the deepest respect and confidence for the President of the United States, but I am glad I am not in his shoes because of the disparity of advice that he gets from so-called experts.

Senator PROXMIRE. Thank you very much. My time is up.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. Mr. Maisel, we have wage-price guidelines and use of stockpiles to enforce Government policy. This is quite obvious right now. Equilibrating economic forces are not being allowed to operate. If distortions in the economy persist or grow worse and call for further controls, wouldn't the use of a general policy instrument such as monetary and fiscal policy be preferable to selective controls?

Mr. MAISEL. I think on the whole not, Mr. Widnall. I would prefer the present administration's policy. I think what we are dealing with here is the basic concept of the wage-price guidelines. As I understand the concept, it is based on the fact that in certain major industries, because of their oligopolistic nature the market simply does not work as described by Adam Smith.

The same thing obviously holds true with unions. Where you have a union that dominates an industry, the market gives rather wide limits to the potential wage increases the union can demand.

As I understand the present administration policy, it holds that it is necessary in such cases for the public point of view to be expressed. It should be made clear that in these markets if the union fights the company and then the company fights the union, the United States of America will lose. If the wage bargains exceed the rate of increase in productivity, we will be in a position where the monetary authority will be faced with a choice of either ratifying the wage-price increase by furnishing more money or not to ratify it by refusing to furnish sufficient money. If it takes this last path it will cause a large amount of unemployment.

As I say, this is my understanding of the way in which the President is operating. I personally think that it is a proper policy for a period such as this. As we approach the full employment level, we are walking on a tightrope.

I think it has been clear from our discussion today that none of us are very certain of the best policy in such a period. You have to weigh different risks. We might compare the problem to a mother training a child. One of the ways of getting the child used to basic danger is to let him go close to the danger if you feel sure you can get him back in time, even though this is running a risk.

Other types of parents feel, no, that is not right. We had better not have the child go out in the street or take any risks for fear it might get hurt. I think there is a similar philosophical difference among the members of the Board, and probably among the members of the committee, as to how you should best operate in a period near full employment.

My own opinion is that in this period the President has made the proper choice by attempting to use the stockpiles and the price guidelines in order to hold prices down while expanding output. As I indicated in my opening statement, I preferred to give the President his chance to see whether his policies could operate or not. I felt it wasn't up to me to say that I know your policies are wrong and therefore we should impose a tighter monetary policy upon the administration.

It seemed to me the political officials—Congress and the President—had to make a basic decision here as to what risks they were willing to take.

Only if they went beyond reasonable bounds, if they attempted to force bonds into the Federal Reserve System from the Treasury or to take other measures such as that, would the independence of the Federal Reserve become critical.

I also think it is important for the Federal Reserve to express its opinion to the other groups. The administration should have the best advice of the Federal Reserve System as to what dangers we think are in prospect. We should also speak out giving our views on whether the policy package can work or not.

But I, at least for the time being, would prefer to let the political authorities make the decision as to what types of risks they believe are proper for the country. Until the danger is clear and evident, they should determine what policy mix is most likely to achieve the country's goals.

Representative WIDNALL. What bothers me is the selectivity of the administration action. I don't know how these cost-of-living index figures really get arrived at. As a personal shopper for many years, I am talking now of a middle income family and low income family, I have found the cost of living going up considerably when you go to a store, whether it is a chain store or an independent, for the things that you have to buy day-by-day for the average family.

You get a figure that it is 1 percent or so. It is just not true if you are buying for the average family. There are shortages which have been created artificially, some by Government action. I think it is particularly true with respect to farm labor. I deplore action that is taken against the aluminum companies and others on a selective basis.

When bread goes up 2 cents a loaf or milk goes up 2 cents a quart, nothing seems to happen to things that affect the cost of living of the people of the United States, and far more so than I think, the price of aluminum.

I believe that the Joint Economic Committee and other committees of the House and Senate could well look into our cost of living index and rework the figures on that so that we can get a more realistic figure.

Now if we assume for the moment that rising Vietnam spending will make it difficult to cut overall Federal expenditures, what is the next step you would favor if the economy begins to overheat?

Would you want to see an increase in taxes, a further tightening of credit, or both?

Mr. MAISEL. If I may first respond to the first statement. I think the problem of aluminum is the fact that there are only four or five major aluminum companies. If there were more companies, we would have the market actually determining prices as we do in other areas.

Secondly, I am concerned with the price of bread and feel strongly as you do that the cost of living index ought to be looked into. I am also aware, however, that small items may give us an exaggerated view of price movements. For example, I also buy cars. A car is a very heavy part of the cost of living for the average family. As I recall, I think I paid less for a car this year than I paid for my car 15 years ago, even though they appear to be roughly the same car.

I think we have to be careful when we look at costs not to weigh very heavily the cost of bread that we buy every day while we forget the cost of the car which we buy once every 5 years.

With respect to the second part of your answer, as I said and as I think Chairman Martin said earlier, it has long been my own opinion that we have not raised taxes soon enough when the country has been in a war period. I think failing to raise taxes has been an error in the past for which the country has paid.

If we are going to have a major expansion of demand in the case of Vietnam, and if it becomes clear that this will be an excess demand, I think the proper way of meeting it is through a tax increase.

Representative WIDNALL. Mr. Mitchell, would you comment on that latter question that I just asked. If the economy does begin to overheat, would you want to see an increase in tax, a further tightening of credit, or both, or something else?

Mr. MITCHELL. At the moment, I would not want to commit myself. There are the two methods, really three methods. If Vietnam leads to larger military expenditures, we could have a policy of cutting back on other Government expenditures and programs. There is also the possibility of tax increases of one sort or another; some we are going to get anyway. And there is the prospect of tighter money. If I had to choose among all of these at the present time, I would favor higher taxes.

Representative WIDNALL. Mr. Martin, would you comment on that?

Mr. MARTIN. I think you have to use everything, Mr. Widnall. It is very difficult to forecast the picture we are going into. This is, as Governor Maisel said earlier, bordering on a wartime situation. What the expenditures will be in Vietnam, I don't know.

I personally don't think that knowledge of the fiscal 1967 budget was an essential element in the majority's decision with respect to monetary policy at this juncture, but I recognize fully that we may be having a larger commitment there. This is not my area. The administration will have problems here, and I don't think we ought to rule out using anything or everything, because this is what a real wartime situation requires.

Representative WIDNALL. I certainly, for one, believe that it is most important to obtain and keep the objectivity of the Federal Reserve System with respect to the economy, because you can't do the job if it is all being directed and the shots called from one source.

I would like to commend you on the way that all of you have been acting in the responsible action you have shown on a very difficult problem.

Mr. MARTIN. I might say I have heard a lot of people say, "Isn't it terrible that the Federal Reserve Board is divided." It would be a lot easier if we all agreed. But there would be no point in having a board if we all agreed on everything.

Representative WIDNALL. That is all, Mr. Chairman.

Chairman PATMAN. I believe it is my time.

I would like to start where I left off with Mr. Martin a while ago.

I have before me the Wall Street Journal of December 6, 1965. The headline is "Reserve Board Lifts Discount Rate to 4½ From 4 Percent Directly Defying Administration."

It says: "Inflationary pressure, time deposits, interest discount rate is raised to 5½ percent."

Further on in the article it says: "As late as Wednesday, Mr. Martin was under pressure from Treasury Secretary Fowler to delay

any move, but he told Mr. Fowler," that is you, Mr. Martin, that is what this says, "but he told Mr. Fowler of the two district bank requests and said the New York bank, despite some division in its own ranks was putting great pressure on him to grant approval."

Now is that correct or is that incorrect?

Mr. MARTIN. That story is not correct, Mr. Patman.

Chairman PATMAN. You didn't have pressure from the New York bank and Chicago bank?

Mr. MARTIN. No, no pressure at all from them.

Chairman PATMAN. Did you have a request from them to raise the rates?

Mr. MARTIN. Both of the boards of directors of those banks sent in a recommendation to increase the discount rate from 4 to 4½ percent, and I reported that to the Secretary of the Treasury.

Chairman PATMAN. Did they follow up by getting Mr. Hayes and the president of the Chicago bank to call you?

Mr. MARTIN. They did not.

Chairman PATMAN. They did not make any other communication to you except just that one resolution?

Mr. MARTIN. We had a meeting of the Federal Open Market Committee, as I explained to you, on the 23d of the month. We discussed all aspects of this. There was no pressure of any sort brought. There has been no pressure of any sort.

Chairman PATMAN. I am just quoting what the paper said.

I have here a speech made by Governor Balderston that gave the bankers notice, the way I read it, that they were going to have trouble with these CD's. The title of the speech is: "Is the Liquidity of Your Banks Still Adequate?" Remarks of C. Canby Balderston, Vice Chairman of the Board of Governors before the 71st Annual Kentucky Bankers Association on Monday, October 25, 1963.

He points out that the concept of banking has changed in the last 3 or 4 years and the bankers better look out. He winds up by saying:

> Are you satisfied that the assets in your liquidity cushion are truly liquid? To what extent might they become unmarketable if many sellers tried to liquidate them simultaneously?
>
> To what extent are you relying, to meet future liquidity needs, on the issuance of CD's or unsecured notes? Are you counting on the runoff of assets for which there is substantial risk that repayment at maturity might not be realized? Are you placing undue reliance on emergency borrowing, considering the possibility that some of those sources might dry up?

Mr. Balderston's words are very plain. He was saying that the banks had increased their negotiable CD holdings from about a billion dollars in 1961 to about $16 billion now. It is a kind of new source of funds and something new in the banking business, and they were approaching a crisis if something wasn't done. And you solved their crisis, Mr. Martin, by raising the rate of interest banks could pay on these CD's to 5½ percent.

Now, let me turn to another subject. The Federal Reserve Bank of New York naturally has a lot of influence on the Federal Reserve Board. All the important activities of the Federal Reserve Board are carried on in the Federal Reserve bank in New York. I don't have to ask you this. I have asked it before. I know what the answer would have to be.

Mr. MARTIN. And I deny it.

Chairman PATMAN. No, you did not deny it.

Mr. MARTIN. The Federal Reserve Bank of New York runs the System?

Chairman PATMAN. I say that the Federal Reserve Bank of New York, which operates and controls open market activities, controls the most important functions of the Federal Reserve Board's activities. That is correct, is it not?

Mr. MARTIN. They operate as agent for the Federal Open Market Committee.

Chairman PATMAN. That is what you say. But that is the biggest thing in the Federal Reserve System, the Open Market Committee, is it not?

Mr. MARTIN. The decisions of the Open Market Committee are not made by the Federal Reserve Bank of New York. They are made in the Open Market Committee after due discussion.

Chairman PATMAN. The Open Market Committee is the biggest and most important activity of the System. Now the Open Market Committee has $40 billion in Government security holdings currently. The president of each Federal Reserve district bank runs his bank. That is according to the law. Now the law says that, "The president"—I am talking in this case about the president of the Federal Reserve bank in New York—"shall be the chief executive officer of the bank and shall be appointed by the board of directors with the approval of the Board of Governors of the Federal Reserve System for a term of 5 years and all other executive officials and all employees of the bank shall be directly responsible to him."

Now that is very plain language in the law. No one can dispute that language. You have delegated to the Federal Reserve Bank of New York, operating under one man, Mr. Hayes, all the power to run the Open Market Committee, to keep the $40 billion in bonds, to collect the billion and one-half dollars a year interest on the $40 billion in bonds, and then you allocate it out to the other 11 banks. They spend what money they want to, and you spend what money you want to. Then the balance goes over into the Treasury.

There can be no question then that a fantastic amount of power resides in the hands of the president of the Federal Reserve Bank of New York.

Mr. MARTIN. Mr. Patman, I respectfully comment as I have previously, the five men you see in front of you, plus the two who were unable to be here today, have authority to deny Mr. Hayes' salary and to get rid of him.

Chairman PATMAN. Do you think the salary would bother him?

Mr. MARTIN. I happen to think it is a fairly important item for anybody.

Chairman PATMAN. I think the power he has would be worth a lot more than any salary he has.

Mr. MARTIN. The staff of the Federal Open Market Committee is appointed by the Federal Open Market Committee, not by the Federal Reserve Bank.

Chairman PATMAN. The law says here, it is very plain, I think.

Mr. MARTIN. Those are the bylaws, I take it, of the New York Federal Reserve Bank but the Board supervises the entire System. The Board of Governors has the authority and there isn't the slightest question of that.

Chairman PATMAN. I resent your saying that the law is a bylaw. Now you are saying that these are bylaws. They are not bylaws. This is the law. They operate under this law.

Mr. MARTIN. They operate under the Federal Reserve Act which was enacted by the Congress of the United States and which is the law under which we operate until the Congress makes——

Chairman PATMAN. That is right. In the 1913 Federal Reserve Act—you are talking about independence—there was no central bank in 1913. You know that. There was not a central bank until 1933, before that all these 12 banks were separate and distinct. The situation that has prevailed since 1933 under the laws is entirely different from what it was up until 1933 because there was no central bank between 1913 and 1933.

Now, I want to talk about the Board of Governors' term of office—especially that of the Chairman and Vice Chairman. You have said that you believe that the Chairman of the Board term should be coterminus with the President. You have said that, have you not?

Representative CURTIS. Let him answer, Mr. Chairman.

Chairman PATMAN. I know he has.

Representative CURTIS. I would like to hear it from the witness.

Chairman PATMAN. Go right ahead.

Mr. MARTIN. I have discussed this a number of times as you know, Mr. Chairman. I did at one point make that comment, I don't like to be quoting people who are dead but I did discuss this with President Kennedy at some length. He and I both agreed, and I regret that he is not available for comment, that it would be desirable, since the chairmen were appointed, to have the Chairman of the Board persona grata to the President of the United States. He suggested to me in our conversation that the Chairman's term should expire perhaps 6 months after a new President took office; it might be a desirable thing to separate the appointment of the Chairman of the Federal Reserve Board from the members of the Cabinet.

I had told him that I would undertake to take that up with the American Bankers Association to see if I could not get their support for it.

Now I think this is a very broad thing. The Federal Reserve is evolving in many ways. Part of that evolution occurred with the amendments made by the Congress in the Banking Acts of 1933 and 1935, and as I have indicated again this morning, the Federal Reserve can be changed in any way that the Congress sees fit.

I would only hope that it would be done in an objective dispassionate way as I am sure you would want it to be done for the best interest of all the people.

In all I have done I have tried to represent not the bankers but what I conceive to be the people of the United States in their desire to safeguard the currency which I happen to think is very important to them.

Again, I want to use a word that I don't intend to be sloppy but I happen to think that the trusteeship that has been vested in the Board and the presidents of the Federal Reserve banks is a sacred trust and we should discharge it to the best of our ability.

Chairman PATMAN. You won't find anything in the Federal Reserve Act saying it is a trusteeship or that it is independent, either one. I

think that is a myth which some people and groups have tried to sell to the people.

Mr. MARTIN. I don't want to let that go by because that is a constitutional judgment that you are making.

As I say, I did not come up here today to argue the constitutional setup of the Federal Reserve but the law, if it is not clear, ought to be made clear.

Chairman PATMAN. I can't argue with you about what President Kennedy said. But I can't conceive of his being in any other mood except very much displeased when he found out that he was forced to select a Chairman of the Board of Governors of the Federal Reserve System from the existing members of the Board. He could not pick out the best person in the United States by his standards to do that. He was in a straitjacket.

Under the law he had to select one of the existing seven members of the Board. He could not go outside at all. I am sure that was not pleasing to him. I can't argue with you as to what he said but I am sure that it was displeasing to him to learn that here he was in a democracy and the President of the United States could not select the best man in his opinion, for the Chairman of the Federal Reserve Board. He was forced to choose one of the existing seven members as his Chairman.

Mr. MARTIN. Mr. Patman, never have I suggested that I am the best man in the country for this job.

Chairman PATMAN. My time is up, Mr. Martin.

Mr. MARTIN. I simply want to say in President Kennedy's behalf I don't believe that President Kennedy would have had any great difficulty at the time he appointed me in getting rid of me. I don't know that but I don't think so.

Chairman PATMAN. The only way you can make this coterminous is to resign.

Mr. MARTIN. Are you asking for my resignation again?

Chairman PATMAN. I would love for you to, yes, if you want to put it on that basis. It would please me very much and I think it would please a lot of folks and displease a lot of people. Nobody impugns your motives or honesty. I don't.

Mr. MARTIN. I have never impugned yours.

Chairman PATMAN. I feel you are a good patriotic citizen. However, you have views that are not consistent with the Constitution of the United States: If we had—will you pardon me for one moment, Mr. Curtis?

Representative CURTIS. Surely.

Chairman PATMAN. If we had what you wanted we would have two governments in Washington. We would have them right now because you have assumed the power, you have seized it in a genuine way, not in a bloody revolution but you have seized it. Now we have two governments, one is an elected government, the President and all the Members of Congress. They have certain powers but you have the power over money and credit and interest rates and the supply of money and everything that goes to the economic well-being and that is the banker government. We have two governments. One, the constitutional government, elected government, and the other composed of the most powerful group of men in the United States like

yourselves, the unelected officials of the country who are not accountable to anybody. The people can't vote against you. The Federal Reserve Act does not have any way of removing you.

I am not now proposing removal of any of you but I am strongly of the opinion that it is contrary to the Constitution of the United States to have two governments in Washington, one a banker government and one elected by the people.

Mr. MARTIN. This has been your view for a great many years, Mr. Chairman.

Chairman PATMAN. And my views have been strengthened by developments.

(The following material has been supplied by Chairman Patman:

(Chairman PATMAN. It is most informative of Mr. Martin to admit, as he did here in his testimony, that, in his conversation with President Kennedy concerning the idea of making the Chairman of the Federal Reserve Board "persona grata" to the President that he (Martin) "would undertake to take that up with the American Bankers Association * * *" to see if he could "* * * get their support for it."

(No additional proof could be needed to support the fact that the ABA dominates the Federal Reserve Board and System. The ABA through its continual lobbying and pressure extending over almost 100 years has succeeded in subverting the firm intentions and legislative directives of the framers of the System. The System was designed to serve in the public interest. This fact has been documented many times in the past. The following quotes by some of the proponents and framers of the Federal Reserve Act of 1913 indicate their thoughts on this matter:)

DEMOCRATIC PLATFORM, 1912

Banking legislation

We oppose the so-called Aldrich bill or the establishment of a central bank; and we believe our country will be largely freed from panics and consequent unemployment and business depression by such a systematic revision of our banking laws as will render temporary relief in localities where such relief is needed, with protection from control of dominion by what is known as the money trust.

Banks exist for the accommodation of the public, and not for the control of business. All legislation on the subject of banking and currency should have for its purpose the securing of these accommodations on terms of absolute security to the public and of complete protection from the misuse of the power that wealth gives to those who possess it.

We condemn the present methods of depositing Government funds in a few favored banks, largely situated in or controlled by Wall Street, in return for political favors, and we pledge our party to provide by law for their deposit by competitive bidding in the banking institutions of the country, National and State, without discrimination as to locality, upon approved securities and subject to call by the Government.

(The Aldrich plan provided for a great central bank owned by private banking institutions and controlled by them through a clear majority, both in the directorate and in the executive board. The ABA as a body at its meeting in New Orleans in 1911 endorsed the Aldrich bill.

(Representative Glass, who supported what became the Federal Reserve System, a Government institution, met strong eastern opposition to prevent him from being chairman of the House Banking and Currency Committee.)

* * * * * * *

"Beyond all these, waiting to be solved, lying as yet in the hinterland of party policy, lurks the great question of banking reform. The plain fact is that control of credit—at any rate of credit upon any large scale—is dangerously concentrated in this country. The large money resources of the country are

not at the command of those who do not submit to the direction and domination of small groups of capitalists, who wish to keep the economic development of the country under their own eye and guidance. The great monopoly in this country is the money monopoly. So long as that exists our old variety and freedom and individual energy of development are out of the question. A great industrial nation is controlled by its system of credit. Our system of credit is concentrated. The growth of the Nation, therefore, and all our activities are in the hands of a few men who, even if their action be honest and intended for public interest, are necessarily concentrated upon the great undertakings in which their own money is involved and who necessarily, by very reason of their own limitations, chill and check and destroy genuine economic freedom. This is the greatest question of all, and to this statesmen must address themselves with an earnest determination to serve the long future and the true liberties of men." [1]

[1] Address at Harrisburg, Pa., June 15, 1911, The Public Papers of Woodrow Wilson, vol. II, p. 307.

* * * * * * *

No group in the Nation was more anxious for reform than the bankers themselves. They "wanted a change but they wanted the change so made that they might control." [1]

[1] Oscar W. Underwood.

* * * * * * *

"I called [President Wilson's] attention to the fact that our party had been committed by Jefferson and Jackson and by recent platforms to the doctrine that the issue of money is a function of Government and should not be surrendered to banks * * *."

"I also pointed out my objection to a divided control and argued in favor of making the entire board of control appointive by the President, so that the Government would have complete and undisputed authority over the issue of the Government notes which, in my judgment, should be substituted for the contemplated bank notes." [1]

[1] William Jennings Bryan, Secretary of State.

* * * * * * *

Senator Owen also drafted a bill to establish a monetary reform as chairman of the Senate Committee on Banking and Currency. It contained both provisions that Bryan demanded: a board of governors, "all of them Government officials," and "a note circulation consisting of U.S. Treasury notes * * *."

"I had entered the Senate," he said, " * * * in the hope I might be of real service to my country in improving the banking laws whose deficiencies as a practical banker I had had many concrete reasons to keenly appreciate." [1]

[1] Senator Robert L. Owen.

"Power to issue currency should be vested exclusively in Government officials, even when the currency is issued against commercial paper" and the board should be distinctly a Government body and "the function of the bankers should be limited strictly to an advisory council."

"Conflict between the policies of the administration and the desires of the financiers and of big business is in irreconcilable one."—Louis D. Brandeis.

* * * * * * *

"I was very definitely committed to giving the banks some voice. Senator Owen, of the Senate committee, had sided with Mr. Bryan in opposition. At the White House conference [Secretary of the Treasury] McAdoo agreed at first with me; but later in the evening he proposed a compromise"—Carter Glass.

The President after listening to the arguments decided against any banking representation whatever. It must be a Government board. Glass argued valiantly, urging the "essential injustice and political inexpediency" of exposing "the banking business of the country to political control."

But Wilson, having made up his mind, was adamant. Recognizing a deep-seated progressive principle, that the government, not private interests, must be supreme.

Glass was entirely right in his prediction that the decision would raise an uproar among the bankers. He himself, still unconvinced, agreed "with scarcely suppressed satisfaction" to head a delegation to the White House "to convince the President he was wrong"—Carter Glass.

Among the bankers who were thus received were some of the foremost in the Nation, though mostly of the more liberal midwestern group who had been more or less favorable to the Glass bill as originally drawn. Glass himself gives an account of the meeting.

"Forgan and Wade, Sol Wexler and Perrin, Howe, and other members of the Currency Commission of the American Bankers' Association constituted the party. The first two, peremptory and arbitrary, used to having their own way, did not mince matters. They evidently were not awed by 'titled consequence,' for they spoke with force and even bitterness. Sol Wexler and Perrin were suave and conciliatory. The President was courteous and contained. These great bankers, arbiters for years of the country's credits, were grouped about the President's desk in the executive office adjoining the cabinet room. I sat outside the circle, having already voiced my own dissent from the President's attitude. President Wilson faced the group across the desk; and as these men drove home what seemed to me good reason after good reason for banker representation on the central board, I actually experienced a sense of regret that I had a part in subjecting Mr. Wilson to such an ordeal. When they had ended their arguments Mr. Wilson, turning more particularly to Forgan and Wade, said quietly:

" 'Will one of you gentleman tell me in what civilized country of the earth there are important government boards of control on which private interests are represented?'

"There was painful silence for the longest single moment I ever spent; and before it was broken Mr. Wilson further inquired:

" 'Which of you gentlemen thinks the railroads should select members of the Interstate Commerce Commission?'

"There could be no convincing reply to either question, so the discussion turned to other points of the currency bill; and, notwithstanding a desperate effort was made in the Senate to give the banks minority representation on the Reserve Board, the proposition did not prevail"—Carter Glass.

Wilson's arguments at this time, if they silenced the bankers, entirely convinced Glass—"Mr. Wilson knew more about these matters than I did" [1]—and

[1] Carter Glass. Woodrow Wilson Life and Letters, Ray Stannard Baker, pp. 165–167.

from that time onward Glass was a vigorous defender of this change in his measure.

Also included at this point are my supplementary views, submitted as part of the Report of the Joint Economic Committee on the January 1965 Economic Report of the President, 89th Congress, 1st session, 1965.

These views, among other things, show the ways in which the commercial banking interests have taken over the Federal Reserve System, influence and dominate the Open Market Committee, and the way in which the Federal Reserve Board has become completely isolated for the will of the people, the duly elected President and the Congress.

This document presents the facts which clearly support the conclusion that the Federal Reserve Board operates in fact as a fourth branch of Government, not responsible and responsive to the people or their elected officials, but only to the self interests of the banking community.

Supplementary Views of Chairman Patman

The Joint Economic Committee has just completed intensive hearings on the Economic Report of the President, and members of the committee have devoted many hours of careful analysis to the crucial questions involved in achieving full employment in our economy. Prior to that, the President and his advisers spent many hard hours working on the content of the report, which is indeed an excellent one. Yet all this work can come to nothing because of a grave weakness in the existing system: the fact that neither the President nor the Congress controls the vast monetary powers of the Nation. The purposes of the Full Employment Act cannot be carried out unless the Government has the power to control and coordinate all of its economic activities, including the all important monetary powers which involve control of the money supply, the extent of the credit

available, and the interest rates charged to borrowers—the very economic air that we breathe.

The policies of the U.S. Government for full employment, international stability, equitable taxation, and domestic prosperity can never be sound or dependable while the most important part of the Nation's economic powers is in the hands of a private group which exists as a separate government. We have two governments in the District of Columbia. One consists of the Congress and the President—the elected representatives of the people. The other is the Federal Reserve, operating as a self-appointed money trust, far removed from the will of the people.

This shocking state of affairs has been brought home bluntly to the American public by the assertion of the Federal Reserve that it is independent of the executive branch and that it can operate contrary to the President's wishes. It is an open and defiant proclamation that the Nation's gold and money printing press have been seized by a private group and are now being used by them in utter disregard of the principles of democratic government.

The Constitution clearly vests the monetary power in Congress, and with good reason. History has repeatedly demonstrated that possession of the monetary power gives its holder a life and death power over a society. But in spite of our Constitution, Chairman Martin left no doubt as to his views when he told this committee, on February 26, that "the Federal Reserve Board has the authority to act independently of the President," even "despite the President."

Federal Reserve System is banker dominated

What makes these claims even more appalling is the fact that our Federal Reserve System, as it functions at the present time, is a banker-dominated, banker-oriented autocracy. The fact of the matter is that there has been a struggle over control of the Federal Reserve System for 50 years, ever since it was founded. It is a struggle that the bankers have been winning, and it is clear now from Mr. Martin's statement that they have come out in the open defiantly. Savings and loan associations, cooperatives, credit unions, and other financial institutions not within the privileged banking circle should take notice that this usurpation of monetary authority places them in jeopardy.

The key to an understanding of the Federal Reserve System is the method of selecting directors. Each of the 12 Federal Reserve banks has 9 directors. Three of them are called class A, three are called class B, and three, class C. The class A and class B directors are elected by member banks. Class A directors are chosen from officers of banks in the area. The class B directors are chosen from the fields of commerce, industry, or agriculture, and may be stockholders in banks. The class C directors are appointed by the Board of Governors, and they must not be officers, directors, employees, or stockholders of any bank.

It should be noted that the member banks, each of which holds "stock" in the System, do not vote according to their stockholdings. Rather, each exercises one vote. Obviously, the word "stock," is a misnomer.

The presidents of the 12 Federal Reserve banks are elected by the 9 directors of the bank. Significantly, no oath of office is taken by these presidents or by the directors of these banks.

Polls and studies have shown heavy preponderance of banking background among directors. Early in 1964 the House Banking and Currency Committee, in connection with a comprehensive review of the Federal Reserve System, sent to all B and C directors of the Federal Reserve System a questionnaire regarding bank affiliation and bank stock ownership. Since class A directors are chosen from officers of banks themselves they would be expected to have banking connections. But the study showed that of the 36 class B directors in the System, all of whom responded, 17 had been directors of banks before becoming Federal Reserve directors, and an additional 4 had held other positions or offices in banks. Of this total of 21, there were only 3 who did not own some bank stock. Of the remaining 15 who had never been directors or officers of commercial banks, 9 owned bank stock. Thus, out of 36 Federal Reserve directors, 30 had some connection with banking.

Of the 36 class C directors, all of whom responded, 18 had formerly been bank directors and an additional 2 had held other bank positions. Of this group of 20, there were only 3 who had never owned bank stock. Out of the remaining 16 who had never been directors or officers, 5 had owned bank stock at one time.

Thus, out of the total of 108 directors in the 12 banks, 91 are, or have been, connected with the private banking industry, which they are supposed to regulate.

Open Market Committee exercises tremendous power

The fundamental monetary powers of the Nation are exercised by the Open Market Committee which is made up, on the record, of five Federal Reserve bank presidents and the seven members of the Board. In practice, however, all 12 presidents participate in the deliberations which, of course, are conducted in secret every 3 weeks. Thus, the basic power for good or ill in our economy is exercised by a group closely identified with the banking community and operating willfully and knowingly outside the pale of Government. This extralegal power is so great that the banker-controlled group can create prosperity, or, by turning the financial screws, can create recession, depression, or even panic. That this power can be abused to the advantage of a particular political party or candidate is too obvious to need elaboration.

The $36.8 billion portfolio of the Federal Reserve System is a fund that could be considered a recession fund, or a depression fund, and if its masters so choose, a panic fund. There is nothing to prevent them, in an election year, from letting a candidate President know that if he didn't manage to see eye to eye with them for the next 4 years his November election might be endangered.

Present situation is a distortion of congressional intent

Contrary to notions spread around by spokesmen for the banking interests, this shocking state of affairs was never sanctioned by the Congress. It was deliberately engineered by the banking interests, aided, I regret to say, by the inactivity of the Congress which failed to take action as, step by step, the people's control of their own monetary powers was whittled away.

The Federal Reserve Act, as passed in 1913, was never intended to set up anything like the system that exists today. What the act did was establish 12 regional banks, each with autonomy in its own region and designed to operate more or less automatically to provide a flexible supply of money and credit under general supervision of a Presidentially appointed Board. There was no central bank; President Wilson was opposed to the whole concept of a central bank. He also laid heavy stress on public control. When the act was under consideration in 1913, President Wilson said:

"The control of the system of banking and of issue which our new laws are to set up must be public, not private. * * * It must be vested in the Government itself so that the banks may be the instruments, not the masters, of business and of individual initiative and enterprise."

This is the crux of the matter. There is no reasonable basis in public policy for permitting bankers to run the central bank. Indeed, Wilson, when approached by bankers who desired to assure themselves of control of the Federal Reserve System when it was in the stage of formulation asked them, "Which one of you gentlemen would condone putting railroad presidents on the Interstate Commerce Commission?"

The leaders of the banking community did not win their points with Woodrow Wilson, but they achieved certain compromises in the final legislation, one of them being the provision under which a majority of six out of the nine directors of each regional Federal Reserve bank are chosen absolutely by the banking community. It is this provision, more than any other, that has been the Achilles' heel in the Federal Reserve System, permitting the bankers to dominate and centralize a system which was meant to be made up of 12 autonomous regional banks.

President Wilson opposed centralization of Fed

It is important to note that, at the time of the Federal Reserve legislation, in 1913, the basic issue was whether or not the Federal Reserve would be a central bank or a system made up of 12 independent regional banks. The Aldrich Commission had proposed a system of branch Reserve banks operating under the control of a central Board of Directors. Under this system, the branch banks would have carried out mechanical operations without any control over policy. The Aldrich plan was a big bankers' dream and it was opposed strenuously by President Wilson. Thanks to his vigorous efforts and those of the many other patriotic legislators mindful of the public interest, the Aldrich plan was rejected in favor of a system of semiautonomous regional banks which had the power to

buy and sell bonds and notes of the United States and of States and counties, to purchase and sell bills of exchange, and to establish discount rates. The Board, which was appointed by the President, had certain supervisory powers, such as the right of review over discount rates. The power to conduct open market operations, which is, of course, the basic power to control the money supply, was not recognized at the time, and it was believed that the power to establish rates of discount was the essential one in the system. It was this feature that was meant to provide a flexible money and credit system.

Under the Aldrich plan, the Central Board of Directors, which would run the System, would have been made up of eight people chosen from the System and the Comptroller of the Currency. Clearly, it would have given control of the System's policies to private banks through the power to buy and sell securities in the open market.

In contrast to the Aldrich plan, the 1913 Federal Reserve Act gave power to a Board of Governors that was entirely appointed by the President, and it also provided that one-third of the directors of the 12 regional banks be appointed by the Federal Reserve Board. There is no question that these Government-selected directors were expected to serve as watchdogs to insure against private banks' abuse of power at the local level of the System. Unfortunately, the legislation as enacted did provide that two-thirds of the directors be chosen by the banks and this proved to be the open door through which the big bankers managed to gain control.

Dominant banking interests move away from public control

One of the first steps away from public control was a palace revolution in 1922 which resulted in the formation of an ad hoc committee of the Presidents of five eastern district Reserve banks to coordinate open market operations. Somehow, they managed to obtain permission from the other banks to conduct the open market function. In 1923 this "Committee of Governors" which, of course, was completely outside the law, was acquiesced in by the Board, which called it the "Open Market Investment Committee."

As soon as the Committee was formed it started on a policy of tightening money and raising interest rates. This was the point at which the dominant elements in the banking community began to reshape the System to their own ends. It was then that they converted the System to a central bank in direct disobedience of the law.

In the manipulation of open market operations these men recognized the tremendous power that could be exercised in controlling the money supply and interest rates. The open market function consists of buying and selling Government bonds by the Federal Reserve System. In this way it controls the bank reserves and, ultimately, the supply of money and credit in the country. When it sells bonds, bank reserves shrink, and when it buys bonds, they increase. The portfolio of Government bonds has built up through the years to the present level of $36.8 billion. These interest-bearing bonds were acquired by the Open Market Committee in exchange for Federal Reserve notes which are non-interest-bearing obligations of the Nation. Yet, instead of canceling these bonds and the interest on these bonds when they are repurchased, the Fed holds them and collects the interest. To me, this has always been like collecting interest on a mortgage that is completely paid for and canceled.

One other important step in the Fed's history was the provision in the McFadden Act of 1927 removing the 20-year limitation on the System so that it now has a perpetual charter. This was the banker's vote of confidence. By then, they were assured of enough control for them to approve permanent existence for the Federal Reserve System. The two previous central banks had both expired after limited lives. The first lasted from 1791 to 1811, when Congress let its charter lapse after its 20-year life. In 1816, Congress enacted another charter creating the second Bank of the United States and this, too, was permitted to lapse after a 20-year life.

Change in Open Market Committee

In 1930, the membership of the Open Market Committee was informally expanded to include representatives from all 12 Reserve banks, and in the 1933 legislation this was put into law, thus giving legal sanction to this complete domination of the fundamental money powers by the private banking interests. Significantly, this legislation was reported by the House Banking and Currency

Committee without any hearings and it slipped through the House without a record vote after an intensive campaign led by the American Bankers Association. In the words of Representative Lemke, of North Dakota, "A bill of this kind could never have been born in the bright sunlight of day. It had to be born in executive session."

Legislation of 1933 a banker's victory

The 1933 legislation also contained provisions extending the terms of the six appointed Governors to 12 years and placing them on a staggered basis. The legislation was clearly and bluntly contrived to put the Federal Reserve Board beyond the reach of the President and the administration, and it served its purpose. It was a great victory for the bankers.

But, this time, they had gone too far and there was a reaction. In the aftermath of President Roosevelt's overwhelming victory, he determined upon the work-relief program to ease the ravages of the depression. Recognizing that the Federal Reserve System would have a key role in determining the reception to be accorded the necessary borrowing by the banking system, he was fearful that the Reserve banks might exercise their power to block his program by failing to take appropriate action in the open market. In particular, he was afraid that they would offset the stimulative effects of large-scale Government spending. This situation is documented by Marriner Eccles, who served for many years as Chairman of the Federal Reserve Board.

The 1935 reform bill

In 1935, President Roosevelt submitted a reform bill. The original bill, as proposed by the administration and passed by the House in 1935, would have kept a Board with six appointed members and with the Secretary of the Treasury and the Comptroller of the Currency serving as ex officio members. However, both of these officials were knocked off the Board in the Senate. In the final bill, appointments to membership were scheduled over periods of from 2 to 14 years so that not more than one would expire in any 2-year period. The 14-year term has remained in the law to the present time. Furthermore, the Chairman has to be selected from the members of the Board. When Chairman Martin's term expired during the administration of President Kennedy, the President found his hands tied so far as any freedom of choice was concerned. He was limited to the seven members of the existing Board.

A President who serves two full terms will not have the opportunity to appoint more than two members in his first 4 years in office. The third would come in the first half of his second term. Of course, under a recent amendment to the Constitution, no President can serve longer than two terms.

President is helpless to choose a Board

It is interesting to look at the specific situation at the present time as it affects President Johnson. Of the present seven members of the Board the first expiration date is that of Mr. C. Canby Balderston, whose term expires January 31, 1966. The second is Mr. Charles N. Shepardson, whose term expires January 31, 1968. Thereafter, the expiration dates extend on up through 1978 as follows: Mr. William McC. Martin, Jr., January 31, 1970; Mr. A. L. Mills, Jr., January 31, 1972; Mr. Dewey Daane, January 31, 1974; Mr. George W. Mitchell, January 31, 1976; and Mr. J. L. Robertson, January 31, 1978.

It is evident that this schedule of terms precludes the President from ever appointing a Board of his own choosing. He has two reappointments in his first term and, assuming a second term, he would have one reappointment at the beginning of a second term while the fourth would not come up until his last year of office.

Control of the Open Market Committee—the 1935 compromise

A most important feature of the original 1935 House bill was a drastic revision of the Open Market Committee which, because of its vast control of the money system, is the most powerful group in the world. The House bill would have placed this important function in the Federal Reserve Board and relegated the Committee of bank presidents to an advisory role. This House bill passed, 262 to 110, on a vote of record. However the Senate subsequently considered and passed a bill that was much more freindly to the bankers' position, and this substitute measure passed both House and Senate without a record vote. Its provisions, which remain in effect to this day, provided for an Open Market Committee made up of the Board of Governors and five bank presidents,

and it sanctioned the 1933 removal of the Secretary of the Treasury and the Comptroller of the Currency from the Federal Reserve Board, thus eliminating the possibility of any day-to-day administration influence on the Board.

New York bank runs the show

Since enactment of the 1935 legislation, there have been other developments which strengthen control of the System by the banking community. For one thing, the president of the New York bank was made a permanent member of the Open Market Committee in 1942, effective March 1, 1943. Second, the operations increasingly have become centered in the New York bank which now conducts the open market operation in its entirety. The 11 other banks conduct no open market activities; they are mere service centers for check clearing and similar functions. They do not even know their condition until the New York bank sends them a telegram to advise them. It is the New York bank which assigns the other 11 banks their share of the portfolio of Government bonds held by the Committee. These bonds, of course, are the basis for the earnings of the various banks. Detailed questioning of the bank presidents during the 1964 hearings held by the Banking and Currency Committee revealed that most of the bank presidents don't even know how the allocation of the portfolio or its income is determined. That is all handled in New York and the other 11 banks are merely passive recipients.

This is particularly revealing inasmuch as the original Federal Reserve Act never mentioned New York. As a matter of fact, it contemplated taking the money market out of New York and decentralizing it to the 12 regional banks, with the sole overall coordination to come from Washington.

These developments in the history of the Federal Reserve, all of which were made possible by the inaction or indifference of the Congress, put the Federal Reserve System well beyond the reach of the people and their elected Representatives. It had become an autocracy and it has so remained.

This was accomplished through a number of steps which may have looked small or harmless at the time. But each formed part of a pattern that added up to control of the central bank by the private commercial banks.

Existing situation intolerable and dangerous

The existing situation is intolerable in our society which, as Madison said, is a "democracy in a republic." The welfare of the Nation is at the mercy of a group who not only are beyond popular control but openly admit it, and assert that the people, through their elected Representatives, cannot be trusted to exercise their own monetary powers—in spite of the Constitution which vests the money powers in the Congress.

Inevitably, the Federal Reserve System reflects the bias of those who dominate it. Interest rates are the bankers' income; and the higher they are, the more the lender receives. Bankers live on debt. If there is no debt, there is no money and no interest. Bankers want only high-grade, low-risk debt paper, especially Government bonds. In fact, the one thing they do not want is for the Government to pay off the public debt.

Prof. John Kenneth Galbraith, testifying before the committee on February 24, stated that "it is hard to recall any occasion when the Federal Reserve was known to be agitating for lower interest."

"* * * We have come to envisage the Open Market Committee," he said, "as a group of men of excellent character and reassuring demeanor who meet to consider whether there is good reason for tighter money."

Professor Emeritus Seymour Harris, testifying on the same day, stated as follows:

"Financial groups seem to believe that the higher the price of their product, the more profits.

"They exercised excessive influenc in the 1950's when long-term rates rose by two-thirds. But, in my opinion, they will do better with lower rates. Their attitude toward restrictive monetary policy since 1961 only strengthens the case for the exclusion of the Federal Reserve bank presidents from the Open Market Committee, as Congressman Patman so effectively argues."

Lid taken off interest rates in 1953

It is instructive to compare the history of monetary rates in the period 1940–52, with the period of the Republican regime, 1953–60. In the first period—which included the recovery from a terrible depression, the most destructive war in history, a global reconstruction period, and the Korean hostilities—our Gov-

ernment was able to finance itself adequately and without the rate on long-term Government bonds ever going above 2½ percent. In fact, during these 12 years, no bond ever sold below par. By contrast, when the Republican regime came into power in 1953, the brakes were taken off and the Fed showed its true colors. Interest rates began to rise early in 1953. The yield on long-term Government bonds was 2.68 percent in 1952. By June 1953, it was 3.13 percent. The result was a recession that began in the middle of 1953 and, because the economy faltered and expansion slowed, interest rates finally dropped for cyclical reasons. Undaunted, however, the Federal Reserve began to push up rates again and, by June of 1957, the long-term yield averaged 3.58 percent. By October, it was 3.73 percent and another recession started. And all economic activity fell off, with the result that interest rates fell again for cyclical reasons.

In spite of these two bitter lessons, involving vast damage to the economy and heavy unemployment, the same conduct was repeated in the recovery period after the 1957 recession. This time, the Fed actually decreased the money supply and forced interest rates up to 4.37 percent by January 1960. The result, again, was a recession which lasted until the Democrats came back into power. From that time on, the Fed, tempering itself to the prevailing winds, has maintained a more adequate money supply—sufficient, at least, to permit the prolonged recovery we have had since then. But they are always ready to seize the slightest pretext to raise rates.

Congress must be vigilant

Congress must exercise the greatest vigilance against such attempts. Tragically, it has been the failure of Congress to exercise its responsibilities in the field of money that has permitted this deplorable situation of banker control to develop. Congress has not been alert to what has been happening.

A more detailed history of interest rates on long-term Federal obligations can be obtained from a publication of the House Banking and Currency Committee, entitled, "A Primer on Money," which is available at the Government Printing Office for 40 cents. This shows the actual rates monthly for each year, from 1919 to 1964.

Dangerous level of interest rates

Interest rates are at a dangerous level. The long-term rate on new issues is well over 4 percent and, as indicated in the report, there is a campaign underway to lift the present statutory ceiling of 4¼ percent on long-term Government bonds and force up the whole level of interest rates. It is well to remember that in 1958, when the Fed was in the middle of its last big money-tightening campaign, there was a determined move to lift the 4¼-percent ceiling. This move was forestalled only by prompt action on the part of a number of us in the Congress who formed a steering committee to resist the attempt.

The 4¼-percent rate was established in the Second Liberty Loan Act, which was passed in September 1917. Under its provisions, the Secretary of the Treasury, with the approval of the President, has the power to set the interest rates on long-term obligations of the United States within a ceiling of 4¼ percent. Thus, this ceiling has been in effect for almost 50 years, through the vast changes in that period ranging from deep depression to global war. And never in that time has the 4¼-percent ceiling been breached. But it is in jeopardy now, and it is obvious that the high-interest campaign has the enthusiastic support of Chairman Martin who, in his testimony before the committee, came out flatly for removal of the ceiling.

No congressional control

Federal Reserve officials frequently resort to the argument that they are in the last analysis answerable to the Congress. But this is misleading.

In the first place, the normal congressional control is through the power of the purse, through appropriating funds for the operation of Government agencies, and through its postaudit function, conducted by the General Accounting Office. The Fed, however, is not subject to either. It has never undergone an outside audit and it derives far more income than it needs through income earnings on the open market portfolio, earnings that exceed $1 billion a year. The Federal Reserve System uses as much of these funds as it wishes, allocating some to surplus and paying the balance over to the Treasury.

In the second place, the Congress is not in a position to exercise the day-to-day supervision of important public agencies that the executive department is. The President is entrusted with this executive power under our Constitution. If the

Federal Reserve errs in its monetary policy, the only sanction Congress has is to abolish the System, or revise it drastically. Obviously, this is a drastic control measure which cannot realistically be used. Moreover, the powerful bankers' lobby is always vigilant to protect the System's "independence" against any congressional scrutiny or direction. Such activities are invariably castigated by them as "political interference." As a result, the Federal Reserve System can be equally as resistant to the Congress as it is to the President.

Federal Reserve actions must be coordinated with other national policies

In the United States of today, the achievement of maximum employment is a specific national goal, and both the President and the Congress have a solemn responsibility under the Employment Act to pursue it. The Employment Act of 1946, which I took the lead in formulating and getting through the House, did not say that all agencies except the Federal Reserve should contribute to the promotion of maximum employment, production, and purchasing power. Clearly, the Fed's responsibility is to the Nation and its policy affects the whole Nation in a most fundamental way and should therefore be completely accountable to the whole Nation. Yet, in fact, the Fed has gone its own way and has never coordinated its activities with other Government programs, despite the fact that section 2 of the Employment Act of 1946 declares it to be the—

"* * * responsibility of the Federal Government * * * to coordinate and utilize all its plans, functions, and resources

"* * * to promote maximum employment, production and purchasing power."

The President and the Congress must be able to require that the Fed refrain from jeopardizing economic policies which the Congress and the President, as the elected officials of the people, have established as necessary. When the President submits his economic program to the Congress under the requirements of the Employment Act, he has to include recommendations on monetary policy. These run to the very heart of our economic welfare. The President is the one person and the only one who can coordinate the whole national program. It is ridiculous to give the President the burden of responsibility for diplomacy and war, for national security, for our nuclear arsenal, the national budget, selective service, and debt management—and yet at the same time permit the Federal Reserve to assert that the Chief Executive cannot be trusted with authority over monetary policy. The same principle applies to the Congress, which has the vast responsibility of enacting the laws to establish our Army and Navy, draft young men, levy taxes, and pass hundreds of other laws that affect the lives of every citizen.

Such a state of affairs is intolerable in the world of today. Yet the Federal Reserve System continues to be organized as though its responsibilities and accountabilities were to the banking community. And the bankers continue to spread the doctrine that it is all right for the Government—the Congress and the President—to exercise all these tremendous powers, but not for the Government to control the money supply. That, they would have us believe, must be left to the mercies of the bankers.

Welfare of citizens imperiled by banker domination of monetary system

Interest rates have a tremendous effect on the well-being of every citizen. Our total national debt, public and private, is $1.3 trillion. A 1-percent interest rate on this amount is $13 billion. This conveys some idea of the tremendous leverage that the prevailing level of interest can exert. It is not too much to say that an arbitrary increase in interest rates automatically sentences millions of workers to unemployment and businessmen to bankruptcy.

So long as our most important institution remains under banker domination and beyond the reach of executive and legislative control, our welfare is imperiled. In my view, the most important economic and governmental problem facing the Nation today is the need for immediate rehabilitation of the Federal Reserve System, so that it is again subject to the will of the people, acting through their elected representatives. If the big bankers are able to have their way they will continue to encourage monetary policies that will produce larger and larger public debt and higher and higher interest rates. If they have their way, our national debt will be $600 billion in 15 years, which, at a 6-percent rate of interest, will cost the taxpayers $36 billion a year. This would mean that so much of Federal revenues would be required for debt carrying charges that insufficient funds, if any at all, would be available for veterans' programs, social welfare, housing, community health, and the many other services needed by our people.

Representative CURTIS. If I can grab my time now, Mr. Chairman, this is why I suggested that you and I might debate properly on the floor of the House next year. Of course, I must say that you read the Constitution differently than I do. I think there are three branches of Government and they are all equal. This is one reason for the balance and separation of powers, to preserve freedom in this fashion.

The same arguments that the gentleman has made were made in the Federalist papers on the creation of an independent judiciary. As I stated in my opening remarks, this is a provision of the constitutional power of Congress. In my view the Federal Reserve System is an arm of the Congress as I view the other independent regulatory agencies that regulate our power over interstate commerce and other areas. The Tariff Commission is our arm, and very clearly so, to regulate international trade. We gave the power of appointment to the President only as a mechanism, a method of moving the System forward, just as we did in the case of the Comptroller General of the United States. There is no question about the General Accounting Office being an arm of the Congress but for convenience, and good convenience, I think, we gave the President the power of appointment.

The reason there were 14-year terms, and the terms were staggered, was so that no single President could use the power of appointment to exercise his political judgment in this area which is congressional, of maintaining the value of money.

So we do have a basic difference of opinion on the constitutionality, Mr. Patman. I think Mr. Martin and the Board is certainly carrying out what the Congress at any rate interpreted the Constitution to be.

Chairman PATMAN. Will the gentleman yield briefly?

Representative CURTIS. I will simply say this, that the gentleman has had an opportunity for years and as a powerful person in the House, to persuade his colleagues that we ought to turn this power over to the executive, or share it with him but, thank goodness, his views have not prevailed even among his own colleagues in his own party, let alone any in my own party.

Chairman PATMAN. Would you not be less vulnerable in advocating the independence of the Federal Reserve, if they could be told what the President wanted to do, if they were under the Government?

Now the agencies you mentioned, the Interstate Commerce Commission and Tariff Commission and others, they are under the Government. They get their money from Congress. Congress can have something to do with guidance and stop them if they are going in the wrong direction.

Representative CURTIS. You can handle the Federal Reserve this way, too.

Chairman PATMAN. They are not under the General Accounting Office. They have not been audited in 52 years.

Representative CURTIS. We have them here right today. This is a very good function. We always have this right to bring them before us. I think they have always respected our right.

I do not regard this appearance, I might say, as in any sense disciplinary. Quite to the contrary, I agreed to these hearings because I thought they would be a forum to help Congress as well as the

people to understand. I thought maybe we would profit from this forum and find a way that the law should be changed.

Let me ask one question: Mr. Maisel, you said that concerning this action which the Board has taken here, even though you disagree with it, you think it will not mean any immediate recession. Is that correct?

Mr. MAISEL. Yes.

Representative CURTIS. Mr. Mitchell, did you agree with that sentiment, too?

Mr. MITCHELL. Yes, I think the issue as I see it is whether with this move we can continue to pull down the level of unemployment to the point where it does consist primarily of the frictional unemployed.

Representative CURTIS. You do not think this action is that serious?

Mr. MITCHELL. No.

Representative CURTIS. Now I know we won't have time at this point but I was going to embark upon a line of questioning in which I am very much interested and that is in the area of what can be called the new economics that I find expressed here. Yet I felt this concept has never been very well stated.

One statistic that I am particularly interested in at this time is the fact that the rate of increase of productivity seems to have gone down considerably. I think Fortune magazine estimated around 2 percent. This is a very difficult figure to estimate, of course. It has been averaging about 3.5. This would indicate very strongly to me that this so-called 90 or 91 percent of plant capacity is actually utilizing inefficient plant, obsolete plant. I have argued that the so-called unused plant capacity that the new economics always point to is to a large degree of this nature.

Also I would suggest that this figure indicates that the labor force is being employed inefficiently. That people without proper training are being taken in. It is certainly true this can happen. It would seem to me that the indications quite clearly are that the unemployment that still remains is largely of the structural and frictional character. I would also, and this is all a base for further questions, I would also point out that apparently Mr. Maisel and others who adhere to this idea ignore the tremendous emphasis that the Federal Government has placed upon treating the problems of strictly structural unemployment.

The Manpower Training Act which I had a great deal to do with developing, and putting into the law—it has been in effect for 3 years—is only one aspect of activity in this area. The whole thrust of the civil rights legislation, I would argue, is in this area. Just take a look at the governmental sector where there has been a great increase in Negro employment. But if we consider all of the legislation that Congress has passed in the past few years, directed toward treating structural and frictional unemployment, including area redevelopment, and the whole poverty program, I can't believe that we can say we have been completely unsuccessful in this area. But I do want to point to a specific switch that I was very pleased to see occur.

When I started talking in terms of frictional and structural unemployment what came to my attention in the Ways and Means Committee in dealing with unemployment insurance was this high incidence of unemployment and if we did move into emphasizing training and retraining we might succeed in reducing it.

At that time I think only 7 out of the 50 States permitted a person on unemployment insurance to retrain without losing his unemployment insurance benefits. I argued that this situation should be completely turned around; it should be almost the reverse. That is, if a person didn't retrain, if he was in a skill that was obsolete, that he ought to be removed from unemployment insurance. I am happy to say that I think there are now 44 out of the 50 States that have adopted this reversal of policy.

With all of this emphasis on education and vocational training, as well as all the work we have done, it would be very disturbing to me to think that this has had no impact at all on the problem of unemployment in the past 2 or 3 years.

Again, if we had time I would be glad to have you comment. If this figure of 2 percent is anyway indicative of recent productivity increases, compared to the average that we had been having—the three point five—isn't this an indication that we are overheated and that further increase of aggregate demand, however, you do it, is not going to get at these unemployment problems but aggravate the inflationary forces.

Mr. MAISEL. Mr. Curtis, as you realize fully the figures in this sphere are again not the best figures in the world. There certainly has been a drop in the rate at which productivity is increasing. Here, we have the industrial production index per man-hour for the 5 years from 1961 through 1965. It includes the latest period for the industrial production index. It shows a 3.8-percent average rise in productivity for the whole 5-year period. The figure for this year shows 3 percent.

Now part of that fall to 3 percent is probably because of the steel industry. We have to be very careful with these figures. We all recognize that in a period when you are rehiring people figures on productivity rise faster.

When you are at a high level, they just don't rise as fast as during the rehiring period. Then, if you have a situation where a major industry such as steel built up inventories and then reduces production, this has a decided effect upon the figures by themselves.

I think we would have to agree that there has been some decrease in the figures. On the other hand, the wage-price guidelines have been based on a 3.2 percent increase. It is not at all clear yet that when we finish this year, productivity increases will have been below existing guidelines.

With respect to your other point on retraining, I agree very heartily with you. My assumption is that the retraining enables us to say that 4 percent unemployment was only an interim goal. If all of the programs you have cited are successful, then we certainly should be able to move that interim goal down very rapidly.

In other words, I think that you very properly cited the fact that these programs are meant to do away with the structural problems. If successful they will not leave the kernels of unemployed resources in the economy that have previously been left. As a result 4 percent might have been a proper goal 5 years ago and certainly we didn't get there for a long time. Now we ought to think in terms of these retraining programs you have cited and see what our present goal should be. Should it be 3 percent or what?

I think Chairman Martin made the point very well, that our figures are not comparable with most European ones. However, most people who have examined both situations would say that most European countries have probably had a 2-percent lower unemployment rate than we have had. They have been able to run at much lower unemployment rates than we have.

We would have to agree that part of our problem is that we are a larger country, that our areas are different, that we have a much broader scope and that these facts are likely to leave more frictional problems at various times.

I agree fully with you that the type of programs we have are extremely important. I hope that they will reduce the level of necessary unemployment.

Representative CURTIS. Thank you very much. My time has expired. Let me make this comment, though.

I have never accepted the 4-percent figure as a final goal. I have always felt we could get less unemployment if we met these problems of structural unemployment. We do agree that this is a statistic to watch, that if the rate of productivity increase is decreasing, that this factor is important to the subject we are discussing.

Mr. MAISEL. That is right.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Martin, on what dates did the New York and Chicago Reserve banks ask permission to raise the rediscount rate?

Mr. MARTIN. Thursday, December 2.

Representative REUSS. For both of them?

Mr. MARTIN. For both of them.

Representative REUSS. I want to return now to the matter which I discussed before, which to me is a matter of the gravest importance, and that has to do with the fact that the Federal Reserve, while it raised interest rates the other day in the rediscount action, is doing so far as I can see nothing about the certificate of deposit problem.

I must say I found the answer I got from the Federal Reserve Board as to the mechanics of certificates of deposit not comprehensible to me. I would like to follow through on a model with you. I will make it very simple.

Let us suppose in a given period the Federal Reserve System maintains neutrality with respect to reserves generally, it does not by open market policy raise or lower reserves. Let us suppose that that happens which has been happening; namely, one or another of the large corporations decides that it is going to withdraw a demand deposit in a bank and instead take out a certificate of deposit.

Incidentally, the propensity to do that has been enormously increased by raising the interest rate to 5½ percent that may be paid on as short as 30-day certificates of deposit.

Now let us follow the mechanics. You tell me if I misstate anything.

The corporation withdraws $1 million from its demand deposit, its checking account. That means if that and only that occurs, that means that the banking system as a whole has lost $6 million worth of lending, is that not so?

Mr. MARTIN. No, sir.

Mr. MITCHELL. No. Banking assets would be unchanged. They have the same deposits they had before.

Representative REUSS. It withdraws currency, keeps it in the corporate safe.

Mr. MITCHELL. Withdraws currency?

Representative REUSS. Yes. Cashes a check.

Mr. MITCHELL. It moves something from demand to time. Time total deposits remain unchanged and total assets.

Mr. MAISEL. If we are now talking about moving the million dollars from demand deposits to time deposits, the total amount of credit stays constant, but the total required reserves drop by $120,000.

Representative REUSS. But I haven't. I wanted to take this one step at a time.

Mr. MAISEL. I am sorry.

Representative REUSS. The bank withdraws a million dollars, puts it in a safe overnight. That reduces the lending capacity of the banking system by $6 million. Is that not so?

Mr. MAISEL. Yes.

Representative REUSS. Is there any argument on that?

Hearing none, I proceed.

Mr. MITCHELL. I am trying to think what to say in response to your initial assumption. Is it that the corporation writes a check and takes currency out of the bank? Is that what you are saying?

Representative REUSS. Yes. I hear no dissent.

The next step. The next morning the corporation purchases a certificate of deposit, a 30-day one. The lending capacity of the banking system has now increased by $25 million, has it not?

Mr. MAISEL. It depends on what happens to the currency. If they keep the currency, the currency continues to stay out of the bank. You have a very unrealistic situation.

Representative REUSS. The bank issues the certificate of deposit.

Mr. MAISEL. I think if you will follow the example Governor Mitchell and I were trying to get you to follow——

Representative REUSS. Governor Mitchell had the total reserve creation of the System changing.

Mr. MAISEL. In other words, assume you hold the reserves of the System constant, and the corporation transfers a million dollars from its demand account to a time deposit. If the bank writes a CD for a million dollars, the net effect is to lower required reserves.

Representative REUSS. By a million dollars at 4 percent?

Mr. MAISEL. That is right. So its $160,000 required reserves are lowered by $120,000. Assuming the System holds the amount of reserves constant, the banks can create, if they use their reserves to issue certificates of deposit, they can create $3 million of additional credit.

Representative REUSS. Isn't the Federal Reserve, by sitting still for this enormous transmogrification of demand deposits into new certificates of deposit, thereby sitting still for what could well become an engine of inflation, or to put it in another metaphor, in raising your rediscount rate to 4½ percent, aren't you straining at a gnat while you swallow the camel of the certificates of deposit; or in any metaphor you like. tell us what you are doing.

Mr. MITCHELL. This is not a typical operation. The typical operation is that the time deposit was created by the corporation selling a million dollars worth of Treasury bills.

Representative REUSS. In many cases the operation is simply one of transferring a demand deposit into a certificate of deposit. That changes the multiplier, as I compute it, from 6 to 25 on the credit creating capacity of the banking system.

It, furthermore, skews matters badly, small banks and savings and loan associations find their deposits cashed and transferred into certificates of deposits mainly at the 30 big New York banks who were, as I understand it, the engine behind this interest rate increase.

I am very, very seriously concerned about what the Federal Reserve is now doing, not just on the deflationary side but on the inflationary side.

Mr. MITCHELL. Could I offer one comment?

Representative REUSS. Surely.

Mr. MITCHELL. A corporation has to maintain a minimum checking account balance on which to operate. It can't continue to transfer funds out of its demand deposits to time accounts because it can't use time accounts to pay its bills.

Representative REUSS. No, but a corporate treasurer can lower his balance to this irreducible minimum.

Mr. MITCHELL. They did it long ago, that is the point.

Representative REUSS. They seem to be able to keep right on doing it, $4 billion this year.

Mr. MITCHELL. No. Those figures over there in the first place have not changed since September. They have been down to $16½ billion since September.

Representative REUSS. That is because the banks have not been able to switch any more money from savings and loans and the others. By your action the other day you have made it possible for them to do it. You are not only producing disequilibrium but while ostensibly acting to combat inflation you have to a large extent lost control over the situation.

I have not heard anything from any of you five gentlemen which so far reassures me on that. I would be greatly helped by such reassurance.

Mr. BALDERSTON. May I make a point, Mr. Congressman?

Representative REUSS. Certainly.

Mr. BALDERSTON. There was a time 2 or 3 years ago during which the internal flow of funds in our American corporations exceeded the need for those funds for either inventory or plant building. But this year that particular source of funds for the banks to tap has grown thinner and thinner.

Representative REUSS. Overall; but averages always conceal the corporation which does have a considerable excess cash flow and those are the ones that are going hog-wild on buying certificates of deposit.

Mr. BALDERSTON. Let me break the figure down for you. I have before me the figures for 121 weekly reporting member banks who have negotiable certificates in denominations of a hundred thousand or more. There are only 5 of those 121 banks who possess negotiable CD's in excess of 20 percent of their total deposits.

Representative REUSS. What does that have to do with it?

Mr. BALDERSTON. Now the average for all the 121 is 6.7 percent of total deposits. So while there is real risk of a banking system getting into a bind because of the inability to renew negotiable CD's in the

volume that now exists, these CD's are after all but a portion of the total deposits of the system, a small portion, 6.7 percent.

Representative REUSS. With all due respect, I don't find that makes contact with the point I was making. My time is up but I do want to reiterate my sincere belief that the independent judgment of the Fed, and I believe it should continue to remain independent, is mistaken, and that your two actions of doing nothing about certificates of deposit such as raising the reserve requirement on them, at the same time that you raise the rediscount rate is grievously wrong.

Since you give your opinions, I have the right to give mine, and I do.

Mr. BALDERSTON. Of course, Mr. Congressman, being a lawyer you know that the two pieces of paper, the old-fashioned CD that has been used in banking for many, many years, and the new form of a negotiable CD are exactly alike. Therefore, to differentiate between the negotiable CD and the time-honored CD of the old type would be a little difficult.

Chairman PATMAN. Let us see if we can have an understanding. It is getting nearer and nearer to Christmas, as Mr. Martin suggested. We want to get through as soon as we can. Would it be all right for you gentlemen to be back tomorrow afternoon and we will start with Senator Miller. Would that be satisfactory, Mr. Martin? Can you gentlemen be here tomorrow afternoon at 2:30?

Mr. MARTIN. We will be here. At least I am prepared to be here. I hope it is limited to that because we have a lot of things to do. We have an Open Market meeting tomorrow all morning. Everybody is in here.

Chairman PATMAN. We are not insisting on you coming tomorrow morning for that reason.

Mr. MARTIN. That is fine. I would hope you will limit it to tomorrow afternoon.

Chairman PATMAN. I can't limit the members of the committee.

Mr. MARTIN. When I say limit, limit it until after the first of the year, then, because I wouldn't be available.

Chairman PATMAN. We will try to work it out with you. We are in sympathy with your desire to get away for Christmas.

Without objection, we will stand in recess until tomorrow afternoon at 2:30.

(Whereupon, at 5:45 p.m., the hearing was recessed, to be reconvened at 2:30 p.m., Tuesday, December 14, 1965.)

64-292 O-66-pt. 1-13

RECENT FEDERAL RESERVE ACTION AND ECONOMIC POLICY COORDINATION

TUESDAY, DECEMBER 14, 1965

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

The joint committee met at 2:30 p.m., pursuant to recess, in room 318, Senate Office Building, Representative Wright Patman (chairman of the joint committee) presiding.

Present: Representatives Patman, Reuss, Curtis, Widnall, and Ellsworth; Senators Sparkman, Proxmire, and Miller.

Also present: James W. Knowles, executive director; John R. Stark. deputy director; Donald A. Webster, minority economist; and Hamilton D. Gewehr, administrative clerk.

Chairman PATMAN. The committee will please come to order.

The committee meets this afternoon to continue the questioning of the members of the Federal Reserve Board which was started yesterday.

Senator Miller was about to take his turn when we adjourned at the end of the afternoon, so the questioning this afternoon should begin with him. Before we start, however, there are a number of items to be placed in the record. Without objection, I offer them for the record now.

One is a statement from Senator Paul H. Douglas, vice chairman of this committee, who was unable to attend.

Also, there is a letter from Representative John R. Schmidhauser and a statement submitted by Representative George M. Rhodes.

(The material referred to follows:)

PREPARED STATEMENT OF SENATOR PAUL H. DOUGLAS, OF ILLINOIS, VICE CHAIRMAN OF THE JOINT ECONOMIC COMMITTEE

The action of the Federal Reserve Board in raising the interest rate on time deposits and also lifting the rediscount rate to 4½ percent is unduly sudden and sharp, since the basic financial decisions about Vietnam have not been made nor a tax program laid out. Common courtesy as well as the need for coordinating monetary with fiscal policy would seem to have called for the postponement of this decision by the Federal Reserve until the budget message was submitted to Congress, but Chairman Martin and his supporters evidently thought differently.

Let us note in passing that wholesale prices in November were only 3½ percent higher than in 1957–59. This is the lowest rate of increase of any country in the Western World and does not show any

of the inflation which Mr. Martin fears and which he sees behind every stump.

As a permanent policy I favor:

(1) Increasing the total supply of bank credit through open market operations by the Federal Reserve Board at the same rate of increase as the production of goods and services, thus insuring a stable price level. This increase in credit should neither exceed nor fall below the real growth rate of the country.

(2) Instead of making big jumps in the rediscount rate, as the Federal Reserve Board has done, a sounder principle would seem to call for making the rediscount rate equal to the competitive short-time rate on Government bonds. According to current conditions this would be approximately 4.12 percent instead of the 4.50 percent ordered by Mr. Martin and his followers. Just as President Truman pegged the interest rate in 1950–51 at too low a level and disregarded market forces on the down side, so Mr. Martin is pushing the interest rate too high and disregarding market forces on the up side. Why should we not let competitive market forces, to which Mr. Martin seems to give verbal adherence from time to time, determine the rediscount rate instead of having these decisions made by either political politicians or monetary politicians?

(3) If there is an excess demand for rediscounting, then the Federal Reserve can fix a quota within the allowance for growth, and then ration within this total the amounts given to individual applicants, just as is done in the case of oversubscribed Government bond issues.

In short, Mr. Martin, in his zeal to raise interest rates has overstepped the limits of sound banking and of competitive forces.

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., December 9, 1965.

Hon. WRIGHT PATMAN,
Longworth Building, U.S. House of Representatives.

DEAR CONGRESSMAN PATMAN: I was delighted to learn that the Joint Economic Committee has scheduled open hearings into the recent actions of the Board of Governors of the Federal Reserve System. Unfortunately, I am committed to be in Iowa during most of this time, but I plan to have one of my staff members in attendance during these sessions.

I would like to take this opportunity to commend you and the members of the Joint Economic Committee for your prompt action in holding these hearings into the decision of the Board of Governors of the Federal Reserve to raise the discount rates. The effect of this action could have disastrous consequences to the First District of Iowa whose economy is dependent on a viable agricultural sector. The people of the First District of Iowa are most grateful to you for your prompt action in this matter.

Sincerely,

JOHN R. SCHMIDHAUSER,
Congressman, First District of Iowa.

STATEMENT SUBMITTED TO JOINT ECONOMIC COMMITTEE BY CONGRESSMAN GEORGE M. RHODES RE FEDERAL RESERVE BOARD'S DECISION TO RAISE DISCOUNT RATE

Mr. Chairman, thank you for this opportunity to lend my support to the necessary and vital work of your committee concerning the recent action by the Federal Reserve Board.

I share with you the opinion that decision by the Board to raise the Federal Reserve rate from 4 to 4½ percent will have a detrimental effect on the growth of our Nation's economy.

There is ample evidence to support this contention. Among the evidence is the narrow 4 to 3 margin on the Board itself. If we are to better our record of 58 months of sustained prosperity we must diligently guard against the danger of imprudent fiscal measures which could bring on a recession. The raising of the discount rate carries with it such danger.

Another ill-effect which flows from the Federal Reserve Board's decision is the increased cost to local communities to meet pressing social needs. It is not a matter of conjecture or debate that this decision will make the building of schools, homes, and hospitals more costly. The truth of this hard economic fact was brought home to residents of my Sixth Congressional District last week only 2 days after the Board made its decision. The Reading School District sold $5.9 million worth of bonds on December 7 to build four new elementary schools. As a result of the Board's action, the taxpayers in the school district will pay an additional $75,000 in interest over the life of the bond issue. Multiply this instance by the number of school districts in this country who are building to meet the needs of the future and the costs of the increase are staggering.

It is my belief that it is possible to keep our prosperity going without taking measures such as this which significantly increase the costs of social progress.

Thank you, Mr. Chairman, for considering my views on this vital issue.

Chairman PATMAN. Additional materials received will be included in the appendix to these hearings. These include: a telegram from Mr. Walter P. Reuther, president, industrial union department, AFL-CIO, together with a press release on a statement made by Mr. George Meany, president, AFL-CIO, and an article which appeared in the United Auto Workers Washington Report.

Also, telegrams from the National Farmers Union, the Production Credit Associations, the Cooperative League of the United States of America, and the Rural Electric Cooperatives.

There is a letter from the United States Savings & Loan League, offered for the record yesterday by Senator Javits, and a statement from the National League of Insured Savings Associations.

In addition, I have a telegram here from the executive director of the Midwest Electric Consumers Association and a statement from our former colleague, the Honorable Jerry Voorhis.

TESTIMONY OF HON. WILLIAM McCHESNEY MARTIN, CHAIRMAN, FEDERAL RESERVE BOARD; ACCOMPANIED BY GOVERNORS C. CANBY BALDERSTON (VICE CHAIRMAN), CHARLES N. SHEPARDSON, GEORGE W. MITCHELL, AND SHERMAN J. MAISEL—Resumed

Chairman PATMAN. Before yielding to Senator Miller, I hope you will bear with me to make this one suggestion.

Mr. Martin, do you have with you a copy of the request that the New York bank and the Chicago banks made to the Federal Reserve Board for an increase in the interest rates?

Mr. MARTIN. I have no copy. It merely consists of a wire which the Secretary can provide to you.

Chairman PATMAN. Would you get one of your staff to call for it and have it up here in the next few minutes, please? I want to ask you about it when it comes my turn.

Mr. MARTIN. We can get that.

Chairman PATMAN. That will be fine. I will appreciate it very much.

Mr. MARTIN. Could I at the start, Mr. Patman, make a report on your request of yesterday just to bring it up to date?

Chairman PATMAN. Yes, sir.

Mr. MARTIN. Your request for information on use of the discount window. Wires were sent this morning to all Reserve banks asking for information covering the year 1964 and the current year to date on the number of banks using the discount window and the number and amount of discounts advanced.

Replies are expected in another day or so.

(Tables relating to foregoing were subsequently received and appear below:)

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, December 15, 1965.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
Congress of the United States,
Washington, D.C.

DEAR MR. CHAIRMAN: At the hearing before your committee on December 13, 1965, you requested the Board's staff to update the information regarding the number of banks accommodated and the number and amount of discounts and advances made by Federal Reserve banks and branches previously furnished.

Accordingly, I am enclosing this data for the full year 1964, and for the year 1965 through November 30.

Sincerely yours,

WM. McC. MARTIN, Jr.

Discounts and advances; average daily balance outstanding

[In millions]

Federal Reserve district	1961	1962	1963	1964	Jan. 1 to Nov. 30, 1965
Boston	$4	$5	$7	$10	$17
New York	17	26	70	61	128
Philadelphia	4	3	7	6	12
Cleveland	5	4	15	8	14
Richmond	5	7	17	15	25
Atlanta	5	6	16	28	37
Chicago	20	24	49	77	98
St. Louis	4	4	7	6	13
Minneapolis	2	1	5	7	15
Kansas City	9	11	24	18	43
Dallas	2	7	16	27	26
San Francisco	2	6	16	26	44
Total	79	104	249	289	472

[Enclosures]

Discounts and advances, 1964

	Banks accommodated	Discounts and advances	
		Number	Amount
Boston	130	924	$1,406,625,000
New York	145	1,029	11,184,580,000
Buffalo	31	219	501,320,000
Philadelphia	112	653	862,582,000
Cleveland	37	191	565,306,000
Cincinnati	19	74	191,665,000
Pittsburgh	18	107	833,205,000
Richmond	68	693	1,473,715,000
Baltimore	21	187	326,339,900
Charlotte	13	192	861,400,000
Atlanta	23	334	1,799,600,000
Birmingham	5	9	13,450,000
Jacksonville	22	186	497,407,000
Nashville	4	93	442,197,000
New Orleans	19	228	779,410,000
Chicago	138	920	5,982,360,000
Detroit	41	484	5,401,465,000
St. Louis	22	83	338,840,000
Little Rock	5	33	65,080,000
Louisville	10	162	582,798,000
Memphis	7	49	161,605,000
Minneapolis	63	299	761,638,000
Helena	29	220	127,039,000
Kansas City	48	277	783,625,000
Denver	26	180	323,354,000
Oklahoma City	46	410	946,087,000
Omaha	61	389	308,368,000
Dallas	32	272	2,816,604,492
El Paso	7	40	17,127,000
Houston	7	60	519,600,000
San Antonio	8	96	161,335,000
San Francisco	8	334	2,426,925,000
Los Angeles	5	85	1,750,750,000
Portland	5	127	634,350,000
Salt Lake City	4	44	160,400,000
Seattle	4	39	543,250,000
Total	1,243	9,722	46,551,402,392

Discounts and advances, Jan. 1–Nov. 30, 1965

	Banks accommodated	Discounts and advances	
		Number	Amount
Boston	100	727	$2,203,643,000
New York	129	1,169	19,308,770,000
Buffalo	27	242	2,173,396,000
Philadelphia	106	625	1,956,089,000
Cleveland	21	140	910,380,000
Cincinnati	15	90	438,060,000
Pittsburgh	15	79	749,465,000
Richmond	64	719	2,064,660,667
Baltimore	16	214	1,296,956,000
Charlotte	13	146	877,295,000
Atlanta	16	251	1,519,108,000
Birmingham	5	13	32,670,000
Jacksonville	25	184	227,344,900
Nashville	7	178	1,085,170,000
New Orleans	26	375	1,728,665,000
Chicago	123	1,029	7,856,366,000
Detroit	44	281	2,386,160,000
St. Louis	14	104	573,753,000
Little Rock	6	56	69,680,000
Louisville	6	170	618,600,000
Memphis	6	128	733,740,000
Minneapolis	67	436	1,661,201,000
Helena	27	254	191,425,000
Kansas City	43	415	1,701,393,000
Denver	29	292	938,036,000
Oklahoma City	38	444	2,156,568,000
Omaha	65	586	1,257,768,000
Dallas	23	200	2,120,306,658
El Paso	7	21	18,900,000
Houston	6	50	610,133,000
San Antonio	8	38	62,115,000
San Francisco	7	157	1,848,000,000
Los Angeles	4	114	4,318,500,000
Portland	6	103	719,975,000
Salt Lake City	5	77	338,700,000
Seattle	3	77	996,700,000
Total	1,122	10,184	67,749,692,225

Discounts and Advances

Number of banks accommodated, 1964, by month

	January	February	March	April	May	June	July	August	September	October	November	December
Boston	32	37	45	42	57	54	33	34	22	32	43	38
New York	53	56	69	64	70	51	53	51	44	36	50	43
Buffalo	15	9	13	10	12	8	12	13	5	7	12	7
Philadelphia	36	45	47	40	43	36	37	29	32	20	21	31
Cleveland	14	14	13	13	15	13	13	12	5	7	4	4
Cincinnati	3	8	7	7	7	5	4	4	3	1	2	1
Pittsburgh	11	10	5	8	5	5	6	5	5	4	5	5
Richmond	21	26	26	32	39	28	27	30	24	25	21	18
Baltimore	8	12	10	7	4	7	9	6	10	8	7	6
Charlotte	2	8	9	11	10	8	7	6	7	4	7	3
Atlanta	6	7	7	10	7	7	10	7	13	9	9	6
Birmingham	------	1	------	2	------	2	------	------	------	------	2	1
Jacksonville	5	6	2	2	6	6	6	12	14	12	9	8
Nashville	2	1	2	3	4	1	1	1	1	2	2	1
New Orleans	3	5	7	5	6	6	8	10	9	11	9	5
Chicago	48	51	49	51	57	43	43	39	44	38	27	40
Detroit	13	12	15	18	21	13	17	15	10	14	14	14
St. Louis	8	8	2	7	10	4	44	3	4	6	5	2
Little Rock	2	2	2	1	1	------	1	1	3	2	2	1
Louisville	3	4	2	5	5	3	5	6	1	5	4	------
Memphis	1	3	1	------	1	2	3	3	6	6	3	2
Minneapolis	17	9	13	15	19	17	18	17	9	9	16	13
Helena	9	6	10	13	13	8	12	11	7	12	7	1
Kansas City	12	7	15	18	17	17	11	9	8	15	12	11
Denver	7	6	7	5	12	11	9	11	8	9	12	8
Oklahoma City	18	18	17	14	26	18	13	7	11	14	18	17
Omaha	20	16	16	26	22	28	29	22	17	11	16	10
Dallas	5	7	7	13	15	15	13	13	12	7	7	6
El Paso	2	1	2	1	3	4	2	4	1	1	1	------
Houston	3	1	2	1	1	1	5	3	2	1	4	3
San Antonio	1	3	1	1	5	3	3	2	2	2	3	1
San Francisco	3	4	3	5	6	2	4	6	6	6	4	6
Los Angeles	3	2	2	3	2	1	1	3	2	3	2	3
Portland	2	3	4	4	3	3	4	4	2	3	4	3
Salt Lake City	1	1	1	3	3	1	1	1	1	2	2	2
Seattle	1	1	1	3	1	2	1	2	2	------	3	2
Total	390	410	434	463	528	433	425	402	352	344	369	322

DISCOUNTS AND ADVANCES

Number of D's and A's; by month, 1964

	January	February	March	April	May	June	July	August	September	October	November	December
Boston	57	66	76	91	133	113	61	69	46	52	77	83
New York	90	82	111	85	106	90	91	91	67	65	89	62
Buffalo	36	18	33	16	14	9	20	23	10	12	19	9
Philadelphia	67	66	63	70	77	66	63	37	35	31	35	43
Cleveland	24	18	15	19	29	15	28	16	4	12	6	5
Cincinnati	3	12	5	9	14	9	4	12	2	1	2	1
Pittsburgh	18	12	7	10	10	8	10	7	8	5	5	7
Richmond	55	63	62	58	101	58	55	59	39	59	59	25
Baltimore	23	21	21	18	13	12	10	10	22	12	15	10
Charlotte	10	31	32	24	17	21	10	15	10	8	9	5
Atlanta	23	21	33	22	28	31	34	22	36	24	37	23
Birmingham	----------	1	----------	2	----------	3	----------	----------	----------	----------	2	1
Jacksonville	17	14	3	5	12	15	14	20	26	25	19	16
Nashville	2	12	10	12	14	15	1	3	1	5	6	12
New Orleans	5	12	12	12	30	24	16	29	25	33	19	11
Chicago	89	88	83	70	81	78	84	73	83	63	52	76
Detroit	23	23	20	36	49	42	59	47	40	44	53	48
St. Louis	12	6	5	11	14	5	4	4	5	7	5	5
Little Rock	3	8	5	1	1	----------	1	3	4	2	3	2
Louisville	9	5	8	19	24	21	20	26	10	11	9	----------
Memphis	1	3	1	----------	3	3	3	5	12	12	4	2
Minneapolis	25	11	19	18	33	33	37	37	13	16	33	24
Helena	25	18	16	25	28	13	26	20	9	28	11	1
Kansas City	30	19	36	30	23	28	15	13	15	24	27	17
Denver	8	10	14	17	27	18	12	12	10	21	16	15
Oklahoma City	42	35	31	29	64	35	30	22	23	28	38	33
Omaha	32	24	29	40	42	51	50	35	26	18	23	19
Dallas	16	13	32	32	29	35	25	28	29	13	13	7
El Paso	3	1	5	3	7	7	5	6	1	1	1	----------
Houston	8	2	2	1	1	1	16	5	6	4	11	3
San Antonio	3	3	3	2	24	15	8	5	12	14	6	1
San Francisco	9	12	7	9	26	13	9	22	52	62	58	55
Los Angeles	9	10	5	4	5	6	8	16	8	4	4	6
Portland	7	11	5	6	20	8	11	22	6	10	12	9
Salt Lake City	5	4	1	3	13	1	5	1	2	2	4	3
Seattle	4	1	1	4	1	2	4	13	3	----------	3	3
Total	793	756	811	813	1,113	904	849	828	700	728	785	642

DISCOUNTS AND ADVANCES

Amount, 1964; by month

[In thousands]

	January	February	March	April	May	June	July	August	September	October	November	December
Boston	$43,530	$41,150	$97,575	$95,412	$157,196	$212,526	$80,960	$70,116	$81,725	$58,585	$130,075	$337,775
New York	927,105	1,259,570	724,950	438,250	643,365	1,143,320	962,485	615,150	738,190	927,400	1,936,210	868,585
Buffalo	31,265	13,775	129,015	61,445	41,205	10,485	18,880	61,340	16,375	22,700	52,610	42,225
Philadelphia	38,945	49,657	36,605	146,980	83,190	15,940	46,075	26,560	82,970	53,020	224,360	58,280
Cleveland	82,415	30,065	96,775	45,972	14,627	8,074	40,512	63,242	11,760	54,527	85,537	31,800
Cincinnati	1,650	11,740	5,475	7,200	57,450	23,200	7,700	60,700	11,000	700	4,700	150
Pittsburgh	186,705	112,100	59,125	91,150	20,300	12,550	42,800	126,125	59,275	22,850	75,225	25,000
Richmond	128,415	108,746	55,006	56,005	164,633	85,695	64,170	57,890	104,370	280,570	341,585	26,630
Baltimore	6,830	39,360	81,535	55,874	20,500	6,885	3,850	1,550	23,101	30,300	49,900	6,655
Charlotte	15,300	82,000	66,000	54,650	64,850	130,350	17,550	166,300	94,100	71,500	16,475	82,325
Atlanta	133,250	103,350	183,975	129,386	116,008	220,076	271,925	110,660	108,410	143,450	216,410	62,700
Birmingham		5,500		7,200		400					300	50
Jacksonville	78,650	49,000	13,070	19,700	35,300	49,450	37,625	57,200	75,692	26,742	20,354	34,624
Nashville	3,750	82,000	43,050	42,250	71,550	69,251	600	10,146	300	19,150	23,650	76,500
New Orleans	1,800	8,100	25,100	20,800	187,200	79,950	63,700	90,560	80,850	126,550	71,700	23,100
Chicago	494,855	818,715	1,169,130	317,550	174,080	241,850	377,600	306,150	493,265	502,170	394,930	692,065
Detroit	68,955	138,095	104,225	214,100	258,275	441,625	980,665	669,500	555,000	573,200	621,600	776,225
St. Louis	120,100	8,275	14,000	15,050	22,990	13,125	2,750	56,800	19,450	21,350	36,050	8,900
Little Rock	650	27,200	2,250	200	200		2,900	8,450	10,800	2,750	5,680	4,000
Louisville	59,400	5,600	17,100	74,000	79,750	78,800	104,750	77,550	33,900	34,548	17,400	
Memphis	6,000	15,700	5,000		600	9,900	5,800	23,020	29,785	40,800	22,300	2,700
Minneapolis	9,075	3,425	76,150	25,010	67,285	29,650	39,309	100,784	45,000	77,325	199,825	88,800
Helena	22,500	14,500	6,500	13,100	9,835	7,700	19,200	8,849	4,450	15,480	4,825	100
Kansas City	67,605	65,760	100,021	60,629	36,949	21,252	17,690	51,580	98,690	137,924	81,920	43,605
Denver	9,500	17,800	30,700	62,656	67,473	18,915	18,025	20,275	14,605	29,465	17,285	16,655
Oklahoma City	97,600	87,800	58,300	47,525	110,412	95,760	104,550	83,320	47,840	66,026	107,230	39,724
Omaha	8,745	23,080	7,415	36,050	18,200	45,335	29,945	16,270	8,032	53,830	15,296	46,170
Dallas	472,900	143,653	215,174	255,608	110,457	272,474	262,395	309,833	434,847	105,171	151,200	82,892
El Paso	750	100	2,800	1,700	4,200	2,322	1,455	2,990	410	100	300	
Houston	98,700	400	10,200	8,000	200	300	67,900	18,500	51,000	75,000	169,200	20,200
San Antonio	8,400	3,550	1,250	7,000	43,040	24,550	27,500	5,927	12,768	15,600	10,750	1,000
San Francisco	160,500	138,000	60,000	93,800	282,700	136,500	129,300	183,400	162,800	503,350	304,800	271,775
Los Angeles	188,250	348,000	34,500	82,000	84,000	98,500	78,500	419,500	213,000	88,500	51,000	65,000
Portland	47,500	41,250	10,400	13,800	146,800	43,700	81,600	134,100	11,500	41,300	54,700	7,700
Salt Lake City	15,000	14,500	5,000	9,600	52,000	4,000	22,800	800	5,000	10,500	6,200	15,000
Seattle	56,000	7,000	12,000	54,750	500	14,000	64,000	244,000	23,000		21,000	47,000
Total	3,692,595	3,918,516	3,559,371	2,664,402	3,247,320	3,668,410	4,097,466	4,259,137	3,763,260	4,232,433	5,542,582	3,905,910

DISCOUNTS AND ADVANCES

Number of banks accommodated, Jan. 1–Nov. 30, 1965; by month

	January	February	March	April	May	June	July	August	September	October	November
Boston	25	31	37	36	47	45	28	32	25	22	21
New York	49	39	60	50	49	46	49	60	49	39	49
Buffalo	7	6	10	11	9	8	12	11	4	5	11
Philadelphia	30	37	37	32	41	41	30	36	30	19	22
Cleveland	5	9	6	11	9	8	5	11	10	3	4
Cincinnati	2	3	6	5	6	6	6	5	4	5	3
Pittsburgh	3	3	1	6	4	3	4	3	6	3	6
Richmond	20	19	19	27	31	28	34	33	26	17	26
Baltimore	9	6	8	7	9	7	7	10	8	5	9
Charlotte	3	4	6	4	5	9	7	8	6	5	7
Atlanta	7	9	6	8	5	6	6	6	7	4	6
Birmingham	----	1	----	1	1	2	----	----	1	1	2
Jacksonville	6	13	8	5	7	9	11	13	10	7	9
Nashville	2	3	3	4	3	3	3	5	2	4	5
New Orleans	6	6	9	7	14	15	12	13	17	10	11
Chicago	39	44	47	39	42	44	50	45	49	48	37
Detroit	9	11	10	14	15	11	15	9	13	15	22
St. Louis	2	5	4	5	7	4	4	4	3	4	4
Little Rock	----	2	1	----	1	1	2	3	4	1	2
Louisville	----	2	2	4	5	5	4	5	2	5	6
Memphis	----	3	3	2	2	2	3	4	6	4	3
Minneapolis	11	17	12	14	22	22	28	24	18	23	24
Helena	8	6	12	12	15	12	15	13	13	6	10
Kansas City	8	14	11	8	22	16	12	12	11	14	16
Denver	11	8	6	5	15	13	12	15	9	7	9
Oklahoma City	11	15	12	13	19	15	12	13	11	14	15
Omaha	14	19	19	19	24	36	32	28	26	19	19
Dallas	2	7	9	8	10	13	12	9	12	7	5
El Paso	----	----	2	2	2	----	2	2	1	2	----
Houston	1	2	2	2	1	1	1	4	4	4	3
San Antonio	1	1	4	2	5	4	1	3	2	1	1
San Francisco	4	4	3	4	5	4	4	3	3	4	2
Los Angeles	2	3	1	2	2	3	3	3	3	2	3
Portland	3	2	2	8	4	2	5	5	4	2	4
Salt Lake City	----	1	3	4	4	4	4	3	3	1	4
Seattle	----	2	1	2	3	2	3	2	3	2	3
Total	300	357	382	378	465	450	438	455	405	334	383

Discounts and Advances

Number of D's and A's, Jan. 1–Nov. 30, 1965; by month

	January	February	March	April	May	June	July	August	September	October	November
Boston	43	52	88	89	131	100	48	61	38	37	40
New York	85	75	141	103	101	94	132	155	96	89	98
Buffalo	13	10	23	38	38	28	24	28	12	14	14
Philadelphia	46	63	58	55	77	58	57	87	57	28	39
Cleveland	6	16	19	25	15	10	7	21	12	4	5
Cincinnati	2	4	6	13	14	11	15	10	5	5	5
Pittsburgh	7	7	3	11	9	8	6	4	13	4	7
Richmond	34	40	59	83	88	69	66	67	59	80	74
Baltimore	15	14	16	18	32	36	12	20	13	15	23
Charlotte	5	13	14	10	13	16	18	19	9	12	17
Atlanta	14	24	19	31	29	28	11	17	18	20	40
Birmingham		1		2	1	2			2	2	3
Jacksonville	9	20	13	8	15	16	17	24	22	21	19
Nashville	4	10	11	26	31	20	17	21	11	9	18
New Orleans	12	24	43	36	56	56	20	28	42	26	32
Chicago	64	83	102	84	96	105	113	94	112	99	77
Detroit	17	13	15	23	19	26	36	18	33	41	40
St. Louis	5	8	6	7	22	12	11	14	5	7	7
Little Rock		5	8		2	2	2	17	9	6	10
Louisville		9	4	29	19	21	11	31	5	16	25
Memphis		9	4	12	13	12	7	9	12	19	31
Minneapolis	18	45	30	32	47	42	65	55	26	35	41
Helena	19	11	18	45	37	20	37	27	17	8	15
Kansas City	17	29	34	16	54	52	31	28	45	52	57
Denver	16	12	7	13	41	41	47	36	20	31	28
Oklahoma City	20	29	27	30	50	53	45	53	37	46	54
Omaha	27	33	44	68	68	79	89	57	40	34	47
Dallas	2	16	18	21	28	29	24	21	20	16	5
El Paso			3	4	2		4	3	2	3	
Houston	3	5	8	8	1	1	1	6	4	8	5
San Antonio	3	7	6	2	5	6	1	4	2	1	1
San Francisco	35	6	7	10	21	15	20	14	11	14	4
Los Angeles	3	6	2	11	25	17	16	19	7	4	4
Portland	6	3	2	4	20	17	23	14	4	4	6
Salt Lake City		1	3	11	12	15	7	7	5	2	14
Seattle		2	3	9	5	9	15	9	12	8	5
Total	550	705	859	987	1,237	1,126	1,055	1,098	837	820	910

Discounts and Advances

Amount, Jan. 1–Nov. 30, 1965; by month

[In thousands]

	January	February	March	April	May	June	July	August	September	October	November
Boston	$275,258	$137,340	$337,915	$353,830	$242,550	$156,520	$188,405	$164,680	$94,690	$45,640	$206,815
New York	2,146,250	1,407,250	2,653,235	1,350,460	482,520	2,687,025	2,064,630	2,397,730	1,527,200	977,400	1,615,070
Buffalo	43,250	28,850	95,260	336,500	541,660	640,200	110,141	153,845	113,000	81,060	29,630
Philadelphia	63,925	108,652	195,560	97,650	152,727	152,740	297,795	262,350	166,265	146,450	311,975
Cleveland	9,950	84,806	190,300	142,731	165,300	59,500	16,076	53,702	85,490	42,625	59,900
Cincinnati	2,500	7,100	20,400	109,300	51,360	62,200	87,200	71,900	7,200	13,200	5,700
Pittsburgh	216,500	332,575	16,000	109,750	21,500	12,600	12,940	4,200	12,100	1,000	10,300
Richmond	44,506	106,750	126,500	264,000	159,045	139,735	96,280	164,838	193,725	500,425	268,857
Baltimore	41,645	128,900	45,350	118,140	222,500	322,121	80,290	90,480	48,230	116,000	83,300
Charlotte	58,000	85,420	143,175	45,490	91,300	57,900	69,125	91,335	78,000	81,250	76,300
Atlanta	64,525	76,600	131,279	156,744	211,968	204,805	27,345	56,550	103,242	160,750	325,300
Birmingham	----------	100	----------	200	100	150	----------	----------	12,620	10,000	9,500
Jacksonville	25,874	69,374	16,307	8,825	13,325	17,300	14,100	18,690	21,500	10,350	11,700
Nashville	5,150	58,350	53,800	195,300	233,800	121,150	125,800	116,995	68,100	9,375	97,350
New Orleans	36,300	155,400	261,450	279,200	372,600	247,950	50,350	24,675	114,400	63,800	122,540
Chicago	424,235	657,825	622,595	608,420	520,260	662,810	725,125	723,270	1,059,515	1,247,875	604,436
Detroit	154,475	43,240	64,650	228,400	56,965	355,600	277,075	239,600	440,630	310,850	214,675
St. Louis	5,400	39,950	3,090	17,090	96,818	53,217	91,129	105,189	60,300	35,345	66,225
Little Rock	----------	12,200	6,500	----------	3,600	2,850	2,200	16,350	8,810	6,000	11,170
Louisville	----------	21,050	9,750	63,550	63,000	66,750	22,250	101,050	5,800	71,800	193,600
Memphis	----------	63,500	17,100	67,900	79,200	55,200	9,200	11,400	29,200	115,150	285,890
Minneapolis	116,574	289,505	163,825	248,650	145,007	79,825	171,415	67,400	136,875	96,600	145,525
Helena	20,050	6,250	12,375	33,550	30,995	13,940	28,950	14,675	9,640	4,500	16,500
Kansas City	196,250	259,295	377,924	68,834	226,912	118,140	31,554	61,950	110,870	77,464	172,200
Denver	40,150	6,650	7,875	53,350	175,088	119,690	169,565	80,725	50,276	128,660	106,007
Oklahoma City	37,375	72,236	64,382	92,720	167,301	312,430	198,391	358,097	352,420	234,391	266,825
Omaha	20,900	49,490	75,380	292,760	187,269	144,765	210,599	59,830	25,995	74,300	116,480
Dallas	25,100	203,745	226,358	157,894	443,202	454,019	317,451	69,580	83,176	87,814	51,968
El Paso	----------	----------	3,600	2,100	750	----------	8,600	1,550	700	1,600	----------
Houston	57,000	94,200	158,700	145,300	300	300	5,000	11,283	10,450	74,300	53,300
San Antonio	2,700	6,015	23,800	700	2,350	3,300	100	2,050	5,600	5,500	10,000
San Francisco	231,300	130,300	31,000	105,400	99,300	116,300	321,900	223,500	278,000	200,000	111,000
Los Angeles	129,000	110,100	19,500	566,500	817,500	630,500	678,200	1,138,000	117,100	39,000	73,100
Portland	4,700	22,200	3,100	24,750	163,700	133,000	187,300	102,775	15,550	25,300	37,600
Salt Lake City	----------	4,000	17,450	70,500	58,250	67,000	28,300	17,500	19,000	2,500	54,200
Seattle	----------	21,500	87,000	206,500	26,500	173,500	179,000	101,500	116,000	57,000	28,200
Total	4,498,842	4,900,718	6,282,485	6,622,988	6,326,522	8,445,032	6,903,781	7,179,244	5,581,669	5,155,274	5,853,138

Now your request for information on outstanding CD's, I have here two tables which I will be glad to submit for the record.

Chairman PATMAN. Fine.

(The tables follow:)

MATURITY DISTRIBUTION OF OUTSTANDING NEGOTIABLE TIME CERTIFICATES OF DEPOSIT

This release summarizes the results of the quarterly survey of the maturity structure of negotiable time certificates of deposit outstanding in denominations of $100,000 or more as of the November 17 survey date. Of the 344 weekly reporting member banks surveyed, 245 reported these large denomination certificates outstanding for a total of $16.4 billion. At the time of the previous survey in August, 249 banks reported $16 billion outstanding.

Nearly three-fourths of these, or $12.2 billion, mature during a 4-month period ending March 1966. The largest monthly total, $3.5 billion, will mature during December when corporate needs for funds for tax and dividend payments will be heavy. The approximate average maturity of outstanding CD's as of the November 17 survey date is 3.4 months compared to a 3.9 average at the time of the August survey.

Outstanding negotiable time certificates of deposit, weekly reporting member banks, Nov. 17, 1965

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage
1965—Nov. 18–30	987.0	6.0	6.0
Dec.[1]	3,502.3	21.4	27.4
1966—January	3,430.7	21.0	48.4
February	2,297.6	14.0	62.3
March	1,983.2	12.1	74.5
April	1,214.5	7.4	82.2
May	662.4	4.1	86.0
June	458.8	2.8	88.8
July	403.4	2.5	91.3
August	240.9	1.5	92.7
September	350.4	2.1	94.9
October	172.4	1.1	95.9
November	120.7	.7	96.7
December or later	543.3	3.3	100.0
Total	16,367.6	100.0	

[1] Includes $219,000,000 maturing on Dec. 10 and $945,000,000 on Dec. 15.

Maturity distribution of outstanding negotiable time certificates of deposit by size of bank [1]

[Amounts in millions of dollars, as of Nov. 17, 1965]

Period of maturity	Total deposits of bank [2]					Total	Cumulative total
	Under $100,000,000	$100,000,000 to $200,000,000	$200,000,000 to $500,000,000	$500,000,000 to $1,000,000,000	$1,000,000,000 or more		
1965—Nov. 18 to 30	8.7	19.9	126.5	137.7	694.2	987.0	987.0
December	38.8	80.0	429.9	560.8	2,392.8	3,502.3	4,489.3
1966—January	25.3	64.9	318.4	470.3	2,551.8	3,430.7	7,920.0
February	17.3	38.8	191.3	258.3	1,791.9	2,297.6	10,217.6
March	24.9	31.6	201.1	248.1	1,477.5	1,983.2	12,200.8
April	18.6	36.3	119.5	221.4	818.7	1,214.5	13,415.3
May	12.4	18.9	69.0	135.3	426.8	662.4	14,077.7
June	9.0	17.7	97.0	83.0	252.1	458.8	14,536.5
July	7.0	16.3	49.0	72.5	258.6	403.4	14,939.9
August	3.5	7.3	28.3	38.5	163.3	240.9	15,180.8
September	6.9	6.6	43.1	34.8	259.0	350.4	15,531.2
October	2.5	5.1	35.8	29.8	99.2	172.4	15,703.6
November	2.7	5.8	15.0	17.0	80.2	120.7	15,824.3
December or later	7.8	23.5	86.1	63.5	362.4	543.3	16,367.6
Total	185.4	372.7	1,810.0	2,371.0	11,628.5	16,367.6	
Due on:							
Dec. 10	.2	7.5	21.2	36.8	152.8	218.5	
Dec. 15	8.3	2.6	51.3	110.1	772.8	945.1	
Number of banks reporting	55	52	67	41	30	245	

[1] Includes only negotiable certificates in denominations of $100,000 or more outstanding at weekly reporting member banks.
[2] As reported in the call report of condition of June 30, 1964.

Mr. MARTIN. On Senator Javits' request for comments on the increased interest costs that may result from the Board's recent actions, a staff paper has been assigned and it will probably be at least a week before an adequate reply is possible. (See p. 66.)

Mr. Reuss' request for an answer to the question as to why reserve requirement on time deposits should not be either eliminated or raised, a staff paper on this has been assigned also, and we hope to have it completed in a little over a week. (See p. 590, volume 2.)

Chairman PATMAN. They will be furnished promptly, I assume, when they are ready.

Representative CURTIS. Mr. Chairman?

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. I have a statement which I have released to the press that I would like to have placed in the record. It involves a procedural question, one that we raised yesterday about the appearance of witnesses from the Johnson administraton. At the same time, I would like to make sure of one point. I say in this release that while the administration has been invited to appear, it is true, is it not, Mr. Chairman, that we formally invited the administration to appear here?

Chairman PATMAN. Not to my knowledge.

Representative CURTIS. Even though the minority had requested them?

Chairman PATMAN. There was no motion made to have it done. That was just the request of Senator Javits.

Representative CURTIS. I am informed that at the staff level the administration witnesses were invited.

Chairman PATMAN. I would know it if they were, and they were not.

Representative CURTIS. Let us clarify this.

Chairman PATMAN. The clarification is that I have not conferred with the President or anyone connected with the administration about that.

Representative CURTIS. How did we invite the Federal Reserve Board, may I ask?

Chairman PATMAN. We just requested them to come.

Representative CURTIS. Didn't we do a similar thing to the Secretary of the Treasury and Council of Economic Advisers?

Chairman PATMAN. No, we did not.

Representative CURTIS. I am shocked, because how in the name of Heaven—the basis for our consent to these hearings, Mr. Chairman, as you are well aware, was that we were going to have witnesses from all sides. We thought this was very desirable.

Chairman PATMAN. We will pass on that as soon as we get through with Mr. Martin.

Representative CURTIS. No. This is before us now because the chairman assured us that this would be so.

Chairman PATMAN. No; you are mistaken about that.

When we get through with the Board, we will then decide where we go from there. If you want administration witnesses, we will ask they be sent.

Representative CURTIS. Did the gentleman listen to the statement that was read by Senator Javits yesterday, on behalf of six minority

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members? We suggested at that time that the hearings not even proceed unless the administration witnesses were to come before us. We had been assured by the staff that this had been done. This is in accordance with the understanding that we had with the chairman when we agreed to hold these hearings in the first place. Of course the administration witnesses should appear.

Chairman PATMAN. The latter part, I disagree with. I suggest you consult the record at the point where I discussed this with Senator Javits.

Representative CURTIS. The point is this. On December 12 Secretary of the Treasury Fowler renewed administration criticism of the Board before a closed meeting in New York. The Chairman of the Council of Economic Advisers in a full-length article in the Wall Street Journal of December 13, yesterday, criticized the Board, and goes into this subject. Yet they do not avail themselves of a forum where they can make these statements under cross-examination by those who might disagree with them or those who might wish to develop this.

I think this is a grave dereliction on the part of the administration, I must say, and of our committee if we have not invited them.

Chairman PATMAN. Let me make a suggestion, Mr. Curtis. I have no desire to keep the minority from having anyone invited that the minority wants to invite. I am perfectly willing to sit here as long as necessary, but we realized this was just before Christmas holiday period. It is just a question of how long this committee wants to sit.

Now when we get through with the Board—which should be this afternoon—then we will decide the other questions. If the committee wants administration witnesses, we will call on them to appear at a certain time. (See p. 305, this volume, for results of executive session held by committee to resolve this question.)

Representative CURTIS. For Heaven's sake, the administration is the one that has been doing the criticizing. To me it is shocking, and I wonder if my Democrat colleagues on this committee agree with this——

Chairman PATMAN. Would you like that in the record?

Representative CURTIS. Yes.

Chairman PATMAN. Without objection, it is so ordered.

(The press release follows:)

STATEMENT OF CONGRESSMAN CURTIS AT THE JOINT ECONOMIC COMMITTEE SECOND DAY OF HEARINGS ON THE FEDERAL RESERVE BOARD ACTION TO INCREASE THE DISCOUNT RATE

CONGRESSMAN CURTIS ASKS JOHNSON ADMINISTRATION TO RECONSIDER AND HAVE WITNESSES APPEAR AT JOINT ECONOMIC COMMITTEE FINANCIAL POLICY HEARING

Yesterday the Republican members of this committee asked that witnesses from the Johnson administration appear before us to give their views on the recent increase in the discount rate and its likely effects on the economy. While the administration had been invited to appear, they choose not to express themselves before the Joint Economic Committee and in the appropriate context of these hearings. What they have done instead is engage in guerrilla sniping at the Federal Reserve Board.

While avoiding a full and open confrontation that would clear the air, leading members of the administration within recent days have chosen privileged sanctuaries from which to attack the Board's action.

On December 12, Secretary of the Treasury Fowler renewed administration criticism of the Board's action in a speech before a closed meeting in Crotonville, N.Y., where he said that a more restrictive monetary policy would not help to stem the flow of dollars abroad.

The Chairman of the Council of Economic Advisers, in a full length article from the safety of the editorial page of the Wall Street Journal on December 13, criticized the Board by stating that uncertainties in the economy "cannot be treated as facts requiring action today."

I believe that the administration owes it to the American people to come before the Congress, which is the appropriate forum to make its views known and where rebuttals can be heard. A frank and open confrontation between the interested parties would be far better for the economy than the avoidance of open debate which the administration apparently prefers.

Representative CURTIS. I wonder if my Democratic colleagues are aware that this procedure was followed and the administration witnesses were not invited to testify?

Chairman PATMAN. They are certainly welcome to comment.

Representative CURTIS. I see they are silent. But I think their opinion should be on the public record.

Chairman PATMAN. That is up to them.

Representative CURTIS. I know it. I am waiting to hear.

Representative REUSS. What is the question?

Chairman PATMAN. Senator Miller is recognized.

Senator MILLER. I notice we have scheduled some witnesses for Wednesday and Thursday.

Chairman PATMAN. Yes, sir.

Senator MILLER. It had been my understanding that there would be requests made for administration witnesses to appear. I don't know who invited these other witnesses outside of the Board before us.

Chairman PATMAN. That was the agreement that Senator Javits and I had. He consulted with Mr. Curtis, the ranking minority member on the House side. The agreement was that we would balance up the other witnesses, half Republican and half Democrat. I thought this would be a very fine way to do it. That is the only understanding we have had. That understanding has been carried out.

I have no desire to keep anyone from testifying. I will stay here as long as any member wants to have anybody testify and ask questions.

Senator MILLER. Mr. Chairman, may I say in response, I appreciate the agreement worked out on the other witnesses, but I have been under the impression that at least an invitation would be extended to the Council of Economic Advisers and the Secretary of the Treasury. I would hope that the chairman would see fit to do that.

Whether they want to come here or not is another thing, but I think we would all derive a great deal of benefit if we could have their views.

Chairman PATMAN. Tomorrow afternoon we have a period of time when we can hear witnesses, also the next afternoon without interfering with the week's program. If it can be worked out that way, it will be worked out.

Representative WIDNALL. Mr. Chairman, I would like to speak to that point also.

When I first had knowledge of the proposed hearings in this connection, I asked through staff whether or not the administration was being invited. I was told through staff that the administration was

being advised they would be welcome; that we would like to have their testimony. I understood that an approach had been made.

In the words of Mr. Maisel the other day, there was probably a terrible lack of communication, so far as the committee is concerned, and the administration, because my complete understanding was that the invitation was out and that the administration had informally let it be known that they would prefer to testify in January when they had budget figures, and they could come in with more solid figures.

I think that a lot of us who are here today are here under a misconception as to who has been invited to appear before this hearing.

Chairman PATMAN. Well, that misconception could be corrected rather quickly, I assume, if someone from the administration wanted to testify. So let us proceed as we have expected to this afternoon and kind of play it by ear and see if we cannot adjust all those things.

Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Gentlemen, in today's Wall Street Journal on the editorial page appears an article entitled "Monetary Restraint Can Extend Expansion," by Raymond Saulnier.

I don't know whether any of you have read the article. I would ask consent to have this placed in the record at this point, Mr. Chairman.

Chairman PATMAN. Without objection, it is so ordered.

(The article follows:)

[From the Wall Street Journal, Dec. 14, 1965]

MONETARY RESTRAINT CAN EXTEND EXPANSION

(By Raymond J. Saulnier)

There are a good many ways in which an economy can get out of balance, but I propose to comment on only one: The rate at which the volume of credit and the money supply is expanding.

To begin with, commercial banks' loans to business have increased 20 percent in the past 12 months. Just how exceptional this is can be judged from the fact that in 1962 through 1964 the increases were only 7 to 10 percent a year and in the 10-year period ending in 1961 they averaged only 4.5 percent a year.

Increases in consumer installment borrowing have been almost as large—a rise of nearly 13 percent was registered in the 12 months ending September 1965. In this case, we are in the fourth year of exceptionally large increases: In the 3 years 1962 through 1964 (December to December) annual increases ranged between 10 and 12 percent.

Now, these are large increases in the use of specific types of credit, but it would be dangerous to jump from them to conclusions as to what is happening to the total of all debt in the economy, especially since we know that the large increases in borrowing by businesses and consumers have not been matched by similar increases in mortgage debt. What we need is an estimate of what the increase will be in 1965 in overall indebtedness. It would be convenient to have an up-to-date estimate of this but there is none. However, there are pieces of evidence on which one can hazard a guess, and based on these it looks as if there will be an increase of close to 10 percent in 1965 in total private debt and around 8 percent in the total of public and private debt combined.

PRECEDENTS OFFER NO COMFORT

There is not a great deal of comfort to be drawn from the fact that overall debt increases of this order have occurred before, though this is true. It is a little like saying that high tides are not unprecedented. The point is that rates of increase of total private debt as high as 10 percent have not proved to be sustainable, certainly not in the past 15 years.

In order to assess the economic significance of these developments, we have to look at what is happening to the money supply. In this way we can see the extent to which the expanded debt is being absorbed by the banking system and thus being monetized.

First, it is perfectly clear that there have been very sharp increases in the amount of currency in circulation. In the 3 years ended September 1965, increases in hand-to-hand currency averaged 5.5 percent a year; in the preceding 10 years they averaged 1.2 percent a year.

Second, if we look beyond currency to currency plus demand deposits, we find increases recently of around 4 percent a year, whereas in the 10-year period 1952–62 they averaged only 1.4 percent a year.

Third, when we extend our concept of the money supply to include time deposits of commercial banks, and when we look to the growth of a total which we call "selected liquid assets"—currency, all bank deposits, savings and loan shares, U.S. securities with maturities under 1 year, and certain smaller items—we find really startling rates of monetary expansion. To summarize these: Currency plus both types of commercial bank deposits increased 9.1 percent in the 12 months ended September 1965, which compares with annual increases in the preceding 3 years of about 7 percent and in 1952–60 of only about 3 percent, and selected liquid assets increased close to 8 percent in the past 12 months (and in each of the past 4 years), which compares with annual increases in 1952–60 that averaged under 4 percent.

RESERVE'S POLICY GENEROUS

Obviously, this monetary and liquid asset expansion could not have taken place unless permitted by Federal Reserve policy. And, contrary to what you may gather from some public discussion of these matters, Federal Reserve authorities have been outstandingly generous in recent years in making available the central bank credit which is the basis of member bank reserves, and thus of the ability of the commercial banking system to expand the monetary base of the economy.

The question that comes immediately to mind as one reviews this record and looks to the future is this: How have we managed to have such a rapid expansion of credit and liquidity without experiencing marked inflationary effects? I believe there are five principal reasons.

First, the really spectacular increase has been in time deposits—which are much less volatile than demand deposits—and this has greatly moderated the demand-boosting and price-boosting effects of the deposit expansion.

Second, although demand deposits—the most volatile element in the deposit total—are turning over more rapidly all the time, it must be recognized that increases in the absolute amount of deposits outstanding have not been out of line with annual increases in physical output.

Third, through large deficits in the U.S. balance of international payments—a total of nearly $25 billion in the 7 years through 1964—we have been exporting to the rest of the world part of the impact of our domestic monetary expansion.

Fourth, I believe we have been able in the sixties, to date, to absorb rapid money supply increases, and rapid increases in the economy's overall liquidity, because increases in money supply and overall liquidity in the fifties were distinctly smaller; and they were smaller because monetary and fiscal policy in the second half of the fifties had to help expunge an inflationary psychology and help establish a relationship between labor-cost increases and productivity improvements consistent with stable prices and thus with sustainably high rates of economic growth. It took a taut monetary and fiscal policy to do that.

Fifth, partly because the cost and price stability objectives of policy in the fifties had been achieved as the sixties began, and partly because a good relationship between labor-cost increases and productivity improvements has continued, at least until recently, we have had relatively steady consumer prices (again, until recently) and this has contributed mightily to the willness of individuals and businesses to hold the rapidly expanding time deposit and liquidity balances that an aggressively expansive monetary policy has helped create.

The question now is whether we can have further comparable increases in the money supply and in overall liquidity without bringing on inflationary consequences. To produce such consequences would, of course, be to risk an interruption of the expansion.

FURTHER EXPANSION UNWISE

My judgment on this question is that it would be clearly unwise to expose the U.S. economy to further doses of monetary expansionism, certainly not to a dose such as we have had in the past year. This means that monetary policy should move cautiously toward restraint. Thus the increase in the Federal Reserve discount rate, which raises the cost of credit, is a step in the right direction. Let me give you my reasons for thinking so.

First, to the extent that a relatively slow growth in the supply of money and liquid assets in the fifties has permitted a relatively high rate of expansion of money and liquid assets in the sixties to date, does it not seem likely that this basis for monetary expansion is wearing thin? So it seems to me.

The statistical series that reflects the unique character of money supply changes in recent years—that which includes commercial bank time deposits—is higher relative to the gross national product, even to GNP at current prices, than at any time since 1955; and it is headed toward a level that would be unprecedented for any expansion period in recent years. And the aggregate of liquid assets has not only expanded very much faster than physical output, but is higher relative to current-price GNP than during any expansion period in the past 15 years. What this means to me is that monetary expansionism has gone as far as it is safe to go. I am not saying that we are over the brink, or even that we are hanging on the edge; I am saying, I hope constructively, that we are as close to the edge as it is safe to get.

Second, although I don't at all like the methods that have been adopted to correct our international payments imbalance—because I believe they will ultimately be counterproductive, to put it mildly—it must be conceded that the so-called voluntary restraint program has forced the accounts much closer to balance. One implication of this is that henceforth we will be feeling here at home the full impact of whatever monetary expansionism policy produces.

Finally, a move toward restraint is clearly indicated by what is already happening to costs and prices. As regards costs: We are slipping away from the favorable relationship that has existed since 1960 between labor-cost increases and productivity improvements. Wage increases negotiated in the first 6 months of 1965 were not only distinctly higher than in 1964 but were well above what could be justified by the current average rate of productivity improvement. The median of these increases is well outside the so-called wage guidelines, and the effect can be seen in increases that have occurred recently in labor cost per unit of physical output.

As for prices: There is evidence on all sides that suggests the need for a more cautious monetary policy. After a decline of about 11 percent from early 1959 to the fall of 1963 the index of prices of industrial materials has risen over 20 percent in the past 2 years. The index of wholesale prices, which was flat or trending slightly downward from 1960 to mid-1964, has risen about 3 percent in the past 15 months. And the consumer price index rose 1.8 percent in the past 12 months as compared with increases in the preceding 3 years that averaged only about 1.25 percent a year.

When one looks for circumstances that might justify a continuation of money supply increases at unchanged rates, there is, of course, the prospect of a continued high rate of growth of physical output. But however optimistic one may be on this point, I doubt that we can expect a growth rate that will justify money supply increases as rapid as in the past year. The labor force will continue to grow at a high rate, which favors high rates of growth of output, but capacity is much closer to full utilization; and there are indications, too, that productivity improvement rates are slowing down. In my judgment, these considerations also favor a shift toward monetary caution. Now that the Federal Reserve has raised the discount rate, it also should become somewhat less generous with central bank credit.

FAMILIAR OBJECTIVES

The objectives to a shift of policy toward restraint are familiar: They are that it would slow the economy's growth and prevent reaching the reduced levels of unemployment to which policy aspires.

It is far from clear, however, that a little more restraint would check the economy's growth, and I doubt that it would; the point is that it need not prevent us from achieving the growth that the expansion and improvement of our real resources will permit.

As regards residual unemployment, surely we must by now be at a point where we can see the wisdom of relying for further reductions on the essentially nonmonetary approaches of vocational and personal training—of rehabilitation where necessary—rather than on the increase of aggregate demand through what I call double-barreled expansionism: A combination of an easy money policy and an easy fiscal policy.

It is never anything but disturbing to slam the brakes on, and I most definitely do not suggest that. What is needed is that degree of restraint, practiced now, that will keep us from getting into a situation where there may be little option but to slam the brakes on.

Thus, the answer to the perennial question: What is the outlook for the economy? is more than usually dependent at this time on Government policy, and on monetary policy in particular. In my judgment, a willingness to practice a little restraint now would make it possible to extend the current expansion well into the future.

Senator MILLER. Let me read a couple of statements from this, and then I would like to ask your comments on it.

He says that:

> Commercial banks' loans to business have increased 20 percent in the past 12 months. Just how exceptional this is can be judged from the fact that in 1962 through 1964 the increases were only 7 to 10 percent a year and in the 10-year period ending in 1961 they averaged only 4.5 percent a year.
>
> Increases in consumer installment borrowing have been almost as large—

he points out.

Then he says:

> What we need is an estimate of what the increase will be in 1965 in overall indebtedness. * * * However, there are pieces of evidence on which one can hazard a guess, and based on these it looks as if there will be an increase of close to 10 percent in 1965 in total private debt and around 8 percent in the total of public and private debt combined.

Then:

> In order to assess the economic significance of these developments, we have to look at what is happening to the money supply.

In discussing the money supply he says currency plus both types of commercial bank deposits increased 9.1 percent in the 12 months ended September 1965, which compares with annual increases in the preceding 3 years of about 7 percent.

Then he says:

> Obviously this monetary and liquid asset expansion could not have taken place unless permitted by Federal Reserve policy and contrary to what you may gather from some public discussion of these matters. Federal Reserve authorities have been outstandingly generous in recent years in making available the central bank credit which is the basis of member bank reserves and thus of the ability of the commercial banking system to expand the monetary base of the economy.

Finally, he says:

> Now that the Federal Reserve has raised the discount rate, it also should become somewhat less generous with central bank credit.

I would appreciate a comment from Mr. Martin on these statements that I have alluded to and any comments from any other members of the Board.

Mr. MARTIN. I would agree with the analysis that Mr. Saulnier—I have not read his article, but I would agree with the analysis you have read. I would not make any comment with respect to what we should or should not do because that is for the Open Market Committee to

decide with respect to implementing the action which has been taken already on the discount rate. That is in the process of policy formation. I wouldn't want today to make any comment about what the Board or the Open Market Committee will or will not do in the light of this increase.

Senator MILLER. Do you include in that his suggestion that the bank should be somewhat less generous with central bank credit?

Mr. MARTIN. That is the part I would not like to discuss. In our announcement you will recall that we very clearly pointed out that we recognized the problem here and we did not want to slow down the economy, we wanted to provide for the seasonal needs of the economy. This is a matter of judgment. I would stand on the statement that we have already made.

Senator MILLER. May I say I appreciate the fact that nobody wants to slow down the economy unduly, at least, but Saulnier seems to indicates that there has been a very generous policy on the part of the Federal Reserve Board with respect to the expansion of our money supply.

Mr. MARTIN. I concur fully in that. There are differences of view around the table on that. I agree entirely with that analysis. I think some of my colleagues might like to comment.

Senator MILLER. Yes; Governor Mitchell?

Mr. MITCHELL. This is a view that Milton Friedman has espoused for some time: that the money supply should include time deposits. We touched on this yesterday afternoon in our discussion. At that time and in my original statement, I indicated that it confuses bona fide savings with monetary creation.

The actual growth in the money supply which represents monetary creation in the past year, in the year 1965, is 4.2 percent, just about what it was in 1964. There has not been an abnormal, or an unwarranted, or unsound increase in the money supply. What has happened is that the banks have been able to expand their ability to lend by borrowing directly from savers, not from monetary creation.

Now, if you want to discourage saving, there are ways of implementing such a policy. But if you are prepared to go with the fact that the amount of saving should depend on the decisions of individuals given the incentives the market provides, then it is hardly consistent to increase these incentives while advocating a monetary policy to offset them. This is exactly the position that Saulnier is arguing.

Senator MILLER. In a little book entitled "An Inflation Primer," by Melchior Palyi, published in 1961, starting on page 15—and I would like to have any one of the Board, particularly the Chairman, respond, and maybe Governor Mitchell—he says:

> The point is that the credit expansion of commercial banks is limited by liquidity considerations. Since the law requires (on the average) 10 percent of the bank's liabilities to be held in "cash," and prudence requires at least another 30 percent to be readily available in the shape of "short treasuries," the bank's ability to create purchasing power is trimmed accordingly.
>
> So far so good. The rub is that these reserves are literally produced by the Federal Reserve System. It has the power to do so, and it makes ample use of this power. That is the difference between the rank and file of banks on the one hand and the central bank on the other. Both create purchasing power, but the former would soon be stymied if the latter did not provide the ultimate means

of payment which keep the deposits convertible into cash and the banks from going broke. Thereby, the credit expansion is being kept going.

Technically, the Federal Reserve has three direct methods by which to provide the banks with "liquidity," enabling them to extend credit to the economy * * *

In the process, the Reserve System accomplishes something else that goes far beyond its proper function and begets a nefarious inflationary drift. Indirectly, the Federal Reserve provides the member banks with their "secondary" reserves as well. It does so by creating a safe and secure market for public securities, U.S. Treasury bills, certificates, and notes, in particular * * * Thereby these securities become equivalent to cash. Their monetization by the banks and remonitization by the Reserve System is the hard core process by which the currency is being diluted.

* * * Especially, the politicians' "freedom" to run the Federal budget into deficits is greatly enhanced when nothing more serious seems to be at stake than throwing a few billions of additional "short treasuries" on the market.

Could I have your reaction to that, Mr. Martin?

Mr. MARTIN. Yes, I will react first by saying that there are definite limits on what the central bank can supply because the central bank acting as the banker of last resort has to take into account the confidence factor in the economy.

Take the loan-deposit ratio of member banks. Nobody knows exactly what the right level should be; what the economy can stand. I happen to think that we have been moving into a dangerous area. Others feel that we are not at that point, but I question very seriously whether the central bank can keep the economy rising endlessly by using credit. I have frequently emphasized that credit is like a rubberband. A rubberband is there to be stretched. But if you stretch it too far, it snaps. I think this is where the area of judgment comes in on the use of credit in the economy, and one of the reasons why I favored the move that we have just taken is because I think we are very close to a point where it would be unwise to increase the rate of credit expansion in the United States.

Let me give you one final explanation of what I mean. One banker came to me a few years ago—not recently, so we are not putting this in too current a context—and his loan-deposit ratio was well over 100 percent. When I questioned whether this was wise, he said, "What do we have the Federal Reserve for?" It seems to me this is really the heart of the problem.

Mr. MAISEL. Since Governor Mitchell did the last one, I will try this one, Senator.

I think we are all agreed that we are here talking about the main issue of the Federal Reserve—the reason it was set up—which was to give a sound monetary system to our country. This is the function of the Federal Reserve and this is what we are all working toward.

Clearly, therefore, the problem is what we mean by a sound monetary system, how we fulfill the functions of the Federal Reserve bank. Mr. Martin has described the manner in which the functions of the act are fulfilled, and I think this becomes a matter of judgment then as to the necessary amount of currency we need, the amount of money that the system requires, if we are going to have the type of prosperity that we have.

I think we can all agree if the Federal Reserve had failed to supply reserves that we would simply not have gotten the type of expansion we have got. We would have large unemployment. We would go through the same type of things that we did in the thirties. In the early thirties the rate of expansion in the system was simply not enough. As a result we got continuing increases in unemployment. This has been the history of the United States. All through the 19th century, the period in which the banking system failed to increase the amount of money sufficiently, we had major depressions, I think we can all agree with this, sir.

Now, with respect to the actual facts under Palyi's argument, reserves ought to be raised at a tremendous rate because if we look at the figures for the last 3 years—as I have here for the last 3 years—the amount of Government securities held by the banking system has dropped every year so that in terms of this critical factor we have been very, very deflationary during the last 3 years because the banks have not been increasing the amount of Government securities they have held. They have been decreasing the amount of Government securities they have held at a fairly rapid rate.

If you take the actual amount of reserves furnished by the System, this has been one-third of the rate of expansion of the GNP. So that again the amount of reserves furnished by the System has been very small compared to the rate at which the economy has been expanded and this is evidenced by the way in which interest rates have gone up during the past period; particularly so if we look at the last 5 months.

I might say one of the problems of Mr. Saulnier's analysis is that he uses annual figures rather than figures for the recent period. If we look again at the last 5 months, we find actually the reserves held by member banks at their Reserve banks have decreased slightly on a seasonal basis.

I think in terms of the argument he is talking about the critical question is: what rate should the amount of money in the System increase? But, simply, it becomes a fact that in recent years the amount of reserves furnished by the System has been comparatively small compared to the growth of the economy; and in terms of his second argument that the System is enabling the commercial banks to buy the public debt during the last 3 years, that is simply incorrect.

The commercial banks of the country have been selling the public debt at a fairly rapid rate.

Senator MILLER. Mr. Chairman, I just thought I ought to point out to Governor Maisel that the statement I have read here was from Melchior Palyi rather than Mr. Saulnier.

Mr. MITCHELL. I realized there were two statements.

Senator MILLER. I just wanted to clarify that in case you had assumed it was Saulnier instead of Palyi.

Mr. MITCHELL. No.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. You have a piece of paper that I have circulated to the committee and to the other members of the Board who are here today entitled, "The Economic Policy Civil War."

(Paper referred to follows:)

THE ECONOMIC POLICY CIVIL WAR

The Federal Reserve Board versus Congress and the administration

Fiscal policies of Congress and the administration	Economic impact	Monetary policies of the Federal Reserve Board	Economic impact
1. 1962:		1. 1963:	
Accelerated depreciation guidelines announced by Treasury Department in July.	Promotes expansion.	Discount rate increased from 3 to 3½ percent in July.	Restrains expansion.
Internal Revenue Code amended to provide tax credit for investment in new equipment in October.	do		
2. 1964: Internal Revenue Code amended to lower rates of personal and corporate income taxes, resulting in net reductions of $11,500,000,000 in February.	do	2. 1964: Discount rate increased from 3½ to 4 percent in November.	Do.
3. 1965: Internal Revenue Code amended to reduce excise taxes by $4,600,000,000 a year in June.	do	3. 1965: Discount rate increased from 4 to 4½ percent in December.	Do.

NOTE.—This series of overt contradictions between the economic policy actions of the Congress and the administration on the one hand, and the Federal Reserve Board on the other, is the apparent consequence of a clear lack of effective coordination between the various economic policymakers in our Government. The result: Bigger deficits, higher interest rates, heavier cost of servicing the national debt, bigger interest burden on borrowers, a far less effective overall American economic policy.

Senator PROXMIRE. The reason I call this to your attention is because I wanted to question you a little bit about the lack of coordination between the Board and the administration and Congress.

As I spell out there, in 1962, two of the most important actions taken by the administration and the Congress were expansionary. The reason for them, as I understand it, was clearly for economic expansion. And yet the Board did increase the rediscount rate from 3 to 3½ percent the following year.

In 1964 we, of course, passed the most significant economic measure, in my judgment, that Congress has acted on in recent times—the enormous tax cut. I voted against that as I voted against the investment credit because I felt that this was the wrong time for it, and I thought it was too expansionary and might be inflationary.

Nevertheless, the Federal Reserve Board increased their discount rate as I have indicated here by one-half of 1 percent again. Again, this year, the Congress cut taxes to expand the economy in part and the Federal Reserve Board, as we have just indicated, increased the discount rate.

The reason I am asking about this is because I think that the main paradox that confronts the country is that we do have the two prime instruments of economic policy going in opposite directions.

I have great sympathy with your position because I feel that we could have an inflationary situation. As I indicated, I did vote against the tax cut and against the investment credit. But I am just wondering if there is not some more effective instrument of coordination which we could somehow achieve between the Federal Reserve Board and the administration. We have a modest element of coordination in these conferences—the luncheons that you have with the Secretary

of the Treasury, the Council of Economic Advisers, and the other top policymakers in the administration. Is it possible that other members of the Board could be brought in directly? Not simply the staff, but other members. It is the Board that makes the decisions. Is there any way the Board could be involved in these conferences so their views could be understood better by the administration and the administration's views could be understood better perhaps by the members of the Board?

Mr. MARTIN. Senator, we ought to explore every means of having better coordination, but I think I should, since I am addressing myself to this paper, make some comments on it.

In the first place, there has been no economic policy civil war. Let me point out that President Kennedy, himself, supported vigorously the increase in the discount rate from 3 to 3½ percent in July, 1963. In that instance some of his advisers——

Senator PROXMIRE. I would not deny that.

Mr. MARTIN. You have this down here as a policy civil war.

Senator PROXMIRE. I think this series of increases culminating in this final increase in 1965 and a total of 1½ percent increase during a period when Congress and the administration have been conspicuously expansionary represents a direct conflict. Maybe "civil war" is too strong language, but to me it represents a clear conflict in policy.

Mr. MARTIN. No, Senator, I respectfully disagree because so far as coordination is concerned, there has never been a better meeting of the minds on my part with the administration than during this period.

Let me say this—and this is not any invidious matter with respect to my own Board—that I have some members of my own Board who were opposing the increase in the discount rate from 3 to 3½ percent. I don't like to stand here and quote a man who is dead, but President Kennedy had a hard time keeping himself from going on the air to support this increase.

Now, I don't know how you can have better coordination between an administration and the Federal Reserve than that. At the same time these accelerated depreciation guidelines were actively discussed and considered, both in the top-level of the Government and with me.

Senator PROXMIRE. Let me point this out. You agreed with me yesterday when you said the main effect of this latest increase in the discount rate is to discourage business investment in plant and equipment.

Much of this, the accelerated depreciation guidelines and tax cut has been to get a more active investment policy on the part of business in this country and to move our economy ahead so that we can have greater production in the future and less pressure on prices.

Mr. MARTIN. Don't misunderstand me. I am not trying to make an issue out of this, but on the matter of coordination here not only has there not been any economic policy civil war, but on this last item there has been an honest difference of opinion as to whether this will actually help investment rather than the reverse.

I know of one small corporation that went to the bank to get a term loan where they knew they should have gone to the capital market, but they knew the bank would not have the courage to deny the loan. This relates to the flow of funds. This has nothing to do with halting

investment. This has to do with providing a better flow of funds so that the new investment can be created.

Now there is an honest difference of opinion. You have my associates on the Board who disagree, and there are some in the administration who disagree, with respect to this last issue.

But with respect to all the rest, there has never been better coordination in my experience in the Government.

When the discount rate was raised from 3½ to 4 percent I called President Johnson on the telephone and informed him of this, and he supported it. It was discussed with the Treasury and with the Council of Economic Advisers. There was complete support. I just think it is important that we get this in the record.

Now, as to the last one, you will in due course hear the views of those in the administration who disagree with the majority of the Board just as you have heard the views of those on the Board who disagree.

Senator PROXMIRE. I would simply say that President Johnson and President Kennedy may have agreed with your actions in 1963 and 1964. That does not mean that there is not a direct economic policy conflict.

I can see why they might take that position, and there are many, many economic reasons why they might. At the same time, I think the overall effect of the increase in discount rate, increase in interest tends to restrain expansion while on the other hand these other policies tend to move the economy ahead. If you take this in aggregate, the consistent policy of the Federal Reserve Board since 1963 has been one of restraint, recognizing in open market operations you again have a more moderate policy. And the clear position of the Congress has been one of expansion.

What I would like to do, if you will permit—and of course you can answer at any length you wish—I would like to ask Governor Maisel to get into this because he was the one whose statement yesterday so intrigued me when he said he was shocked at the lack of coordination. Perhaps he was thinking of the substantive consequence which is spelled out here as well as the fact that he had not apparently an opportunity to consult directly with the administration in any formal or regular way.

Mr. MARTIN. Senator, I will be delighted to have Governor Maisel comment at length on anything he wants to comment on—and here let me say respectfully that Governor Maisel was not on the Board at the time of these actions—so far as coordination is concerned, the first increase in the discount rate had to do with the balance of payments in which the Federal Reserve has performed under Governor Robertson's leadership, in my opinion, yeoman service in the voluntary foreign credit restraint program. The second increase had to do with the problem of the United Kingdom and the pound sterling.

All during this period there has been close consultation and discussion of the problem between myself and the administration. Governor Maisel is entitled to say whatever he wishes to say with respect to the recent actions. As to the actions in 1963 and 1964, I have never worked more faithfully or successfully with a group of people than I have with the administration.

Senator PROXMIRE. On this last one, isn't it possible that a prior consultation, or consultation that extended through December, might

possibly have resulted on fiscal policies which would have been more conservative?

For example, former Internal Revenue Commissioner Caplin announced that there was real consideration for stepping up the withholding tax in the coming year. That kind of thing might be enacted into law.

It seems to me, compared to the action by the Federal Reserve, that sort of conservative action to relieve pressure on prices might have been taken. That is one example of many. So you are acting before the administration made its decisions on fiscal policy.

Vice President Humphrey pointed out now in view of what the Federal Reserve Board has done it seems it will be necessary for the administration to compensate for this by a more expansive policy than they might otherwise have adopted.

Mr. MARTIN. I can't speak for the administration. That is not my role up here. I have not read the Vice President's remarks; but as I indicated in my talk to the Life Insurance Institute—and I think perhaps that talk ought to be put in the record——

(Mr. Martin's speech has been included in the record and appears on p. 232.)

Senator PROXMIRE. That is a very good talk.

Mr. MARTIN. I said in that talk, this is the point I am making, that I had every confidence—and on the basis of having had a visit in Johnson City, I have learned nothing in any way to diminish that confidence—that the administration will come in with just as tough a budget as the President thinks the situation in Vietnam will warrant.

These are matters of judgment between many people, but there has been no breakdown of coordination in the sense of an economic policy civil war over the period that you are discussing here. I don't say this in any heat or anything. I merely think this is a complete mislabeling and misunderstanding of the process of coordination that has occurred during this period.

Now, you are perfectly entitled to say there has been a breakdown of coordination in this last instance, depending on your assessment of what the factors are. I stressed yesterday, and I stress again, that the economic aspects of the problem are arguable and debatable, and the balance-of-payments aspect of the problem is arguable and debatable.

In terms of the flow of funds and the financial problem, I think it is less debatable. To me and to the majority of the Board it was not debatable. It was a clear case in an area that was within our responsibility. But if you want to carry coordination to the point where we should take direction, then of course the coordination broke down completely.

Senator PROXMIRE. May I ask Governor Maisel to comment?

Mr. MAISEL. Clearly I can't talk about the earlier period, as Chairman Martin has made clear. My statement yesterday was in response to the opening statement of Chairman Patman having to do with the Employment Act of 1946. My concern was with the decisionmaking process under the act of 1946.

I simply stated that as a novice I did not know what prior decisionmaking functions had been. However, at least in my case during the period we have just gone through, say from September, there was a basic gap in the information flow necessary for decisionmaking. I

did not feel that I, as a member of the Board, had the necessary information as to possible and proposed combinations of monetary and fiscal policy to come to a proper decision.

It seemed to me that when the Board considered our choices, the administration's view as to what fiscal policy would be and their ideas as to how monetary policy and fiscal policy could be coordinated, were critical. To make up my mind as to proper monetary policy, I felt the need of a systematic and routing exchange of information which I felt to be lacking.

It seemed to me this was the purpose of the employment act to make sure that the necessary interdependence of policies was considered when either monetary or fiscal policy was changed.

I did not have such information at regular intervals or in a systematic form. Instead, when I had lunch with somebody or met them elsewhere, I tried to find out what other people's views were around Washington. I attempted to get their analysis of the current situation, where we were going, and what problems existed.

I felt a lack of formal consideration of many matters. Although in some cases the staff of the Board sat in as unofficial observers because they had particular technical skills. At least until after the decision of December 3, I never received any administration views as to whether changes in fiscal policy were under consideration or considered necessary. I did not know the administration's projections as to where we were going, and whether or not they felt policy should change.

I was somewhat surprised last week when I met a member of one of the other agencies to find that some sort of staff exercise had taken place, whether typical or not I don't know. Apparently some attempt was being made to at least state the different assumptions and the type of numbers that the different agencies felt should be considered in current decisions. I did not find any such information available at the time that the Board's decision was made. While I gather it would differ for each member of the Board, I found that I had to guess at what administration policy was, where they thought the economy was going, what the budget was going to be, what type of expenditure figures were available. While I had assumed that this type of information would be available in attempting to make key monetary decisions I found it lacking for the entire period, from October through December. There were official staff meetings with the Treasury, but I know of none with the Budget Bureau or CEA.

It was this gap that I referred to yesterday—a failure of coordination in the entire decisionmaking process; a lack of agreement as to critical economic changes; the administration's view on some of the Board's arguments, or any statement as to their current goals with respect to prices, unemployment, and production.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman.

At this time I would like to read into the record a statement from a Washington newsletter of the Mortgage Bankers Association of America dated December 8, 1965, with respect to what they call an anomaly—the Farmers Home Administration.

At the same time as the administration has been deploring any tendency to a higher interest rate, the Farmers Home Administration is currently offering to the public 35- to 40-year mortgage notes for initial holding periods of 3, 5, and 25 years at interest rates of 4½, 4¾, and 5 percent respectively. The notes are fully guaranteed as to principal and interest, on maturity of the initial insurance contract are redeemable at par or extendable either for additional periods at such rate as Farmers Home may be offering or to maturity at the initial interest rate.

Since Farmers Home both originates and services the loan, the rates represent absolute net yield. As such, the 5- to 25-year contracts offer returns about comparable to those of Baa bonds. Yet, according to security analysts, they are classified as an AA class for most types of investments. They are collateral for Federal Reserve advance, may be pledged to secure Federal tax loan accounts, eligible for investments for savings and loan associations, are classified as U.S. bonds rather than as real estate investment when held by life insurance companies and may be posted to secure public deposits. They are obviously of less risk, much higher yield than similar maturities.

Farmers Home Administration is authorized to insure on behalf of the Treasury $750 million of its notes during the present fiscal year. As long as the supply holds up the notes are certain to get a favored investor response. Even in the absence of the Federal Reserve action, the availability of the Farmers Home notes would put upward pressure on yields on FHA's and VA's.

Do you agree with that statement?

Mr. MARTIN. Definitely it would put upward pressure on them.

Representative WIDNALL. Do you agree, Mr. Mitchell?

Mr. MITCHELL. Yes.

Representative WIDNALL. Mr. Maisel?

Mr. MAISEL. I would guess so.

Representative WIDNALL. It is rather difficult to understand why the administration does not act in that field while it expressed itself, but not officially, on the record of this hearing with respect to the effect of the change in discount rates. I can't understand the dual swinging on this. It is not up to you to comment. It is up to the administration to comment. That is why we badly need them up on the Hill at this time.

Mr. Chairman, I believe you made a statement that interest costs will rise $25 billion as a result of this action. Can you document for the record the $25 billion?

Chairman PATMAN. Yes. I think that can easily be done. It can be documented.

Representative WIDNALL. Can you do it at this time?

Chairman PATMAN. These are the basic factors to be taken into account. First the fact that the discount rate has been increased from 4 to 4½ percent. Second, when the discount rate was raised last November from 3½ to 4 percent, we saw a rise in gross interest payments from about $75 billion in 1963 to $85 billion in 1964. This is an increase of close to 15 percent in total interest charges to the American people and businesses. The discount rate, by Mr. Martin's action on December 5 was increased by 12.5 percent, and on time deposits the maximum rate was increased by 22.2 percent.

The increase in the discount rate is an increase in the wholesale cost of money. This rate puts a floor under other rates, so the ultimate effect is to raise the retail cost of money to the consumer and business by more than the one-half percent increase in the discount rate.

Now, in addition, I believe there is another $15 billion in interest costs paid by consumers and businesses which never get tallied in the gross interest cost figures compiled by the Department of Commerce

because they are illegal interest charges or are hidden in the form of service charges.

I predicted, and so stated in a press release in November 1964 that the result of the 1964 increase in the discount rate, and the increase in the time deposit rate would result in a total interest cost for 1964 of $85 billion. I proved to be exactly right.

Based on this analysis, I feel it is appropriate to estimate that, based on a $100 billion interest charge for 1965, the total will approximate $125 billion by the end of 1966 as a result of Mr. Martin's action and as a result of the total increase in debt in the United States.

Representative WIDNALL. That is not what is being considered at this time. The action of the Federal Reserve System is what is being considered. I think you made the suggestion that $25 billion will be the increase as a result of this action, not the result of extortionate interest charges on the part of other persons.

Chairman PATMAN. I was just leading up to that. The gentleman asked me to do this. I am doing my very best. I don't know whether it will meet with his approval or not when I get through with it.

Now the rate on time deposits was raised from 4 to 5½ percent. That is a terrific raise. Even from 4 to 4½ is a 12½-percent raise. But the raise from 4½ to 5½ is a 22.2-percent raise.

Now whenever you consider that this is the wholesale rate of interest, when that is translated into retail rates like in housing loans, automobile installment loans, radios, television, all appliances, and consumers generally, I think $25 billion would be a very, very reasonable estimate.

Representative WIDNALL. Mr. Chairman, aren't you trying to figure into that total figure all debt in the United States?

Chairman PATMAN. No, merely the addition to outstanding debt.

Representative WIDNALL. Isn't it just as true that debt is not rewritten? Mortgage debt is not rewritten, the installment debt is not rewritten by an action of the Federal Reserve? There are billions of dollars debt at the present time that cannot possibly be affected by any change in the Federal Reserve debt. The rates are paid on outstanding debt, corporate bonds and mortgages, of course, will not be affected.

Chairman PATMAN. Certainly. Outstanding debt won't be affected; that is right—not quickly. Otherwise it would be a lot more than $25 billion. Our debts aggregate about $1,300 billion—a trillion three hundred billion. Now 1 percent raise on that is $13 billion a year. Just 1 percent raise on that. In addition, new debts will be created. I think the estimate of $25 billion is a very reasonable estimate, and I believe you will agree with me when you take into consideration all the factors.

If $25 billion is unreasonable, what do you say is a reasonable amount?

Representative WIDNALL. Will you break that $25 billion figure down for the record so that we can attribute to one category or another?

Chairman PATMAN. I beg your pardon?

Representative WIDNALL. Will you set up the $25 billion as to what it applies to—long-term debt, short-term debt, debt by foreigners, household institutions, U.S. Government?

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Chairman PATMAN. Remember that last year it was $85 billion known, and it had risen from $75 billion in 1963. That is documented. That is in the record.

Representative WIDNALL. $65.9 billion. I believe you arrived at $85 billion by using a figure of $18.2 billion which is the Commerce Department's figure for imputed interest, which is not a money payment but a dollar value assigned to services rendered mostly by banks to their customers.

Chairman PATMAN. I am considering interest payments. If my figure is high, I would like to know what the gentleman's estimate is as to what the increase will cost.

Representative WIDNALL. Mr. Chairman, I am not making the allegation. You are. I would like to see the figure substantiated.

Chairman PATMAN. You asked me a question. I have a feeling that you should respond to one that I asked. I am asking you. I have estimated $25 billion; if you think that is excessive, how much do you estimate?

Representative WIDNALL. That is all, Mr. Chairman.

Mr. PATMAN. I ask unanimous consent that two letters sent to me which illustrate the effect of this Federal Reserve action on interest cost be printed in the record at this point. The writer of the first letter, Mr. George Ritchie, had to pay 15 percent more in interest on his loan as a direct result of the hike in the discount rate; and the second correspondent has had to pay 8 percent more for his loan.

(The above-mentioned material is as follows:)

BALTIMORE, MD., *December 16, 1965.*

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
House of Representatives, Washington, D.C.

DEAR SIR: Your committee may be interested in what effect the recent raise in the discount rate had on a bank loan here in Baltimore. The attached photocopy tells the story.

The rate on this loan since inception had been 5¼ percent. As of December 10 the balance outstanding remained at $575 and the bank continued to hold as collateral, 100 shares of common stock in Commercial Credit Co.

Under the circumstances, I would not have objected to an adjustment to offset the one-half-percent raise, but it seems to me a boost of three-fourths-percent is unconscionable.

Very truly yours,

GEORGE W. RITCHIE, *Timonium, Md.*

FIRST NATIONAL BANK OF MARYLAND,
Baltimore, Md., December 10, 1965.

Mr. GEORGE W. RITCHIE,
Timonium, Md.

DEAR SIR: We beg to notify you that commencing this date the rate on your call loan will be 6 percent until further notice.

Very truly yours,

WM. G. HOLLAND.

GAINESVILLE, GA., *December 17, 1965.*

Hon. WRIGHT PATMAN,
U.S. Representative, Texas,
U.S. House of Representatives,
Washington, D.C.

DEAR SIR: I am writing in regards to the recent hike in the discount rate by the Federal Reserve Board, and also the hike in the interest rate banks are allowed to pay on time deposits.

For the last year or year and a half the local savings and loan associations have been generally charging an interest rate of 6½ percent on real estate loans. However, they have been making many loans at 6¼ percent interest, and quite a few at straight 6 percent interest. On Monday, December 6, 1965, I talked over the phone to Mr. Buford Battle, president of First Federal Savings & Loan Association, Gainesville, Ga. We discussed a real estate loan at a rate of 6 percent interest. He was very encouraging in the fact the association would advance my loan at that rate. He even went so far as to urge me to apply for the loan that date, which I did, and told me he was so sure I could get it at that rate, he wouldn't even charge me an application fee if the loan was rejected at that rate. I applied for the loan and the officer of the association to whom I made the application stated he too saw no reason why the loan would not be made at 6 percent.

Imagine my surprise when on December 9, 1965, I was informed the loan at 6 percent had been rejected. The rejection of the loan was accompanied by a proposition to grant the loan at 6½ percent straight. I called them and was informed the board of directors "due to the change in the monetary picture" had given directions to the loan officers of the association to advance no loans whatsoever at a rate less than 6½ percent. I am attaching a Thermofax copy of that letter. I am also attaching another letter dated December 15, 1965, in which my loan at the 6½ percent figure is approved. Note in that letter the estimated cost of closing the loan is $623.50 which is about 35 percent higher than has been charged up to the last few weeks. So, they not only have climbed a full one-half of 1 percent on the interest rate, they have raised costs of closing by a full one-third.

It is my firm conviction this association, and others like it, are using Mr. Martin's hike in the discount rate as an excuse to raise the interest rate on real estate loans. I fail to see a direct connection between the two, but I do feel that the discount hike will cause even more inflation, and perhaps even a recession, because, gentlemen, I have canceled my plans to build a $22,500 home because of the higher costs of closing costs and interest. I know several other people in this small town who have done the same. I have a good friend who constructs about 100 residences per year and this increase in costs is causing him to cut back his operation. He indirectly employs about 25 people.

I would appreciate a reply from you telling me your feelings about this increase in the discount rate and its connection with the subsequent increases in the interest rates and what you foresee in the future on such rates.

W. R. FLETCHER.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Gainesville, Ga., December 15, 1965.

Mr. W. R. FLETCHER,
Gainesville, Ga.

DEAR MR. FLETCHER: It is a pleasure to inform you that your application for a loan has been approved in the amount of $17,000, repayable at $115 per month, over a period of 300 months, including interest at 6½ percent per annum on unpaid monthly balance. The approval is conditioned on and subject to the terms and conditions set out on attached sheet(s). Construction money granted if desired. Please call at 532-8411 when ready for attached inspections.

The closing fees and expenses are estimated at $623.50.

This commitment will expire unless the enclosed copy of acceptance is signed and returned to us within 10 days. Take the original of this letter to the attorney listed below with a deed or other legal description of the property and survey plat if available. Any of our loan officers will be glad to discuss details not clear to you.

We appreciate your giving us this opportunity to serve you. May our relationship always be pleasant and satisfactory.

Sincerely,

FRED D. HAYNES,
Vice President.

Undersigned accepts the above loan and agrees to reimburse First Federal Savings & Loan Association of Gainesville for that portion of above closing fees and expenses which it has paid or obligated itself to pay.

This ——— day of ————, 19—.

Copy to: ————————————.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Gainesville, Ga., December 9, 1965.

Mr. W. R. FLETCHER,
Gainesville, Ga.

DEAR MR. FLETCHER: Your loan application wherein that you requested a 6-percent interest rate has been considered by the loan committee.

Due to the change in the monetary picture as we discussed at the time your application was taken, the committee did not see fit to grant you a loan at the interest rate you requested. Should you desire that this application be processed at the current rate charged by the association—6½ percent—I shall be happy to re-present your application under these conditions.

Sincerely yours,

FRED D. HAYNES,
Vice President.

Chairman PATMAN. Mr. Ellsworth?

Representative ELLSWORTH. Thank you very much, Mr. Chairman. I am sorry I was not able to be here yesterday and have the advantage of your testimony, Mr. Martin, and the other members of the Board. But as a result of the review of notes that I arranged to have taken of the testimony yesterday, I do have one or two questions.

First, let me say that I feel, with the excise tax cuts that have taken place this year—and there will be more next year on big consumer items—with the capital spending increases that are indicated next year, and with the evident large increase in spending on account of the war in Vietnam, the Board's action was a welcome action and one that was absolutely necessary to help combat inflation and maintain price stability.

I am concerned about this question of coordination. I notice, Mr. Martin, that you spoke in some detail about the kinds of coordination that have existed between you and the administration. Yet on the other hand, Governor Maisel, you said from your point of view there was no coordination at all, or substantially none on a formal basis.

Mr. MAISEL. I did not say that. I was very clear that there has been an informal exchange of certain views. I was well aware of meetings of the Quadriad, and of the fact that Chairman Martin was meeting with Secretary Fowler almost weekly. What I felt was lacking were specific views and the type of information necessary for proper decisions to be made. I did not receive any formal nor even informal information on key problems. I would say that the best information I received was from the press. There was a lack of the information necessary for me to make a decision as to whether monetary policy should have been changed in contrast to fiscal policy.

Representative ELLSWORTH. In other words, you said that although you understood that Chairman Martin was in communication with the administration all the time about economic policy generally, that you, yourself, weren't; and I understood you to say that your staff, that is the staff of the Board, except on an informal catch-as-catch-can basis, were not in coordination with the administration.

Mr. MAISEL. This is my understanding and feeling; yes, sir.

Representative ELLSWORTH. Chairman Martin, is that true?

Mr. MARTIN. I am not sure I got all the implications.

Representative ELLSWORTH. What I am getting at is, is it true that although you are in communication with the administration on these matters, that the other members of the Board are not, and that the staff of the Board is not.

Mr. MARTIN. The staff of the Board works continuously with all departments of the Government. I think they have had extremely good relations with them. Now we do not take all seven members of the Board to a meeting of the Quadriad. I think it would be very unwieldy if we did.

Representative ELLSWORTH. How many members of the Board do you take to the Quadriad?

Mr. MARTIN. I don't take any. Sometimes I take the Vice Chairman but not very often. I think the Chairman of the Board is usually sufficient. When this Quadriad meeting was set up by Secretary Anderson a number of years ago it was an experiment. At that time we tried to keep it to a small group. Sometimes the group gets rather large as it is.

I try to keep the Board from not being committed in advance. As long as we have a Board system it seems to me that the Chairman of the Board should present his views at the proper time and should report back to the Board at the time of the decisionmaking as to what the views of the others are. But he should not be in a position where he is committed, or where he has committed his fellow Board members.

Representative ELLSWORTH. I agree, although I don't believe that because you attend meetings of the Quadriad that you are committed.

Mr. MARTIN. Absolutely not. I say the situation would be different if you had the whole Board there.

Representative ELLSWORTH. Thank you very much.

Now, Governor Maisel, what about what Chairman Martin said about the staff? He said that the staff worked continuously with other staffs around the administration and elsewhere in Washington. Is that contrary to your understanding?

Mr. MAISEL. I think it is a question of specific things. And as I indicated there is a major difference between relationship with the Treasury on debt management problems and the Budget Bureau and Economic Council on general economic and fiscal developments. Let me cite this specific example of the question of projections of expenditures and revenue. It is my understanding that there are usually no agreed estimates made with the other agencies.

I felt that at a time of very critical decisions a great deal depended upon the administration's view as to what expenditures would be during the next 6 months. This type of information was not available. Now whether it was or was not requested officially, I don't know. At least I received no official view of any sort and our staff expressed grave doubts as to the accuracy of their own projections. We were in a period where I was concerned as to whether we might not be better off using a tighter monetary policy. Now we did receive the general view that the administration was not now in favor of a tighter monetary policy. However we did not get the reasoning behind this view. Did they feel unemployment was still too high? What about the question raised by one of the members of your committee yesterday as to their view of the desirability of higher employment to erase particular areas of unemployment in the country? Such ideas were not available. It was the lack of knowledge of this type that I was referring to.

It seemed to me that in making a decision on monetary policy, the assumptions that various people in the administration were making with respect to problems of the current period were critical. Their general reaction to an increase in the discount rate was not sufficient. I felt that what was needed was a joint study or a list of assumptions, a list of views on factors that had to be taken into account in making a critical decision.

Representative ELLSWORTH. I understand.

Now, let me ask this because I don't know what the situation is. As a Governor there what kind of staff do you have? How many people?

Mr. MAISEL. Personal?

Representative ELLSWORTH. Either personally in your own office or just available to draw on.

Do you feel that you have had adequate staff of professional economist and mathematicians and so forth, to be able to develop material for you to make decisions?

Mr. MAISEL. We have one of the best staffs in Washington. They are excellent. If I give them an assumption they are very able in analyzing the problem and expressing their feelings. We have three of them behind us. They are three of the most highly competent people in Washington. Our reaching certain conclusions as to how the Government ought to run is a different question though from our finding out specifically and certainly how the members of the administration feel that they want to operate fiscal policy.

We could and did make certain assumptions. As I indicated yesterday, assumptions about expenditures and receipts for the next half year were very critical in coming to a decision.

Representative ELLSWORTH. Were your staff not able to get these assumptions from anywhere in Washington?

Mr. MAISEL. They were not. The assumptions they used were their personal ones. They were not received at an official level and I would judge they differed from the assumptions of the administration.

Representative ELLSWORTH. You really felt as though you were in the dark about spending and about income from the official Government point of view, from the Treasury's point of view. Is that correct?

Mr. MAISEL. Yes, sir.

Representative ELLSWORTH. Chairman Martin, did you feel as though you were in the dark about those?

Mr. MARTIN. Not at all. I felt that we were adequately informed. I might just say that before each Open Market meeting it has been our policy for a number of years to have a presentation of economic developments by as many as 30 to 40 members of the staff, the International Division, and the Research Division; and the members of the Board attend this. They are free to ask any questions of the members of the staff that they wish. This is the way we have proceeded in the last 10 years. I think we have an extremely competent staff.

Of course, I had the benefit of access directly to the Secretary of the Treasury that Governor Maisel did not have, but so far as expenditure policy and general budgetary policy, I think that our staff has been kept well informed and they have made their own judgments on it, they have made their own projections and those are brought to the

attention of the Board members and we also have at each Open Market Committee meeting an economic review and a financial review and a balance of payments review by the top staff official in each of these areas who has prepared especially for that meeting and has drawn upon all the resources of the staff to pull together his material.

Let me say that no member of the Board so far as I know has ever endeavored to influence any member of the staff in these presentations. I am sure that our staff will testify that I have certainly never urged them to take any position or point of view.

Representative ELLSWORTH. Thank you very much. My time is up.

Chairman PATMAN. I believe it is my time now.

Mr. BALDERSTON. Mr. Chairman, may I make a comment concerning the questions raised by Congressman Ellsworth and previously by Senator Proxmire?

Chairman PATMAN. Without objection, you may do so.

Mr. BALDERSTON. It seems to me, Mr. Chairman, that the two have raised what your committee may consider the most fundamental question of all; namely, how a developed, mature country such as ours may obtain a proper mixture of fiscal and monetary policy. Fiscal policy as we all know, is inflexible. It is changed but seldom, as when the Congress changes the taxes or approves a budget; but monetary policy is flexible.

Monetary policy is so flexible that it can be modified from day to day in the light of market conditions, in the light of changes in the domestic economy, or in our foreign dealings.

Now, if you are to achieve a proper balance of the two you can no more subordinate monetary policy to fiscal policy than you can run an automobile without both an accelerator and a brake.

The Federal Reserve reports to the Congress. It is a creature of Congress. It was created by the Congress to protect the integrity of the dollar. The Government of the moment has needs and purposes of its own. It uses fiscal policy, which is more potent perhaps than monetary policy, but nonetheless is a vital instrument in promoting economic growth, fuller employment, a higher standard of living, and the other economic goals that our country desires. But if the integrity of the dollar is destroyed in connection with any program, then these goals cannot be achieved.

It is possible to work out a proper mix of the two, but if you think of coordination in terms of subordination, the national goals will not be achieved. The Congress thought it was wise to create a Federal Reserve System that would not be subordinate to the Government of the moment, would not be at the mercy of pressures, private or political, and that is the reason why Congress in its wisdom established a board with terms of 14 years. So, no Board member need be frightened to vote in accordance with his best thinking and his conscience.

Chairman PATMAN. I agree with you that the Federal Reserve Board members are insulated against the electorate but you are not insulated against the bankers. They are right on your boards. They have more to profit from your action than any one. Yet they are serving on these boards and they are the ones who make the orders, the rules, and regulations.

Mr. Martin, on a number of occasions you have repeatedly expressed dedication to the objective of the Full Employment Act of 1946.

The plain reading of this act requires all Government departments and agencies to coordinate their activities to achieve a national policy as set out in the act and as set forth in the President's annual Economic Report to the Congress. You, Mr. Martin, have pledged yourself as Chairman of the Federal Reserve Board to the principles and objectives of the act many times in the past.[1]

Now, on July 6 of this year, 1965, Treasury Secretary Fowler announced the establishment of a Coordinating Committee on Bank Regulations to include the Federal Reserve, the Comptroller of the Currency's office, Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board. At that time he said that any rule, regulation, or policy of any one of the banking regulating agencies which might conflict with an existing rule, regulation, or policy of the other should be discussed by the committee, and a 10-day waiting period observed. Was the jump in the regulation Q ceiling discussed with the committee and considered subject to the 10-day waiting period, Mr. Martin?

Mr. MARTIN. No, it was not. It was discussed with the Secretary of the Treasury. The Comptroller of the Currency was out of town. We did not communicate with the Deputy Comptroller of the Currency.

Chairman PATMAN. Did you communicate with the Chairman, Mr. Randall, of the Federal Deposit Insurance Corporation?

Mr. MARTIN. I did.

Chairman PATMAN. In this Committee did you have a meeting with Mr. Fowler and this coordinating group at any time?

Mr. MARTIN. I did not.

Chairman PATMAN. Did you ever have a meeting with them?

Mr. MARTIN. Mr. Fowler is not a member of the Committee. The Secretary deliberately decided he did not want to be on the Committee.

Chairman PATMAN. Did you ever have a meeting of the Federal Reserve and the Comptroller and the Federal Home Loan Bank Board with this Fowler committee?

Mr. MARTIN. We have had two meetings.

Chairman PATMAN. Did you discuss these matters about raising this rediscount rate?

Mr. MARTIN. We discussed a variety of matters. We have had great difficulty in arriving at even a common agreement on a common report of condition for banks.

Chairman PATMAN. Mr. Martin, you realized that your December 5 ruling would be greatly detrimental to the savings and loans, did you not?

Mr. MARTIN. No, I did not think so. As I testified yesterday——

Chairman PATMAN. You don't think so?

Mr. MARTIN. No, I do not. I think that the flow of funds in the United States became constricted and I have grave question about the use of ceilings in this type of operation insofar as the flow of funds is concerned. But we deliberately—whether wisely or unwisely—decided not to free it completely and not to raise the ceiling on savings deposits so that the savings and loan associations and mutual

[1] An article by Richard E. Mooney in the New York Times, Wednesday, Dec. 21, 1965, comparing degrees of "independence" and autonomy of various central banks appears in appendix to these hearings.

savings banks would not be competitively seriously disrupted by the change in regulation Q.

The saving and loan people have jumped to the conclusion that they are seriously endangered by this. Only time will tell whether that is true. We cannot be sure.

Chairman PATMAN. What will prevent a person from taking his savings account and converting it into a time deposit?

Mr. MARTIN. There is a passbook requirement. We think that too frequently this has been ignored. But a bona fide personal savings account is not supposed to be used as a checking account.

Chairman PATMAN. I am not talking about a checking account; I am talking about a withdrawal from a savings account and putting it in a time deposit for 5½ percent interest.

Mr. MARTIN. He is not getting 5½ percent. The rates at the present time, as of this morning——

Chairman PATMAN. I am talking about under your regulations.

Mr. MARTIN. Under our new regulations—you said yesterday there were a lot of banks at 5½ percent. I don't know what banks they are.

Chairman PATMAN. I am not talking about that. Please answer this one question.

Mr. MARTIN. I am trying to answer the question.

Chairman PATMAN. You seem to think that you accomplish a lot by keeping the savings rate at 4 percent but you cannot keep people from taking their savings out and putting them into time deposits at 5½ percent.

Mr. MARTIN. They are not getting 5½ percent.

Chairman PATMAN. I did not say that, Mr. Martin. Under your present regulations—your new ones—is there nothing to keep a person who has a savings account at 4 percent from converting that by withdrawing it, if you please, and depositing it in a time deposit for 5½ percent under the new rules?

Mr. MARTIN. If he can get 5½ percent, yes. He is not able to get 5½ percent at the present time.

Chairman PATMAN. But he is allowed to do that by your regulation if someone offers it?

Mr. MARTIN. He is allowed to do it. Mr. Patman, as I have said to you a number of times, I think we would be better off if we didn't try to constrict that area at all. That is another question.

Chairman PATMAN. Yes, it sure is another question; yes, sir.

Mr. MARTIN. We endeavor to free the flow of funds in this way.

Chairman PATMAN. Mr. Martin, I don't have much time and we are trying to get through today. You are not responding to my questions. I asked you a very simple question, a very simple one. You say that the 4-percent rate is maintained as a maximum on savings. I asked you the simple question: What is to keep a depositor—a savings account depositor—from withdrawing his savings account and getting a time deposite contract up to the limit that the bank is willing to pay—up to 5½ percent under your new regulation. The answer is, that there is nothing to keep him from doing it?

Mr. MARTIN. There is nothing to keep him from doing it except practical administration. I am simply suggesting that you are misrepresenting, if I may say so.

Chairman PATMAN. That is not true. I am not misrepresenting it at all. I am asking you what is to keep a person who has a 4-percent savings account from withdrawing that savings and entering it into a time deposit account and receive up to—according to your regulations, and if it is offered to him—5½ percent. Isn't that a correct interpretation?

Mr. MARTIN. Nothing would keep him from withdrawing the amount at any time.

Chairman PATMAN. That is what I wanted to know—and depositing it up to 5½ percent—if he can get 5½ percent.

Mr. MARTIN. If he can get 5½ percent.

(Material supplied later appears below:)

[Reprinted from the Wall Street Journal, Jan. 4, 1966]

YEAREND SWITCHING OF SAVINGS TO OBTAIN HIGHER YIELD EXCEEDS NORMAL IN SOME AREAS

Heavier than usual yearend switching of accounts by savers seeking a higher return on their money has been occurring in metropolitan New York City, Los Angeles, and several other places around the country.

The increased activity comes in the wake of moves by banks and savings and loan associations in those localities to pay higher rates on certain kinds of savings, beginning January 1 in most cases. The institutions were influenced by actions by the Federal Reserve System last December 5 lifting interest-rate patterns in the United States generally.

The switching of funds was particularly pronounced in the New York metropolitan area, where a number of rival institutions previously announced rate increases for the new year; some concerns also had announced new special savings plans offering bonuses on deposits left for a set period.

According to some executives of savings institutions in the New York area, however, funds withdrawn from their institutions weren't going entirely to competitors but in many instances were being invested in the stock market. And there were reports that some savings were being drawn out of regular banks in New York City for the purchase of higher yielding "savings certificates" offered by some large suburban banks.

The Federal Reserve in its December action boosted to 5½ percent the maximum rate commercial banks may pay on time deposits and certificates of deposits maturing in 30 days or more. Formerly the ceiling was 4 percent to 4½ percent.

The top interest commercial banks may pay on regular savings accounts was left intact at 4 percent; most commercial banks in New York City and in many other parts of the country already are paying the maximum on such accounts.

SAVINGS CERTIFICATES SPURT

Franklin National Bank, a large suburban New York bank based in Long Island, yesterday reported a substantial increase in purchases of the bank's small-denomination savings certificates whose rate was boosted on December 23 to 4.8 percent from 4.5 percent. The bank said it couldn't estimate how much new money has been attracted by the higher rate, but that a step-up in purchases was noted in the last week in December. Franklin's certificates are issued to individuals and nonprofit organizations in amounts of as little as $25 and for 90 days or more.

Under New York State law, savers are credited full interest for a quarter even though funds are drawn out as early as 3 business days before the end of the quarter; similarly, savers are paid for a full period even on funds that aren't deposited until the 10th business day after the start of the period.

Franklin National is one of the more promotionally minded banks in the New York area. Its move, which had been widely anticipated, to offer a higher yielding savings certificate has strongly influenced recent rate changes in the metropolitan area. A number of mutual savings banks in Brooklyn and Manhattan, for example, aiming to beat Franklin to the punch, announced earlier last month they expected to pay 4½ percent. A number of area savings and loan associations similarly boosted their savings rates to 4½ percent from 4¼ percent.

Despite their announced rate increases mutual savings banks said their loss in deposits since the start of the grace period December 29 has been about twice as great as in the corresponding period beginning in the last week of 1964.

Bowery Savings Bank, the Nation's largest, said net withdrawals in the period amounted to $8.1 million, more than double the $3.8 million in the 1964 days. But a spokesman contended a good part of the withdrawals was used to buy stocks.

Alfred S. Mills, president of the New York Bank for Savings, said savers withdrew a net $6.5 million in the last 3 days of 1965, compared with $3.5 million in the like 1964 period. Most of the withdrawals, he added, were by charitable institutions; these accounts dropped $3.7 million in the three days, compared with only $600,000 the year before.

HIGHER THAN USUAL

Several big New York commercial banks also reported that overall withdrawals of savings recently have been running higher than usual, even though they recently pushed up their rates on savings certificates to 4½ percent from 4¼ percent; these banks issue the certificates only in denominations of at least $2,500. Bankers Trust Co., the city's sixth largest bank, said, for example, its savings withdrawals were running 30 percent more than a year earlier.

The banks ascribed some of the losses in regular savings, which as a practical matter don't have to be left for any set period but can be withdrawn at will, to transfers by depositors to savings certificates offered by their own and other banks.

Bankers and other savings and commercial banks in New York reported, on the in-flow side of the ledger, receiving some deposits of funds that New York residents formerly had kept in accounts at California savings and loan associations. Th prevailing rate paid by west coast savings and loan associations continues at 4.85 percent.

In California, several savings and loan associations reported brisk withdrawal activity but noted it is customary for a certain amount of such activity to take place in the first few days a new dividend-paying period as savers switch from one institution to another. However, Hawthorne Savings & Loan Association, in the Los Angeles area, which boosted its basic rate to 5 percent beginning January 1, said its net withdrawals yesterday were lower than would have been the case normally.

Meantime the relatively few Metropolitan Los Angeles commercial banks that recently offered higher yielding savings certificates reported rising deposits. Abmanson Bank & Trust Co., which is offering 5 percent on certificates of at least $10,000 held a minimum of 90 days said the net inflow is up about 10 to 15 percent from our normal CD sales.

Beverly Hills National Bank, a subsidiary of Gibraltar Financial Corp., said it is paying 5 percent on certificates of deposit of $5,000 or more with maturities of 6 months to a year, effective Demember 31.

Eariler yesterday, John Williamson, financial vice president of Gibraltar Financial, said that holding company's Gilbraltar Savings & Loan Association subsidiary was facing wthdrawals up 20 percent from the first day of the reinvestment period a year ago. He attributed the withdrawals to banks currently paying 5 percent on certificates of deposit.

Mr. Williamson said Beverly Hills National wouldn't guarantee to pay the 5-percent rate past the 1-year limits on the certificates of deposit.

Elsewhere in the country, several other smaller commercial banks offering certificates at higher date reported favorable depositor response. "We're certainly geting more money in than if we hadn't changed the rate," said an official of Philadelphia's Lincoln National Bank, the only one in that area to offer a 1-year certificate paying 4.75 percent.

At most mutual savings banks in the Philadelphia area yesterday, the banking floor was crowded with depositors lining up to have bank tellers credit 1965 interest in their passbooks. Savings bankers said, however, that as the Pennsylvania law provides grace periods up to 10 days for the deposit of savings without loss of interest, they didn't expect any switching trends to become apparent until later in the week.

In Houston, Medical Center National Bank reported its boost to 5 percent from 4½ percent on savings certificates in mid-December brought more than $1 million of new money into the bank through December 31 and nearly another $1 million

yesterday alone. At least half of yesterday's inflow, an official estimated, was transferred from checking deposits in other banks. The bank currently has total deposits of nearly $20 million.

Several additional savings and loan concerns and commercial banks around the country announced rate increases on certain kinds of savings, effective January 1. The Boston (Mass.) Federal Savings & Loan Association, for example, increased its rate to 4½ percent to be paid semiannually from 4¼ percent paid quarterly. In Dallas, Security Savings Association raised its rate to 4¾ percent semiannually from 4½ percent quarterly.

Home Owners Federal Savings & Loan Association and First Federal Savings & Loan Association, both of Boston, also increased their dividend rates to 4½ percent semiannually from 4¼ percent quarterly.

Security National Bank of Long Island, a suburban New York commercial bank, announced it was offering for the first time a savings certificate paying 4.8 percent a year on deposits of at least $1,000. The bank said the interest on bonds held for 5 years to maturity would be compounded annually, producing an average of 5.38 percent a year.

Chairman PATMAN. Now I have here this statement you furnished me about the $16 billion certificates of deposit in the 30 banks. You don't have the maturity here. Do you have the maturity of these certificates?

Mr. MARTIN. We can get you the schedule, Mr. Chairman.

(Data below were subsequently furnished by the Federal Reserve Board:)

OUTSTANDING NEGOTIABLE TIME CERTIFICATES OF DEPOSIT AT 30 LARGEST WEEKLY REPORTING MEMBER BANKS, NOV. 17, 1965

City or district	*Average maturity (months)*
New York City	3.3
Chicago	2.5
Other:	
Boston and Philadelphia, Cleveland and Chicago, Dallas and San Francisco	[1] 3.3

[1] Approximate. Data are not available for all banks by size within district. Average maturity for all 30 of the largest weekly reporters on Nov. 17, 1965, was 3.3 months and for all weekly reporters issuing certificates of deposit (245 banks) was 3.4 months. Average maturity declined from 4.1 to 2.9 months as size of bank declined. The 2.9 months was for nonprime banks with deposits of $1 billion or more.

Chairman PATMAN. If you will furnish that, please. This indicates that 12 banks—9 in New York City and 3 in Chicago—12 out of the 30, have more than half of the $16 billion. I am just asking you if you have considered the fact that these banks were hurting. According to the speech that Vice Chairman Balderston made in Kentucky he indicated that they were in danger, that they had embarked upon something new in banking—they were in an illiquid position. These certificates of deposit have expanded from $1 billion in 1961 to over $16 billion now. That is quite an increase. This is something relatively new in the banking world. Many of these CD's will mature in December and January and February. Now the Federal Reserve has forced interest rates up over the last year. You are realistic people with good judgment and you knew that the banks holding these CD's didn't have a chance of renewing them at the old rates. Therefore, you were compelled to come to the rescue of these hurting big banks, these nine in New York and these three in Chicago. They are really hurting because they can't afford to let these CD's expire and be called upon for the money when they didn't have the money, probably, at least, in such large amounts.

The only way you could help them would be to raise the interest limits to 5½ percent on these time deposits. While you were doing that you were making the first victims, at least the savings and loans. I think that it is very, very poor judgment on the part of the Federal Reserve Board to do anything to let the commercial banks take further advantage of the savings and loans.

I was here in 1932 under a Republican administration that felt compelled to have some institutions that would help people build homes over a longer period of time at low rates of interest. It was under Mr. Hoover that this program was established. Things were so bad the Republicans said the banks won't do the job so let us have a new organization, a financial institution, and these fine savings and loans were created and now they have built up to a $120 billion industry.

All at once, the banks decided they want to run them. I don't say that you have entered into a conspiracy to help the banks take over the savings and loans, but you are doing exactly what the banks would like you to do; I mean a large number of them, not all of them by any means. But a large number of the commercial banks don't like the savings and loans. They would like to take advantage of the savings and loans. They would like to get them out of the way. You have made the longest step, a real giant step in the direction of helping the commercial banks take advantage of and destroy the great savings and loan industry in this country.

I feel so keenly about this, I hope we can bring pressure enough to bear on you, Mr. Martin, to get you to rescind that order. Your action, in addition, will destroy many people; hurt many people; create much poverty, deny education and deny proper hospital care and treatment among other things. High interest rates will do more to cause inflation and retard the growth of this country and hurt the people generally than any other one thing.

And I noticed here that these telegrams that you received from the New York Federal Reserve Bank at 4 o'clock on December 2, and very soon thereafter—about 4:20—from the Chicago bank—identical telegrams. It seems like there was some very close working. I would not say a conspiracy, but there must have been some understanding to account for the fact that you got identical telegrams.

(The telegram sent by the Federal Reserve Bank of New York and received by the Board of Governors of the Federal Reserve System at 4:06 p.m., Thursday, December 2, 1965, is reprinted below:)

Our board of directors today voted to establish following discount rates effective the first business day following that on which approved by the Board of Governors: (*a*) on discounts for and advances to member banks under sections 13 and 13(a), 4½ percent; (*b*) on advances to member banks under section 10(b), 5 percent; and (*c*) on advances to individuals, partnerships, and corporations other than member banks under last paragraph section 13, 5½ percent.

RICHARD A. DEBS, *Secretary.*

The telegram from the Chicago bank arrived 15 minutes later, at 4:21 p.m.

Our board of directors today voted to establish the following discount rates effective the first business day following that on which approved by the Board of Governors: (*a*) on discounts for and advances to member banks under sections 13 and 13(a), 4½ percent; (*b*) on advances to member banks under sections 10 (b), 5 percent; and (*c*) on advances to individuals, partnerships and corporations other than member banks under the last paragraph section 13, 5½ percent.

PAUL C. HODGE, *Secretary.*

Exactly alike.

That was on the afternoon before the day that you had your Board together and you approved exactly these rates. This is the rate you approved, is it not?

Mr. MARTIN. That is correct.

Chairman PATMAN. Exactly these rates. You told Mr. Fowler that morning—in other words, a few hours after you received these telegrams—that you were going to do what the New York and Chicago bank's requested; that you personally favored it. You did not have time to confer with the President of the United States. You did not have time to confer with the Chairman of the Federal Home Loan Bank Board who supervises the savings and loan industry. You did not have time to confer with them. But you quickly replied and responded to exactly what the New York banks wanted.

Now who are the directors of the New York Federal Reserve Bank? Let me tell you who they are. In New York there are nine directors who run the show; nine directors. Six of them were elected by the banks themselves—the private banks—six out of nine. Naturally they would be for the commercial banks and what they wanted—more earnings and higher interest.

The same thing in Chicago. Even the head of the United States Steel was respectful enough to the President to go see him before announcing his decision on the price increase on steel. But you did not respect the President enough to go see him before announcing your action. So I feel Mr. Martin, that in view of the fact that you acted hastily and possibly needed to bail out these few banks holding maturing CD's that you and your Board, in my opinion, ought to consider your action and rescind it.

Do you not think you can give consideration to rescinding this order?

Mr. MARTIN. No, I don't, Mr. Chairman. I want to point out that the Reserve Banks use the standard previously agreed on code to wire discount rate changes. This saves us money and this has been standard procedure for many years in the System.

Chairman PATMAN. Why would you want to save money when you are collecting a billion and a half dollars a year to pay all expenses?

Mr. MARTIN. We want to save money because you are the one who is always complaining about our expenditures.

Chairman PATMAN. It is certainly very wasteful that we would permit you to collect a billion and a half dollars a year on bonds that have already paid for once, as you have and as have others before, you said, and let you take $200 million to spend for any purpose you want so as to keep you from having to go to Congress in the regular constitutional way to get operating funds. I think it is a rather costly thing that we are permitting.

Mr. BALDERSTON. Mr. Chairman, may I comment upon my Louisville talk that you were good enough to refer to?

Representative CURTIS. I ask unanimous consent that they be allowed to answer.

Chairman PATMAN. Certainly.

Mr. BALDERSTON. Mr. Chairman, I would like to remind you that passbook savings may be withdrawn almost immediately. In a practical sense they are withdrawn immediately. That is not true of CD's.

Now you have referred to the matter of the negotiable CD's that were coming due in December. They amounted to $3.5 billion. Of those, $1,854 million were outside of New York and Chicago.

Chairman PATMAN. How much?

Mr. BALDERSTON. $1,854 million.

Chairman PATMAN. Out of the $16 billion?

Mr. BALDERSTON. Out of the $3.5 billion coming due in the month of December. Our concern, of course, was that if those $3.5 billion were withdrawn from the banks, and the banks were placed in a severe enough bind, the impact upon the economy of this country right at a time of seasonal need, might have been very bad indeed.

After all, we don't want to have loans called just because the needs of the economy and of the banking system are not accommodated.

Chairman PATMAN. You felt like more interest should be allowed for that reason?

Mr. BALDERSTON. Unless they were allowed to bid a sufficiently high rate of interest to hold the CD's in the face of the declining flow of funds in our corporations you might have had the bind that I referred to. After all, December 15 is not only a tax date but the approach of dividend dates.

Chairman PATMAN. Thank you very much. You have proved my point.

Mr. BALDERSTON. I am glad you understand, sir.

Chairman PATMAN. Mr. Curtis.

Representative CURTIS. I am hopeful that before these hearings are over we will find out how many of Congressman Patman's colleagues on the Democratic side share his views and also how many people in the administration share these views. I question whether there is anyone who shares the views that were expressed here a few minutes ago. I certainly don't.

I regard a great deal—I hate to use this word but I must—I regard most of what was said as nonsense.

They attack the integrity of many people.

Chairman PATMAN. I resent that.

Representative CURTIS. I understand you resent it.

Chairman PATMAN. I will have my say later.

Representative CURTIS. I think you will. I wanted the record to show that I will not sit idly by and have this committee forum used for the purpose of making charges that cannot be substantiated and that involve people's integrity.

Chairman PATMAN. Will you yield?

Representative CURTIS. No; I will not yield. I have some things I want to say.

Chairman PATMAN. On that one point?

Representative CURTIS. Yes; I will yield.

Chairman PATMAN. You see, the Republican group yesterday passed a resolution——

Representative CURTIS. I don't yield for that. This committee is not for this purpose. I will not yield.

Chairman PATMAN. I don't blame you.

Representative CURTIS. I want to ask unanimous consent to put in the record the remarks of Mr. Martin before the 59th annual meeting of the Life Insurance Association of December 8.

Chairman PATMAN. Without objection it is so ordered.

(The document referred to follows:)

The Federal Reserve's Role in the Economy

Remarks of William McC. Martin, Jr., Chairman, Board of Governors of the Federal Reserve System, before the 59th annual meeting of the Life Insurance Association of America, New York City, December 8, 1965

In meeting with your association, I feel very much at home. Life insurance and central banking have many problems and many attitudes in common. We are both deeply concerned with long-term aims, with maintaining the strength of our economy and the strength of our currency.

Millions of Americans are putting their faith in life insurance for the protection of the future of their families and this faith rests on the expectations that your policies will return to them a full measure of value for the dollars they are paying to you. These millions who entrust funds to you, and who rely on the Federal Reserve to safeguard the value of their money, want most of all safety and security—in your case, safety and security from want for their old age and for their families; in our case, safety and security from the twin dangers of inflation and deflation, the two deadly enemies of rational financial planning.

In trying to fulfill our duties, both your association and the Federal Reserve System must rely on the best information and the most accurate analysis covering the innumerable factors that influence the development of our economy. It is therefore no coincidence that each of us has sponsored programs of basic economic research, and that the Federal Reserve has time and again benefited from the work of your association. I may mention in particular your invaluable studies in the fields of savings, capital markets, and interest rates.

I gladly take this opportunity to thank you for those contributions to our common efforts, and I can only hope that our research program proves as useful to you as yours has proved to us.

Now, if I may, I should like to make some observations on the Federal Reserve's role in our economy. I shall begin with recent developments.

Just a few days ago, the Federal Reserve raised discount rates to 4½ percent, and the maximum rate payable on time deposits to 5½ percent. The discount rate thus reached its highest level in more than 30 years, and the time deposit rate its highest level since the promulgation of regulation Q, also more than 30 years ago.

In view of these developments, I would like to speak to three questions that I believe of interest to you: First, for what reasons and for what purpose did the Federal Reserve act? Second, does the action mean that the Federal Reserve disagrees with the rest of the Government on the basic issues of financial policy? And third, what is the significance of this action for the future?

First, I want to say that the Federal Reserve acted because it believed that the previous level of the discount rate and of time deposit rates was out of line with conditions in the money and credit markets and especially with the need to keep the flow of bank credit large enough to satisfy the needs of our expanding economy but not so large as to threaten to turn that expansion into an inflationary boom.

Second, the Federal Reserve acted not to hamper but to further the goal of the administration—shared by the Congress and by the American people as a whole—to do the best that can be done to assure the continuance of our economic expansion, maintenance of generally stable prices, and restoration of reasonable equilibrium in our international payments.

And third, the Federal Reserve will continue to shape its policies with complete flexibility, firming whenever our further progress is threatened by inflation, and easing whenever that threat has passed.

The Federal Reserve, in all its actions, aims always at the same goal: to help the economy move forward at the fastest sustainable pace. We reach our destination most rapidly as well as most assuredly when we travel at maximum safe speed—and this speed cannot be the same under all conditions and at all times.

Actually, the recent increase in rates is intended not to reduce the pace of the economy's expansion but to moderate mounting demands for bank credit that might jeopardize that pace by overstimulating the economy.

A brief review of developments over the past 12 months in the three critical sectors of production and employment, the balance of payments, and prices will provide background for our recent action.

The production and employment record of our economy has been excellent. Our industrial output will be at least 7 percent higher this year than in 1964, a

significant gain by any standard. Employment has expanded fast enough to reduce the unemployment rate by a full percentage point over October 1964. For the first time since 1957 it seems likely that we may soon reach our interim goal of pushing unemployment down to, if not below, 4 percent of our labor force. And despite such progress, average wages of production workers do not seem on balance to have risen faster than productivity so that labor costs per unit of output in manufacturing have remained virtually unchanged. The American worker—with whose progress all of us are concerned—has shown great responsibility in negotiating wage settlements that help to insure a steady rise in the real incomes of all Americans.

Our record on international payments balance is fair enough, but less satisfactory than in the field of production and employment. Over the first three quarters of the year, our deficit on so-called regular transactions was at an annual rate of $1¾ billion—far smaller than in any calendar year since 1957 but still far too large for comfort. We need to do much better if we are to reach our goal of reasonable payments equilibrium next year, and especially if we wish to do so without interference with the freedom of international transactions.

But in the third critical area, maintenance of general price stability, our record has not been so good as in other recent years. Whenever in recent years our economic growth was less rapid and our payments deficit larger than we would have wished, we could be hopeful because our price level had remained stable. For we knew that such stability was a firm basis for further economic expansion as well as for further progress toward payments balance. But over the past 12 months, the crucial index of industrial wholesale prices has risen 1¾ percent, after 4 years of virtual stability.

It is quite true that prices have not broken out of the pattern of modest and selective advance in recent months. In order to avert such an eventuality, the Government has taken action relating to prices of a number of individual key commodities. But selective intervention to deal with price pressures necessarily has limits. In the longer run, it would be ineffective if not accompanied by measures that affect the source of price pressures rather than the prices themselves.

Unlike price pressures during the period before 1958, recent price developments cannot be explained by cost-push influences. As mentioned before, unit labor costs have remained essentially stable. Such price pressures as are making themselves felt must be primarily attributed to demand-pull.

This fact should not cause surprise. The closer an economy comes to full employment of manpower and capital resources, the greater is the risk that bottlenecks will develop in strategic areas so that large new injections of bank credit and money will serve to raise prices more than production.

Whatever divergent views the experts may take in regard to the ability of a central bank to control price pressures generated by cost push, nobody has ever denied that it is the function of monetary policy to restrain price pressures that originate from private demand. Hence, the threat to continued maintenance of the noteworthy price stability of the first 4 years of the present business expansion must be of concern to the Federal Reserve.

I do not want to imply that monetary policy had ignored the problem before last weekend. Since December 1964, the free reserve position of member banks has changed from a moderate plus to a moderate minus—limiting the ability of banks to increase their credit creation. The interplay between that degree of restraint and the accelerating pace of economic expansion led in many—though not all—financial markets to increases in interest rates, well before the recent rise in discount and time deposit rates. But let us not overlook the fact that, despite such restraint, commercial and industrial bank loans have increased this year by about 20 percent.

As long as unemployment of manpower and plant capacity was greater than could be considered acceptable or normal, we had every reason to lean on the side of monetary stimulus. While this posture did risk some spillover of funds abroad, the adverse effect on our payments balance was more than offset by the benefit to our domestic economic growth. And we have tried to combat excessive capital outflows by selective fiscal and monetary measures, including the voluntary foreign credit restraint efforts of our financial institutions, in which the members of your association have so magnificently joined.

But despite the exemplary compliance of the financial community, and the dramatic decline in the foreign credits of financial institutions, foreign investments of nonfinancial corporations were large enough to explain the persistence of our international payments deficit. As financial institutions reduced drasti-

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cally the availability of dollar credits abroad, and thus had more funds to devote to domestic uses, their domestic customers were in a position to use part of the newly available funds to finance their ventures abroad. This is an example of the leakage inherent in selective credit controls, an indication of their limited effectiveness, and a demonstration of why they can only serve as stopgaps rather than lasting remedies.

Our closer approach to a satisfactory level of domestic output and employment has diminished the weight of the arguments against the use of general rather than selective measures to help counter price pressures at home as well as to help correct our payments imbalance. Obviously, no one—and least of all those of us responsible for monetary policy—would ever want to do anything that could undercut the sustained progress of the economy. But those who are fearful of the economic consequences of any move even toward the mildest restraint—any drop of free reserves below zero, any slight rise in interest rates—would do well to consider the record of the economy's performance over the past 12 months.

Let none of us overlook the fundamental difference between a change in interest rates imposed by a central bank contrary to the trend of basic economic forces, and a change permitted by the central bank in line with those forces.

If the Federal Reserve had followed the advice offered by some and had tried to force interest rates up at a time when the demand for investible funds (even at existing relatively low rates) was not sufficient to employ our idle resources and to move our economy rapidly toward fuller employment, such a policy would indeed have harmed our domestic economy, and in consequence the economy of the entire free world. Conversely, if the Federal Reserve had strained to keep interest rates from rising by providing reserves without limit at a time when funds borrowed from banks were beginning to generate an aggregate demand in excess of output from available resources, the Federal Reserve would again have become, in the words of one of my distinguished predecessors, a veritable engine of inflation.

Recent developments in our economy—mounting danger of price pressures, rapidly climbing bank credit, and continuing deficit in our payments balance—have been warning signals. And they have indicated that prevailing market rates of interest were beginning to distort the flow of funds through the economy. Our recent action has been designed to insure that the demands for credit do not reach inflationary dimensions, and at the same time that the flow of savings remains sufficient to sustain, and be efficiently directed to sustaining, the economy's growth.

I realize that judgments can differ, not only as to the substance of an action, but also as to its timing. To me, the effective time to act against inflationary pressures is when they are in the development stage—before they have become full blown and the damage has been done. Precautionary measures are more likely to be effective than remedial action; the old proverb that an ounce of prevention is worth a pound of cure applies to monetary policy as well as to anything else. It is simpler, for one thing, to try to prevent prices from rising than to attempt to roll them back. And finally, it is surer and safer; so long as inflation is merely a threat rather than a reality, it is enough to prevent the pace of economic expansion from accelerating dangerously. But once that pace has become unsustainably fast, then it becomes necessary to reduce the speed, and once such a reduction is started, there is no assurance it can be stopped in time to avoid an actual downswing.

This is no mere theoretical reasoning. It has been the practical experience of other industrial countries in recent years. Those countries that permitted inflationary trends to take firm hold have been forced to institute harsh remedial measures to restore stability, and invariably they have had to pay the price of actual reduction in output and real income. We shall succeed in avoiding a stop-and-go cycle—as the British call the practice of first permitting inflationary pressures to develop and then taking drastic measures to suppress them—only if we do not delay until inflation is upon us.

One curious concern voiced in the press is that our action might hamper the administration in its efforts to introduce a "tough" budget next year. Nonsense. I have every confidence that the President will come up with a budget for fiscal 1967 just as "tough" as the necessities of the war in Vietnam permit. It is monetary policy that must adapt itself to the hard facts of the budget—and not the other way around.

Now I'd like to add something about our increase in maximum rates on time deposits. This part of the action was designed to permit the banking system as a whole, and the smaller banks in particular, to expand their resources sufficient-

ly to provide the economy with additional credit, especially medium- and long-term accommodation.

In recent weeks, the rates paid by the largest banks on certificates of deposits had been "bumping" against the previous ceiling of 4½ percent. This situation not only made it difficult for those banks to add to their resources; more important, it made it virtually impossible for the smaller banks to add to theirs, since these banks have to pay some premium in order to attract new depositors in competition with the giants.

Let me emphasize that the new rate sets a maximum, not a standard. We expect banks, both large and small, to exercise a high degree of prudence and responsibility in their use of this increased rate flexibility. If they do, there now will be room for smaller banks to attract funds by paying slightly higher rates than the big ones. This opportunity for smaller banks to compete more effectively is both economically advisable and socially equitable. It makes for a better regional distribution of the availability of funds throughout the country; and it makes for a larger flow of funds to small business, which is mainly dependent on the smaller banks for their credit accommodation.

The Board of Governors has purposely refrained from raising the maximum rate for savings deposits. It has done so in order to minimize the impact on competitive relationships between commercial banks and savings banks and savings and loan associations, which depend for their resources mainly on funds deposited by individual savers rather than by corporations. I expect a continued ample flow of funds into residential construction.

I hope this discussion will add to understanding of the reasons and the purposes of our action. But what about its relation to the basic financial policies of the United States?

The administration has—rightly, in my judgment—stated time and again that its goal was the most rapid economic progress compatible with price stability and payments equilibrium. And the administration—no less than the Board of Governors of the Federal Reserve System—has recognized, by deeds as well as by words, that the dangers of spreading price increases and persisting payments deficits are the primary threats to the achievement of that goal.

In the monetary sphere, no less than in others, the making of decisions—on the direction of operations, on the precise timing of actions, and on the precise choice to be made among the instruments of policy available—is often difficult, but the necessity of making these decisions is inescapable.

And in the monetary sphere, the Federal Reserve Act imposes the responsibility—as well as the authority—for making decisions upon the Board of Governors and the Federal Open Market Committee. In the discharge of our responsibility, and in the exercise of our authority, we must—and we do—give careful consideration to the opinions and judgments of others who also bear grave responsibilities. But the use of the authority assigned to us cannot be delegated, nor can the responsibility we bear be escaped. To promote effectiveness and to avoid inconsistencies, we will always endeavor, to the best of our abilities, to coordinate our moves with those of other agencies in seeking to achieve the common goals of economic policy. But we can not take monetary measures that are contrary to our best judgment, or refrain from taking measures that we consider necessary.

As I have said many times, the American people, through the legislative process, can change the authority and responsibility of the Federal Reserve System whenever they choose to do so. But unless and until the law is changed, I should consider it a violation of my oath of office to vote for or against a policy measure for any reason other than my best judgment of that measure on its merits.

Now, in conclusion, a few words about the third question, concerning the significance of our recent action for the future.

I cannot repeat often enough that the main requirement of monetary policy is flexibility, the capacity for adaptation to changes in the economy as they develop. This is particularly true for monetary policy in times of prosperity. Whenever the economy approaches full employment, the central bank must be constantly on guard against two opposite dangers that threaten continued expansion: not only against the risk of orderly growth giving way to an unsustainable boom, but just as much, if not more so, against the risk of an upswing leveling off and giving way to stagnation or downturn. The Federal Reserve is not looking only at those data that seem to be warning of inflationary pressures. It is also scanning the horizon just as carefully for indications of weakness in the economy wherever it may be found—in residential construction, in inventories, in employment, or in any other sector.

Moreover, monetary policy will always need to take into consideration other Government policies and especially fiscal policies. Obviously, it will make a great difference for the development of interest rates, of monetary and credit conditions in general, and thus for the posture of monetary policy, whether the Treasury will need to divert more funds from the private capital and credit market than last year or whether, on the contrary, it will be able to reduce its borrowing. Even if we knew how the private economy would develop next year, we could not know whether any action that might be needed would be taken in the fiscal sector or whether the main burden of policy action would fall on the Federal Reserve.

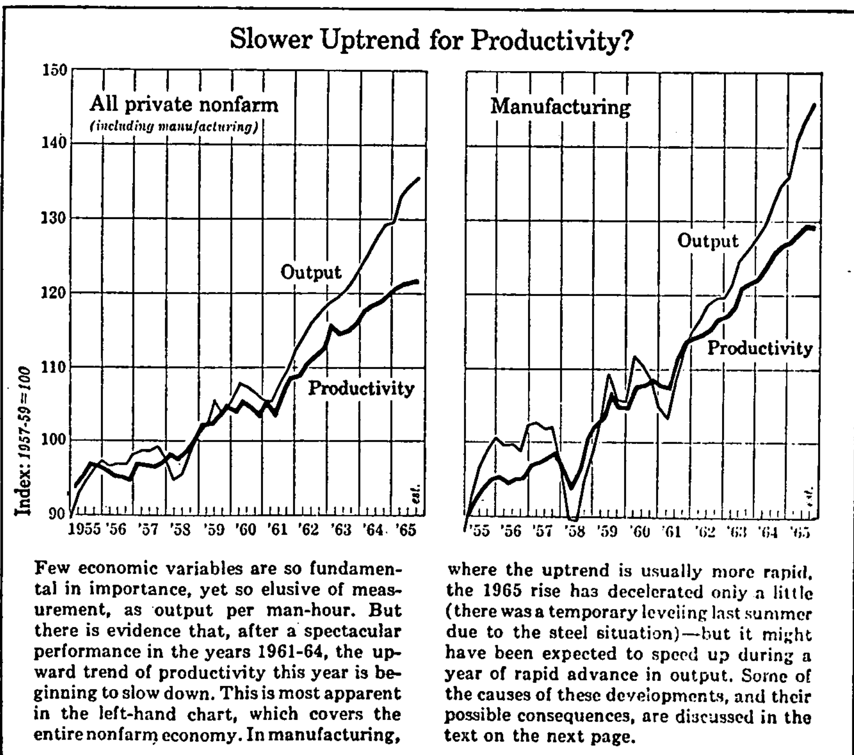
For these reasons, I hope you will understand that neither I nor anybody else can predict whether, in the future, conditions will be such as to require greater firmness or greater ease, or for that matter a policy of neutrality.

There is only one thing I can predict and promise. The Federal Reserve will do its utmost, within the limits of its powers, to maintain a solid monetary and credit foundation on which to build the economy's continued progress.

Representative CURTIS. Yesterday, Mr. Chairman, I referred in my questioning to an article in Fortune magazine, which I now have before me. It is from page 48 of Fortune, November 1965. I want to identify the article.

A monthly report on the economic outlook headlined, "Business Roundup," Chief Economist Sanford S. Parker, Associate Economist Morris Comb, staff economists. This is under a subhead, "A Chilling Reminder."

(Article referred to follows:)



Few economic variables are so fundamental in importance, yet so elusive of measurement, as output per man-hour. But there is evidence that, after a spectacular performance in the years 1961-64, the upward trend of productivity this year is beginning to slow down. This is most apparent in the left-hand chart, which covers the entire nonfarm economy. In manufacturing, where the uptrend is usually more rapid, the 1965 rise has decelerated only a little (there was a temporary leveling last summer due to the steel situation)—but it might have been expected to speed up during a year of rapid advance in output. Some of the causes of these developments, and their possible consequences, are discussed in the text on the next page.

A CHILLING REMINDER

In the equation of prices and jobs, a new element is beginning to appear. The rise in productivity is slowing (see chart). After its initial recovery in early 1961, productivity in the nonfarm economy averaged an abnormal 3.5-percent annual rise up to a year ago, but since then the increase has tapered off to under 2 percent.

This is a chilling reminder of what happened in 1955–57, when productivity virtually stopped increasing for 2 years, thus failing totally to offset the rise in wages. The productivity lag thereby played a major role in the inflation then, which led in turn to a tight credit policy.

The pressing question now is whether the present slowdown in productivity is temporary or the precursor of worse things to come. To look at the happy side, it could be argued that the lag in the rise during the past year is just compensating for the speedup the year before, when demand unleashed by the tax cut ran away from business, which couldn't adjust its manpower hiring rapidly enough. If so, one might expect productivity to resume a normal 3-percent rise in the coming year.

On the other hand the rapidity with which output has been climbing in the past 2 years should have tended to lift average productivity by spreading overhead man-hours over more units. Now output growth is visibly slowing, so efficiency will get less of a lift from this factor. As is plain from the 1955–57 experience, it takes time for new equipment and training of workers to counteract the drag on productivity from increased use of marginal capacity and inexperienced workers.

At the moment it is only safe to assume that productivity will follow the slower trend that the figures, for all their deficiencies, are actually showing now. This trend is beginning to cast a wholly new shadow on the business outlook for 1966. For along with a subnormal growth in demand, we may be getting a subnormal growth in productivity and so in overall supply. This could mean a combination of sluggishness in output and pressure on prices—just what happened a decade ago. It would be folly to jump to this conclusion yet from the productivity figures to date. But it would be even more foolish to ignore these figures in thinking about private or public policies for next year.

I was a little afraid my memory had been wrong. Apparently there is some difference in the base on which you have computed; I think you gave us a 3.8, going down to 3. I do know this says nonfarm productivity. Possibly that could account for some of the discrepancy. But we all recognize that these productivity figures are quite difficult to devise, and there is an area for difference of opinion.

Mr. Chairman, I would like to request, if I may, that our staff, if it will, look into these assumptions on which these productivity figures in the Fortune article were based and see if they can reconcile the Federal Reserve figures in this area. I think that might be very helpful.

Chairman PATMAN. We have some minority staff members. Couldn't you use them for that purpose?

Representative CURTIS. This is not a minority position.

Chairman PATMAN. We will have the majority work with them.

Representative CURTIS. That is what I am asking. It has nothing to do with majority or minority.

Chairman PATMAN. I would like to ask the staff director, Mr. Knowles, to take leadership on this and see that it is done. We want you to get the staff to make a study.

(The following memorandum was developed by the staff of the Joint Economic Committee and subsequently supplied:)

JANUARY 3, 1966.

MEMORANDUM

To: Members of committee.
From: James W. Knowles, executive director, Joint Economic Committee.
Subject: Recent changes in productivity.

On December 14, 1965, at the committee's hearings on the recent actions of the Board of Governors of the Federal Reserve System, Congressman Thomas B. Curtis requested that the staff prepare an analysis of recent productivity data to reconcile the data submitted by Governor Maisel and that contained in an article in the November 1965 issue of Fortune magazine.

I requested a report upon this matter from Mr. Leon Greenberg, Assistant Commissioner for Productivity and Technological Developments, Bureau of Labor Statistics, U.S. Department of Labor.

On the basis of information which he furnished me, it is apparent that the differences arise for two reasons. First, Fortune was discussing the private nonfarm economy while the Federal Reserve data used by Governor Maisel referred solely to manufacturing. The private nonfarm area includes all of the economy with the exclusion of agriculture and Government. Second, a different kind of data are used in the computing of private nonfarm productivity used by Fortune than those used in the Federal Reserve computations.

The Fortune data appear to be those of the Department of Labor, and their computations use as a measure of output gross national product originating in particular sectors of the economy adjusted to constant prices (1958 dollars) and for an input measure make use of BLS establishment man-hours. The figures that Governor Maisel quoted use the Federal Reserve Board index of production as a measure of output and BLS establishment man-hours as a measure of input. Hence, both measures have similar input data but different output data. To see the difference it makes as to what part of the economy is covered and what data are used, examine the following rates of change in measures of output per man-hour:

	1947–64	1959–64
Total private [1]	3.1	3.5
Private nonfarm [1]	2.5	3.2
Manufacturing [2]	2.5	3.2
Manufacturing [3]		3.8

[1] Based on revised (1958 dollars) GNP data and on BLS establishment man-hours.
[2] Based on unrevised (1954 dollars) GNP data and on BLS establishment man-hours.
[3] Based on FRB index of production and on BLS establishment man-hours.

Three facts are immediately obvious:

(1) The total private economy is advancing more rapidly than the private nonfarm economy or manufacturing when all these are measured using the same type of data (see the first three lines above). This is because the total private contains private agriculture with a faster rate of gain.

(2) The rate of increase for manufacturing is higher when output is measured by the Federal Reserve Board index of production than when measured using deflated GNP originating in manufacturing.

(3) It is clear that using consistent measurement techniques; the rate of change was higher for the 5 years 1959–64 than for the entire postwar span 1947–64 (see first three lines of tabulation above).

The Fortune magazine article of November 1965 used productivity data for the private nonfarm economy, which are consistent with the second line of the above tabulation. The article went on to say that the increase in productivity thus far in 1965 was less than 2 percent, substantially less than in earlier years. Available data that could be provided by Assistant Commissioner Greenberg covered the first 9 months of 1965. When these are compared with the same 9 months of 1964 the private nonfarm productivity measure shows a rise of something less than 2 percent. This is the same as Fortune quoted. If we use the data consistent with what Governor Maisel was using; namely, measuring output by the Federal Reserve Board index of production, and confine our

measurement to manufacturing, there was a rise of a little more than 3 percent from the first 9 months of 1964 to the first 9 months of 1965, compared to the prior 5-year average of 3.8 percent.

What is obvious from these figures is that so far as we can now deduce, the preliminary estimates for 1965 show a slower rate of increase in productivity—output per man-hour—than was true in the preceding 5 years, whether we are concerned with the private nonfarm economy, as was Fortune, or with manufacturing, as was Governor Maisel. This is a development that should not have proved surprising as it has long been known to technicians that, when the economy is near or at full employment, the rate of increase in productivity is on the average less than when the economy is recovering from a low rate of use of labor and capital—high unemployment—toward full employment of resources. When demand is not adequate to provide full use of resources, productivity is below what technology makes possible, simply because the use of resources cannot be cut back as rapidly, or to the same extent, as output. Since during the period 1959–64 the economy moved from lower rates of use of resources toward higher rates, it is reasonable to expect that above-average rates of increase in output per man-hour would have occurred, and that as high employment levels were approached in 1965 the rate of gain would slow down.

We will not have confirmation of these developments for some time due to the lags in data reporting, but I would be surprised if when final data are available the rate of gain for 1965 were not somewhat below the rate of earlier years of rapid expansion in output. Furthermore, I would expect this to be shown for all of the four types of measures indicated in the tabulation above when final data are available.

Representative CURTIS. I was pointing out that the figures in Fortune magazine on productivity increases are different from the figures that the Federal Reserve seems to have. Knowing the difficulties we have with productivity figures, I am sure there is a method for reconciliating a great deal of this.

Mr. MAISEL. I believe the difference is that one set of estimates is based on gross national product and one is based on the Federal Reserve index of production. Therefore they cover different areas, and you arrive at different figures based upon them.

Representative CURTIS. The reason I felt this was a very significant figure, and I might point it up again, is that as the economy heats up and as we begin to get to a higher utilization of plant, we tend to utilize inefficient and obsolete plant equipment. At the same time, we begin to use in a similar fashion inefficient labor to the extent that we take labor that is not fully trained and so on. I have always felt that this was a very important indicator in trying to figure out whether we were reaching the problems of inflationary pressures.

One of the big arguments that I have had with others over a period of years has been about what is the profile of the unemployed. I have argued it essentially is frictional and structural, which, of course, you can eliminate to some degree by meeting the demand. But this is at the sacrifice of productivity increases if the real problem is structural and frictional.

I would also argue that very clearly one big portion of our labor force, the Negro, is clearly confronted with very serious structural problems, not the least of which, of course, is training. Heating up the economy through aggregate purchasing power instead of hitting the specific causes is not the way to attack the problem. I think it is foolhardy.

In the same way, I argue on the side of utilization of plant equipment. If we are in a period of high utilization and rapid technological advance, we are going to have a much higher incidence of obsolescence. Therefore, our plant utilization figures must pay closer

attention to uneconomic and obsolete plant equipment and not identify them as usable plant equipment in the sense that we believe we can afford to heat up the economy because there is this buffer area. That is why I wanted to get that particular point on the record.

Now, let me get to this business of expenditure figures. Mr. Martin, I am very disturbed about the seeming lack of information on the Federal Government's expenditure estimates—I am talking about the administrative budget essentially—for the next few months. What sort of information did the Director of the Budget give you on these figures? These are figures I wait for anxiously each month because to me they tell us what we are going to do and what the problems are going to be in the debt management area which I think is a critical area and certainly related to monetary policy.

Mr. Martin. I think you should direct that inquiry to the Director of the Budget. We have a very excellent Director of the Budget in Charles Schultze. He has very real problems in dealing with all these departments. I haven't kept informed at our Monday meetings with the Secretary on what the most recent projection is. This is a problem of the administration.

Representative Curtis. I agree with that. And I also share your high opinion of Mr. Schultze. Indeed this is what the Ways and Means Committee does do when we consider the problems of debt ceiling and other things. Each year we go over the budget with Mr. Schultze for the very reason I am anxious to try to follow these expenditures figures.

Now my understanding is that the administration has actually made statements that they think their expenditures for fiscal 1966 are going to go up to around $110 billion. Now, I am directing my remarks solely to what information you and the Federal Reserve Board, or you, particularly, received in the Quadriad meeting on the expenditure estimates for fiscal 1966.

Did they affirm a figure of around $110 billion?

Mr. Martin. No. I was never given a figure as high as that but I think that it became perfectly clear—and this was publicized—that $103 billion to $105 billion was a very real possibility.

Representative Curtis. $103 billion. The actual figure in the Economic Indicators for the first quarter is $34.4 billion. Multiply that by three and we already are at a figure of $103 billion. Certainly if the Vietnamese war and other expenditures go up at all, which they will, I think, we are going to probably be around $110 billion. That would be my guess.

I am really directing my attention solely to what information you might have on the expenditure side as a basis on which you made your decision.

Mr. Martin. I think our staff and the Board had roughly the information you are talking about.

The projections we have to make on that we have to make on our own.

Representative Curtis. Did you make some projections on your own on expenditures in fiscal 1966?

Mr. Martin. I have my own ideas that the trend of expenditures is up. Now the Secretary of the Treasury urged me to wait until they had the fiscal 1967 figures before taking the action which we took. As I said yesterday in the discussion, I have some question whether

the fiscal 1967 budget really has anything to do with the problem that we are currently dealing with.

Representative CURTIS. I do, too.

Mr. MARTIN. That is a matter of judgment, however.

Representative CURTIS. I do, too, because that is really new power to spend that the Congress may or may not grant in full as we go through the appropriations process.

One other point, Mr. Martin: In our debt management hearings we have been developing and following the capital assets that the Federal Government might have. We have put those in our reports in detail. Many of them are not disposable and many of them are. They total around $34 billion. I have felt that the administration for some time has been selling off capital assets to ease the debt situation. I know as far as the sale of bullion is concerned, we had some $2 billion, and that is now down below $1 billion, I think. The sale of the copper, aluminum, and wheat surplus might easily have been motivated to some degree as a method of easing debt.

I would hope that those decisions didn't enter in. But does the Federal Reserve Board follow at all this inventory of capital assets, which includes FNMA bonds, CCC, and other things. I think about $17 billion or thereabouts is fairly readily disposable?

Mr. MARTIN. The Federal Reserve is aware of what goes on in this area through the reports. I was Assistant Secretary of the Treasury for several years in charge of the international operations and at that juncture I rather resented at times the Federal Reserve trying to tell me how I should conduct my affairs.

Since I have moved over to the Federal Reserve I have been extremely careful not to tell the Treasury how they should administer things that I think are clearly within their jurisdiction. I thought so when I was on the other side of the fence and I think so now when I am on this side of the fence.

I do not think that the Federal Reserve ought to try to run the finances of the Government. We are here to safeguard the U.S. currency. We are the only instrumentality of the Government that is devoting its full time to saving the American dollar.

Representative CURTIS. I see my time has expired. Let me say I agree with the point that you are making, but I was asking the question solely from the standpoint of whether in your computation you followed these things and whether the information was passed on to you about them, not whether you exercised any judgment on what they did. You can't anticipate what they might do.

Mr. MARTIN. Our staff works very closely with the staff of the Treasury in the compilation of the statistics and is very well informed, in my judgment, as to what the moves of the Treasury are and they have never tried to withhold any information from us. Our coordination has been 100 percent.

Representative CURTIS. Mr. Chairman, could I make another unanimous consent request that the tables that relate to these assets that I referred to which are in the Ways and Means Committee report and to which I previously referred in these hearings, go into the record; and ask that the staff can bring them up to date for the purpose of these hearings.

Chairman PATMAN. Without objection it is so ordered.

(Data referred to follow:)

TABLE I.—*Estimated sales of mortgages and other financial assets in fiscal year 1965*

[In millions of dollars]

Agency and program	Estimated in January budget	Revised estimate, May 1965	Change from January budget [1]	Actual sales as of Mar. 31, 1965 [2]
Agriculture: Farmers Home Administration	135	73	−62	40
Housing and Home Finance Agency:				
Federal National Mortgage Association:				
Special assistance functions	550	403	−147	359
Management and liquidating functions	39	72	+33	37
Public facility loans	5	10	+5	7
College housing loans	20	12	−8	
Other (FHA and PHA)	8	3	−5	3
Veterans' Administration:				
Participations	100	100		100
Other:				
Direct loans	187	55	−132	43
Loan guarantee revolving fund	250	250		155
Export-Import Bank	905	570	−335	570
Small Business Administration	25	35	+10	27
All other sales	3	3		1
Total	2,227	1,586	−461	1,342

[1] Increases in sales figures decrease budget expenditures in an equal amount and vice versa.
[2] Actual sales are shown as of Mar. 31, 1965, to be consistent with available data appearing in table II below. As Director Gordon indicated above, sales through Apr. 30, 1965, are about $1,500,000,000.

TABLE II.—*Outstanding loans and other financial assets owned by Federal agencies, Mar. 31, 1965*

[In millions of dollars]

Agencies and program	*Actual or latest estimates*
1. Some classes of financial assets cannot or should not be sold:	
Department of Defense: Military assistance credits	65
Department of Health, Education, and Welfare: Defense education loans	573
Department of the Interior: Bureau of Reclamation loans	85
Department of State: Loans to United Nations	107
Agency for International Development loans	8,473
Treasury Department:	
Foreign loans	3,763
Defense production loans	17
Housing and Home Finance Agency:	
Community Facilities Administration: Miscellaneous programs	81
Federal Housing Administration: Assigned mortgages and defaulted home-improvement notes	386
Urban Renewal Administration	202
Public Housing Administration	50
Federal Home Loan Bank Board: Federal Savings and Loan Insurance Corporation loans	118
Subtotal	13,920

TABLE II.—*Outstanding loans and other financial assets owned by Federal agencies, Mar. 31, 1965*—Continued

[In millions of dollars]

Agencies and program	*Actual or latest estimates*
2. In some programs, legislation would be needed to allow sales, to allow sales below par, or to provide the guarantees necessary to make sales feasible:	
Department of Agriculture:	
Rural Electrification Administration	3,996
Farmers Home Administration (excluding agricultural credit insurance fund, estimated)	1,775
Department of Commerce:	
Area Redevelopment Administration	117
Maritime Administration	93
Treasury Department: Loans to District of Columbia	122
Subtotal	6,103
3. Some classes of assets, otherwise salable, carry low interest rates or are not of investment quality. Sizable discounts below par would be required:	
General Services Administration:	
Sales credit	101
Public power bonds	58
Housing and Home Finance Agency:	
Community Facilities Administration: College housing loans to private institutions	1,024
Housing for elderly loans	79
Subtotal	1,262
4. In 1 case, sales of certificates against a pool of assets are a continuing practice, but an increase in sales would involve significant interest costs to the Government: Department of Agriculture: Commodity Credit Corporation (subtotal)	2,491
5. In most of the remaining cases, sales of substantial amounts of assets are in process or planned, either directly or through sales of participations in pools of such assets:	
Department of Agriculture: Farmers Home Administration agricultural credit insurance fund (estimated)	95
Housing and Home Finance Agency:	
Community Facilities Administration:	
College housing loans to public institutions	851
Public facility loans	181
Federal National Mortgage Association:	
Special assistance functions	1,156
Management and liquidating functions	1,080
Federal Housing Administration (excluding assigned mortgages and defaulted home-improvement notes)	159
Veterans' Administration:	
Loan guarantee program (vendee loans)	526
Direct loan program	1,163
Small Business Administration	1,163
Export-Import Bank of Washington	2,264
Subtotal	8,638
Total	32,414
Very small programs (partly estimated)	140
Grand total	32,554

Senator SPARKMAN. Mr. Martin, it is my purpose to ask just a couple of questions. I am running very late for an appointment in my office.

I want to ask this with reference to the maximum allowable on these certificates of deposit. Am I to understand from the manner in which you answered Chairman Patman that you do not believe that most of the banks will pay the maximum?

Mr. MARTIN. That was our view at the time we adopted it. We could have adopted a rate of 5 percent. We gave the latitude so there would be less pressure to go to a fixed ceiling. At the early stages I think this has been well contained. I think in the neighborhood of the 30-day area it is around 4⅝ to 4¾ percent. It was to make it possible for the smaller banks if they needed to get money to compete with the larger banks.

Senator SPARKMAN. By the way, why should they pay 5 percent when they can borrow money from you for 4½?

Mr. MARTIN. This is to acquire funds. These are people who would not be coming in to our discount window.

Senator SPARKMAN. New funds so far as the banks are concerned?

Mr. MARTIN. That is right.

Senator SPARKMAN. I want to ask just one question regarding the savings and loan associations: You do not feel that they are going to be hurt? I know that a great many people feel that they are going to be hurt. When I say they feel that way—feel they are going to be hurt—it is because it destroys what I think was a very good balance as between the commercial banks and the savings and loans with reference to savings that are taken in.

I note that much emphasis is put on the larger amounts in the certificates of deposit, $100,000 and above. Yet there is no floor. In fact, I have seen an article, I believe it was in a New York paper, to the effect that one bank is advertising for CD's at from $19.99 up and another one is advertising them from $25. I see very little difference between certificates of deposit in that amount and ordinary savings which you have protected by your retaining 4 percent.

Mr. MARTIN. This is a judgment. I think administratively they will find real difficulties in offering this on any scale. We may have to investigate this but actually we have considered this at considerable length.

I might ask George Mitchell, who has really made a lot of study on this, to comment.

Senator SPARKMAN. Yes. In fact, I thought of asking Mr. Mitchell this question myself because I noted he voted against the rediscount rate increase, but he voted for these new rates on the certificates of deposit.

Mr. MITCHELL. That is correct. I think the Board's action in leaving the savings rate alone was that the $90 to $128 billion of passbook-type savings in the commercial banks will not be altered competitively by this move. But the aggregate of CD's, now about $16 billion, can rise in volume in response to an increase in rate.

Another advantage of the rate change is that it brought nonprime banks back into the market. The rate had gotten to the point where these banks were being frozen out. What the raise in rate does is to permit the nonprime banks to get funds that they have not been

able to raise in competition with prime banks. Overall, the raising of the ceiling provided a measure of assurance to the banks as to how far they could go with rates to attract additional funds. It gives more latitude to their business judgment essentially.

Senator SPARKMAN. Mr. Martin, let me ask you this question: You said, in answer to Chairman Patman's question about revoking the discount rate rise that it could not be revoked. You did not mean by that you could not later modify it if you found it necessary, did you?

Mr. MARTIN. I did not intend to say it could not be revoked. He asked me if we would rescind it. I am talking about today. I can say to you that today I have five of my associates here. If they want to vote to rescind this they can do it right now. I would vote against rescinding it.

Senator SPARKMAN. Let me ask you this: Since there has been so much said about the adverse effect that it seems it will have on savings and loan associations, might we not include, also, the smaller banks? It seems to me it might adversely affect the smaller banks, too. Your Board will keep close watch on those things?

Mr. MARTIN. We certainly will. As I have testified repeatedly in this hearing and before, monetary policy is the most flexible instrument we have. We could reverse ourselves tomorrow morning.

Senator SPARKMAN. In the event it is found that it is having an adverse effect—which you do not anticipate—you could consider and would consider modifying or changing it?

Mr. MARTIN. We certainly could. Now, having said this, I hope this won't mean that I will have a hundred wires in the morning. Don't misunderstand me; we don't mind getting a hundred wires, but I think we ought to weigh this on its merits and not on fears and expectations.

Senator SPARKMAN. I believe you will admit that my questions did condition it on merit rather than on fears.

Mr. MARTIN. Absolutely, no question about that.

Senator SPARKMAN. You are keeping close watch on it to see how it develops and to see whether or not it actually has that adverse impact that many of us fear?

Mr. MARTIN. We will watch every aspect of the market on that.

Senator SPARKMAN. Thank you very much.

Chairman PATMAN. Senator Miller?

Senator MILLER. Thank you, Mr. Chairman.

Let me follow on this line of questioning. What is the maximum rate of interest that savings and loan associations can now pay?

Mr. MARTIN. They don't have any maximum, I don't think. Do they?

Mr. MAISEL. They are regulated through the amount that they can borrow from their home loan bank. There is no ceiling on the amount that they can pay. However, if they change their dividend rates by more than a certain amount, they are cut off from borrowing from the Home Loan Bank.

Senator MILLER. In other words, if the Home Loan Bank Board wants to loosen up a bit to enable the savings and loans to roll with the punch that might occur as a result of the new regulation of the Board, the Home Loan Bank Board can do so?

Mr. MAISEL. That is right.

Senator MILLER. Now I just want to reaffirm what Chairman Martin had to say about the change in the discount rate in 1963. I concur wholeheartedly that this does not represent any civil war between the administration and the Federal Reserve Board. As a matter of fact, I remember I took the Senate floor to praise the courage of the President of the United States in promoting this increase in the rediscount rate. So I certainly do not believe that that could be said to be a difference in opinion between the administration and the Federal Reserve Board.

One reason I put Mr. Saulnier's article in the record was to point up his opinion that the mere fact there has been a change in the rediscount rate does not necessarily mean that it will restrain expansion.

Let me read what Mr. Saulnier had to say:

> It is never anything but disturbing to slam the brakes on, and I most definitely do not suggest that. What is needed is that degree of restraint, practiced now, that will keep us from getting into a situation where there may be little option but to slam the brakes on. * * * In my judgment a willingness to practice a little restraint now would make it possible to extend the current expansion well into the future.

I would like to come back to Mr. Palyi's book to which I earlier referred, because he presents a rather serious indictment of the Federal Reserve Board's policy. He says:

> With this position as a central bank goes the monopoly of issuing legal tender—bank notes. The Federal Reserve banks have the privilege of making the money with which to pay their own liabilities. The liabilities are created by the member bank borrowing on a Treasury bill or similar security and drawing out a dollar note or a dollar balance, as it chooses. The note goes into circulation; the balance becomes the reserve on which the member bank "pyramids" its own deposit liabilities.
>
> The process is further simplified if the Federal Reserve instead of waiting for the member banks to ask for money, proceeds on its own by buying Treasury paper on the open market in order to ease the money market and to lower the interest rates.
>
> All of which is as it should be. But the portfolio of the Reserve System is bulging with Treasury securities in lieu of commercial paper * * *. Of the Treasury's shortest term marketable debt, maturing within 1 year, $53 billion were at this writing in commercial banks, savings institutions, and other private portfolios. Theoretically, at least, $53 billion worth of short paper could still be turned into legal tender. Nothing of the sort would be possible if the central bank would stick to its function, as was originally intended, and monetize only credit instruments which represent genuinely commercial, productive transactions of the self-liquidating type.

Do you agree that that is the original intention of the function of the central bank, Mr. Martin?

Mr. MARTIN. I agree that was the original function, but there has been quite an evolution since then. This whole operation has changed in terms of what I was discussing earlier—what the limit of the use of U.S. credit can be without reaching the point where you are what I call "printing" money. Now this causes a great deal of discussion in academic circles particularly because there is an element of judgment which is conferred upon the Federal Reserve Board as to how much money can be permitted to be created for growth in the economy.

The way I have thought this through to my own satisfaction is that there certainly should be some element of growth year to year, perhaps 3 or 4 percent. But when the Open Market Committee, or the Board decides that they will permit this amount of money creation and then the Treasury is unable to finance itself out of that creation

of credit plus the savings of the general economy, and if the central bank at that point cooperates in an attempt by the Government to finance its expenditures by purchasing securities from itself, in my judgment we are printing money and we are beginning to flirt with the limits of credit of the country.

Now, I don't think that Mr. Palyi is quite right in thinking that we have to go back to the original view that 30- to 90-day commercial paper should be the only eligible collateral for Federal Reserve credit. This is my general approach. I would like to have Governor Mitchell, who is also a great student of this, make any comment that he would like because there are various interpretations of how this power can be used.

Senator MILLER. May I continue on with Palyi's statement and then let Governor Mitchell comment on it? He goes on to say:

> * * * Assuming an average reserve ratio of 1 to 6, the monetization of the $1 billion permits an additional credit expansion of $6 billion, or so. And the flood can rise even without further debt monetization by the central bank, which has additional powers available to make or to break the inflation, by changing the member banks' reserve requirements.
>
> The member banks * * * must cover their deposits by holding a fraction of them in balances at their respective reserve banks. Note the broad range of discretionary powers in the hands of the managers * * *. Within the broad legal limits, they can cut the reserve requirements or raise them.

And further, he says:

> On paper, the Reserve System has virtually every power to maintain monetary discipline and to stem the inflation. It is under no legal obligation to grant credits to the member banks, still less to buy Government bonds * * *.
>
> Every stabilization attempt undertaken by the Federal Reserve authorities is, despite their good intentions, stymied from the outset. They are stymied for the simple reason that the Reserve System is a "creature of Congress" that can set down the law. In any case, the central bank cannot let the credit of the overindebted national administration go to pot, which is what would happen if the "printing press" would cease to support a prodigal Treasury. This is called Treasury-Federal Reserve-cooperation in managing the national debt. What is being managed is a progressive inflation, imposed by the Congress.
>
> The Congress votes expenditures without revenues to cover them. The administration finances the deficit by issuing IOU's that are the equivalent of cash. The banks convert many of them into active purchasing power and draw from the Federal Reserve System the cash balances for legal reserves. This house of paper rests on the central bank's readiness to monetize the IOU's which represent no productive effort, no salable goods, no gold, not even tax revenues—in effect, nothing but promises, not to pay but to be renewed, with more of the same to come.

In other words, it seems to me that he is making an indictment that the Congress, aided and abetted by the Federal Reserve's policies in monetizing the national debt, is the cause of inflation.

Do you agree, Mr. Mitchell?

Mr. MITCHELL. Obviously not. The problem that the Federal Reserve faces in deciding whether to add the money or not, or to add it faster or slower, depends on its evaluation of the economy's need for money.

A very short answer to Mr. Palyi's position is that over the past 4 or 5 years the Federal Reserve has moved moderately—I would almost say parsimoniously—in adding to the money supply. The rates of increase beginning in 1961 are as follows: 1961, 3.1; 1962, 1.4; 1963, 3.8; 1964, 4.3; 1965, 4.3 (estimated).

As is well known the economy has been growing faster than this. It seems to me that this is at least a demonstration that there has been no engine of inflation at work here. There has been an effort on the part of the Federal Reserve System to add to the money supply at a rate which would accommodate the growth and expansion of our economy.

Now there are many assets in which the Federal Reserve could invest other than Federal Government securities. But the fact of the matter is that it is more convenient, considering the kind of money market we have today, to use Treasury securities as an asset which the Federal Reserve can not only buy at any time but can also sell at any time. Of course, we trade in these securities daily.

Palyi refers to an earlier theory of an appropriate rate of money growth—the real bills theory. This held that change in the money stock should be dictated by the rise and fall in the demand for commercial short-term loans. This is a theory discredited in the twenties and thirties and that no one adheres to any longer.

Senator MILLER. Then I detect a difference in judgment between Governor Mitchell and Chairman Martin. Governor Mitchell states that in his judgment the addition to the money supply has been "parsimonious." I believe Chairman Martin earlier testified that he agreed that it was "generous."

Mr. MARTIN. That is correct.

Senator MILLER. Thank you.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Balderston, yesterday you made the point that in your judgment one should not really worry much about interest payments in this country because one person paid interest and another person receives it, and it tends to wash out. I am under the impression that the billions of dollars paid out in interest every year in this country go mostly to the top 10 percent of the income reserves of this country.

Accordingly, I would appreciate it if you would file with this committee on behalf of the Board a record of the total amount of interest paid in our economy, both individual, unincorporated enterprise, corporate, and Government; and the total amount; and the total percentage of income received by the various groups of recipients, so that we can have a breakdown of that for perhaps a 5-year period, or whatever is convenient for you.

Mr. BALDERSTON. I will be glad to do it. Of course, Mr. Reuss, I would like to see interest rates as low as compatible with a sound dollar because of the impact upon investment and so forth. I would not want to sacrifice the soundness of the dollar.

Representative REUSS. Right.

(The materials below were subsequently supplied by Governor Balderston.)

INTEREST PAYMENTS AND RECEIPTS IN THE U.S. ECONOMY

Many individual households and businesses owe debt and own interest-earning financial assets at the same time. Persons who pay mortgage debts, for example, frequently are earning some interest at the same time from holdings of savings accounts and indirectly, from their equity in life insurance and pension plans Even governments, Federal as well as State and local, are both debtors and holders of interest-earning financial assets. Data on total interest payments by U.S. nonfinancial sectors thus overstate the magnitude of funds transferred from debtors to lenders, since a part of these payments are a transfer from one pocket to another of the same person or government unit. In some cases this transfer does not result in a cash receipt labeled as "interest"; recipients of life insurance and pension benefits, for example, are receiving the interest earnings of life insurance and pension reserves without ever getting a check labeled as "interest."

As can be seen from tables 1 and 2 attached, households in the United States paid out a little over $19 billion in interest in 1964, but in the aggregate received a little over $20 billion in interest earnings on their savings. (It should be noted that these tables show only those payments and receipts classed in the national accounts as interest, and do not include insurance and pension benefits.) In the net balance of interest payments, consumers as a group definitely enjoy a net surplus. And so, of course, do the financial intermediaries, which receive interest on the savings they invest, and pay out this interest directly or in other forms such as insurance benefits and pension checks. Since many financial intermediaries are mutual organizations—owned by their depositors, shareholders, or policyholders—much of the net surplus on interest payments shown for the financial sector also accrues to individual households. As the tables indicate, the sectors paying out more in interest than they receive are the nonfinancial business groups and the Federal and State and local governments.

Current data on interest flows by income class of recipient are not available. The most recent surveys, relating to the years 1960–61, show that more than 40 percent of all the monetary interest received by consumers was earned by families whose total income (after taxes) amounted to less than $6,000. Families with incomes between $6,000 and $10,000 got about one quarter of all consumer monetary interest income. Families earning more than $10,000 a year received the remaining 35 percent of the total interest that was paid out to consumers.

These data are shown in detail in table 3, and they are further developed in table 4. The latter table shows the average amount of income received in various income groupings, and it shows the percentage of total income that is made up of monetary interest receipts. Relative to their total income, interest receipts are most important to the lowest income group; namely, the 4 percent of consumer units who earn less than $1,000 a year. In this lowest income group 6.5 percent of income consisted of monetary interest, while for the average of all consumer units interest receipts accounted for only 1.2 percent of total income. The proportion of income received in the form of interest was also above the average for the families in the $1,000–$3,000 income group.

The importance of interest receipts to lower income families, a factor often overlooked in discussions of the impact of changes in interest rates, is explained in part by the large proportion of retired people whose income is low because they are living on pensions and the earnings from savings accumulated during their working years. Preliminary results from surveys conducted recently by the Federal Reserve, and now in process of being tabulated and analyzed, show that elderly families account for about one-fifth of the lower- and middle-income groups, but hold about two-fifths of the interest-earning assets owned by these groups. But these older folk account for only one-twentieth of the debt owed by lower- and middle-income classes.

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TABLE 1.—*Monetary interest payments in the United States, calendar years 1959–64*

[In billions of dollars]

	1959	1960	1961	1962	1963	1964
A. Total payments by U.S. nonfinancial sectors	32.7	36.9	38.7	42.8	47.2	51.6
B. Household sector [1]	11.8	13.4	14.4	15.7	17.4	19.2
C. For debt on owner-occupied houses	5.4	6.1	6.8	7.6	8.4	9.2
D. For other debt	6.5	7.3	7.6	8.1	9.0	10.0
E. Unincorporated business and co-ops [2]	5.1	5.8	6.3	7.3	8.3	9.3
F. Corporations [3]	6.7	7.6	8.1	9.0	9.9	10.6
G. State and local governments	1.8	2.1	2.3	2.5	2.7	2.9
H. Federal Government [4]	7.3	8.1	7.6	8.4	9.0	9.6
MEMORANDUM: TOTAL MONETARY INTEREST PAYMENTS IN U.S. ECONOMY						
I. Total payments by U.S. nonfinancial sectors (line A)	32.7	36.9	38.7	42.8	47.2	51.6
J. Plus: Payments by foreigners to U.S. sectors	.8	1.0	1.1	[illegible]	1.5	1.7
K. Plus: Payments by U.S. financial sectors	6.4	7.7	8.4	10.1	11.8	13.5
L. Equals: Total monetary interest payments in U.S.	39.9	45.6	48.2	54.2	60.5	66.8

[1] Includes nonprofit institutions.
[2] Includes mortgage interest payments by individuals who are landlords.
[3] Excludes banks, other credit agencies, security and commodity brokers and dealers, and insurance carriers. The interest payments by these financial businesses for both incorporated and unincorporated institutions are shown on line K.
[4] Excludes intra-Federal Government transfers.

NOTE.—Detail may not add to totals, due to rounding.

Source: Department of Commerce and Board of Governors of the Federal Reserve System.

TABLE 2.—*Sector distribution of monetary interest receipts in the United States, calendar years 1959–64*

[In billions of dollars]

	1959	1960	1961	1962	1963	1964
A. Total monetary interest receipts (line N, table 1)	39.9	45.6	48.2	54.2	60.5	66.8
Received by:						
B. Foreigners [1]	.4	.5	.4	.5	.7	.8
C. Federal Government [2]	.9	1.0	1.1	1.3	1.3	1.2
D. State and local governments	1.1	1.4	1.5	1.7	1.9	2.1
E. Financial sectors	24.0	27.2	28.8	32.0	35.5	39.4
F. Nonfinancial corporate business	1.9	2.2	2.2	2.4	2.7	3.0
G. Households and nonprofit institutions	11.7	13.3	14.2	16.3	18.4	20.3

[1] Interest receipts from claims on United States.
[2] Interest receipts from public including foreigners. Excludes intra-Federal Government transactions.

NOTE.—Detail may not add to totals, due to rounding.

Source: Department of Commerce and Board of Governors of the Federal Reserve System.

TABLE 3.—*The distribution of total income and interest income among consumers in different income groups, annual averages, 1960–61*

After-tax income groups	Number of families [1]	Relative distribution		
		Number of families	Total income [2]	Interest income [3]
Dollars	*Millions*	*Percent*	*Percent*	*Percent*
Total	55.3	100.0	100.0	100.0
Under 1,000	2.1	3.7	0.3	1.8
1,000 to 2,999	11.7	21.2	7.1	13.2
3,000 to 5,999	20.9	37.8	29.8	26.2
6,000 to 9,999	15.8	28.5	39.0	24.4
10,000 and over	4.9	8.8	23.7	34.5
10,000 to 14,999	3.7	6.8	14.7	15.4
15,000 and over	1.1	2.0	9.0	19.1

[1] Families or consumer units.
[2] Total money before taxes.
[3] Includes interest received (or credited to account) from bonds, savings accounts, notes, mortgages, etc. Interest on U.S. Savings bonds is recorded when these bonds are cashed in rather than when it accrues.
The underlying data are estimated on the basis of information gathered in surveys. Such surveys may suffer from an underreporting of total interest income. It is not known whether a tendency toward underreporting introduces a bias in comparisons by income groups.

NOTE.—Detail may not add to totals due to rounding.

Source: U.S. Department of Labor, Consumer Expenditures and Income (BLS Reports No. 237-38 and 237-88); and unpublished data from Department of Agriculture.

TABLE 4.—*Average total income and average interest income of consumers—and percent of families reporting interest income and paying premiums for private life insurance, annual averages, 1960–61*

After-tax income groups	Number of families [1]	Average total income before taxes	Monetary interest income [2]			Families paying premiums for private life insurance [3]
			Average amount	Percent of total income	Families reporting interest income	
Dollars	*Millions*	*Dollars*	*Dollars*	*Percent*	*Percent*	*Percent*
Total	55.3	6,245	78	1.2	34	59
Under 1,000	2.1	573	37	6.5	19	19
1,000 to 2,999	11.7	2,103	49	2.3	23	37
3,000 to 5,999	20.9	4,931	54	1.1	29	59
6,000 to 9,999	15.8	8,542	67	0.8	43	75
10,000 and over	4.9	16,841	307	1.8	59	80
10,000 to 14,999	3.7	13,581	178	1.3	56	80
15,000 and over	1.1	27,752	737	2.7	70	81

[1] Families or consumer units.
[2] For definition and comments, see footnote 3, table 3.
[3] Excludes group insurance policies.

Source: See table 3.

Representative REUSS. Now, Mr. Martin, back to the subject matter of certificates of deposit. I was quite critical of the Board on this yesterday, and I am quite critical of you today, because I think that for the last 3 or 4 years, and particularly on Friday, December 3, the Board did that which it ought not to have done and failed to do some of the things that it ought to have done.

I think you have in these certificates of deposit an "Old Man of the Sea" around your neck that Sinbad the Sailor had and I think you will have trouble shaking it off.

I think you would have had less trouble if you had done something about it earlier. I have three sets of worries about these CD's. In the first place, I think they are inflationary. As I tried to explain yesterday, with their very high velocity 25 to 1 reserve ratio, they can result in the creation of a lot of money, a lot of lending power, that the Federal Reserve may not want to create. I think this same circumstance is going to obtain when you do as you say you are going to do—create adequate reserves for the system in the days and months to come.

I think you are going to find that some of those are going to peel off into certificates of deposit, and you will have a very volatile, high-powered effect.

In this connection, Mr. Chairman, I ask unanimous consent to file with the committee the table which I have caused to be prepared demonstrating that a continuing massive shift from corporate demand deposits and holdings of U.S. Government securities into CD's is taking place.

The source of this is the Federal Reserve's own Bulletin of November 1965, which shows that for this year alone—for the first half of it, the only figures we have available—some demand deposits by corporations were shrinking at the annual rate of $4.5 billion. Almost all of that appears to be going into certificates of deposit.

Chairman PATMAN. Without objection it is so ordered.

(The table referred to follows:)

Corporate nonfinancial business, flow of funds

[In billions of dollars]

Category	1960	1961	1962	1963	1964	1963			1964				1965	
						II	III	IV	I	II	III	IV	I	II
Demand deposits and currency	−0.5	1.6	−2.3	−1.9	−2.6	0.2	−1.1	−0.8	−7.2	2.1	2.1	−7.5	−4.9	−4.3
U.S. Government securities	−5.4	−0.3	0.2	0.4	−1.5	1.1	0.4	−0.8	0.2	−2.4	−0.2	−3.5	−5.5	−4.9
Time deposits (principally CD's)	1.3	1.9	3.7	3.9	3.2	2.4	3.2	5.2	6.4	1.4	1.5	3.4	8.3	6.9

Source: Federal Reserve Bulletin, November 1965, p. 1612.

Representative REUSS. A second worry I have over the certificate of deposit vogue is the discriminatory effect. Slice it how you may, it does mean that the 30 big banks which hold about 70 percent of the Nation's $16 billion negotiable certificates of deposit are, in some large part at least, doing so at the expense of smaller banks and savings and loan associations and Treasury bills, and so on.

My third worry—I see a bank endangering effect in these certificates of deposit, because they can be very close to "hot money".

A corporation puts its money in a negotiable certificate of deposit for 30 or 90 days. Yet it is able to draw it out or to translate it into cash immediately—at a moment's notice—if it needs funds. Or if it finds that the rate on something else is better when the 30 days comes due, it goes into something else.

Accordingly, I would agree that the Federal Reserve had put itself into quite a bind as of Friday, December 3, because if you hadn't raised the certificate of deposits permissible interest rate from 4½ to 5½ percent, dire consequences might have followed.

As I read the figures, about three-quarters of all the Nation's negotiable certificates of deposit are going to come due in the next 2 or 3 months, by March 1966. That means there will be some $12 billion maturing within a 4-month period. The small number of banks which hold these—as I say, 30 banks hold 70 percent of them—would find themselves in a serious bind if these CD's were cashed. By increasing the permissible rate of interest to 5½ percent, you provided the necessary incentive to these corporations to maintain their investments in certificates of deposit.

If you had not done that I think there would have been a strong temptation on the part of corporate treasurers to take them out of CD's when they mature, since the CD had a ceiling of 4½ percent and put it into Treasury 91-day bills, which I know were selling at 4.45 percent this morning. That is 20 basis points more than the legal statutory limit on long-term Treasury bonds.

Therefore, I think it is fair to conclude that the banks might well have faced a demand for cash on the part of a large proportion of the $12 billion worth of maturing CD's. And if this had happened, the banks would have been forced to sell substantial amounts of Government securities, perhaps taking a severe beating on these securities.

Now I have an idea that the staff of the Federal Reserve Board has been conducting several studies on this certificate of deposit matter, and one in particular which deals with the question of how the Federal Reserve System can be used to assist these 30 or 40 or 50 leading banks in rolling over their CD's. What studies, Mr. Martin, have been completed by the staffs and what dates do they bear? I ask because I would like to have them made available.

Mr. MARTIN. I would like to put in the record "The Role of CD's in Credit Expansion" of December 14. I would like to have Governor Mitchell discuss this broad problem because he has been working with this.

Representative REUSS. This is a document dated today?

Mr. MARTIN. Today.

Representative REUSS. I think that should be received, Mr. Chairman.

Chairman PATMAN. Without objection, it is so ordered.

(Document referred to follows:)

THE ROLE OF CD'S IN CREDIT EXPANSION

Negotiable time certificates of deposit (CD's) issued by banks are held as liquid assets primarily by nonfinancial corporations and other large investors. Other major categories of liquid assets in these investors' portfolios include money balances—mainly demand deposits—and market securities, such as Treasury bills, commercial paper, and short-dated Federal agency and municipal securities.

The development of a national market for negotiable CD's in 1961, and subsequent increases in rates paid by banks, has altered materially the composition of these liquid asset portfolios. To some extent, CD's have displaced demand deposits in the pool of liquid assets, but to a larger extent they have

displaced market securities. This is because the characteristics of CD's make them better substitutes for market securities than for money, since they are negotiable instruments with an interest return slightly higher than the yield on Treasury bills of equivalent maturity, and are a safe temporary abode of purchasing power. But they lack the unique contribution of money balances in liquid asset portfolios—the ability to be used directly as a means of payment.

If CD's merely displaced demand deposits in liquid asset portfolios, and if total bank reserves were allowed to remain unchanged, total credit extended by banks could be enlarged, because reserve requirements on CD's are lower than those on demand deposits. But when CD's displace market securities, the total supply of funds is reduced, because the increase in funds available for credit expansion by banks—$0.96 per dollar increase in CD's—is more than offset by a $1 reduction in the supply of funds from investors switching from market securities to CD's.

In this respect, CD's are much like other classes of bank time deposits. Growth in these deposits during recent years has represented, in large measure, a diversion of savings flows from market securities and nonbank savings institutions, and a resulting enlargement of the banks' role as an intermediary. Bank credit has expanded at the expense of other forms of credit expansion. There is nothing inherently inflationary about this diversion of savings flows. On the contrary, the increasing proportion of savings flows channeled through banks, as the banks' intermediary role enlarges, brings a larger segment of total credit expansion under the influence of Federal Reserve policies affecting the growth of bank reserves.

Representative REUSS. Have there been other studies made by the staff of the Federal Reserve System on certificates of deposit?

Mr. MARTIN. I think we have been studying continuously.

Representative REUSS. I know, but has the study given birth to any pieces of paper? If so, may we have those pieces of paper and their dates? Or is this one dated today the only such piece of paper?

Mr. MITCHELL. They are quarterly reports on the composition of the outstanding CD's, their maturity and location.

Representative REUSS. From 1960?

Mr. MITCHELL. I don't think they go back that far.

Representative REUSS. Can we have filed with the committee all quarterly reports dealing with certificates of deposit back to the time when you started making them, and any other papers which have been produced by the staff on certificates of deposit?

Mr. MARTIN. We will be glad to give you everything we can.

Chairman PATMAN. Do you wish to make them part of the record at this point?

Representative REUSS. I would ask unanimous consent to have them made a part of the record at this point.

Chairman PATMAN. Without objection it is so ordered.

(Data relative to discussion follow. See also p. 468, appendix, for additional materials submitted by department on this subject.)

Negotiable Time Certificates of Deposit

NEGOTIABLE TIME CERTIFICATES of deposit have become a major money market instrument. A special survey by the Federal Reserve of 410 member banks indicates that such certificates outstanding at these banks had reached $6.2 billion by December 5, 1962. This compares with just over $1 billion at the end of 1960 and $3.2 billion at the end of 1961. Of the banks covered by the survey, only 44 per cent were issuing certificates in December 1960, but by late 1962, 66 per cent were. The volume of certificates outstanding near the end of 1962 compares with $6.0 billion of commercial and finance company paper and only $2.7 billion of bankers' acceptances.

Time certificates of deposit (CD's) serve as a means for an individual bank to attract funds that might migrate elsewhere in search of higher investment returns. For example, when a corporate depositor draws down demand deposits to buy U.S. Government securities, the deposits move to the bank at which the seller of the bills has his account. And this is often not the bank where the buyer has held his deposit. If individual banks can offer negotiable CD's to potential investors, they can counteract some of this kind of deposit outflow.

Time certificates of deposit, issued for many years on a local and regional scale, are essentially evidence that a depositor will leave his funds for a specified length of time in return for a specific rate of interest. As evidence of such a claim, many of these certificates have always been legally negotiable. But in the last 2 years they have become highly marketable—that is, easily sold to third parties before maturity—as a result of two related events in early 1961. At that time several large money market banks in New York City began to offer CD's in readily marketable form to their corporate depositors. And one securities firm announced that it stood ready to buy and sell CD's in open trading. The practice was soon taken up by other banks and other dealers. By offering certificates with this high degree of marketability, banks have been able to attract large amounts of funds.

Not all CD's are readily marketable despite the establishment of a flourishing secondary market. Many are issued by banks that are not well known outside their own localities. Others have been issued in denominations that are too small to attract the large-scale investors that are active in the secondary market. And in any case, many

NOTE.—This survey was planned by a System Committee on Negotiable Time Certificates of Deposit, with George Garvy, Economic Adviser of the Federal Reserve Bank of New York, as Chairman. The survey was carried out by members of the staff of the Board of Governors of the Federal Reserve System and the Federal Reserve Banks. The 410 banks covered by the survey included all 351 respondents in the weekly reporting member bank series and selected additional banks in several districts which the Federal Reserve Banks believed might have an appreciable volume of negotiable time certificates of deposit outstanding.

Robert Lindsay, Senior Economist of the research staff of the Federal Reserve Bank of New York and Chairman of a System subcommittee responsible for evaluating the results of the survey, prepared this article. Robert R. Wyand II, Economist in the Board's Banking Section, had responsibility for processing the data and preparing statistical tables, under the supervision of James B. Eckert, Chief.

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holders in practice do not buy with the intention of selling. While the typical denomination in this market is $1 million or more, transactions involving CD's as small as $500,000 are fairly common, and there are occasional trades in denominations of $100,000 or less. As the market continues to broaden, these smaller denominations may become increasingly marketable.

Negotiable CD's proved immediately attractive to corporations and others and quickly found a place alongside Treasury bills and commercial paper as a medium for short-term investment. By the end of 1962, the market for negotiable CD's had become national and had become an important segment of the nation's money market.

The rapid growth of CD's and the increasing participation by the banking community have raised several questions. What kinds of banks have contributed to the sharp increase in outstanding CD's? Who have their customers been? And what are the characteristics of the instrument itself?

ISSUING BANKS

The largest banks—those with total deposits of over $1 billion—experienced the most rapid growth in CD's over the period covered by the survey. At the end of 1960 these banks had accounted for only about 10 per cent of total CD's outstanding, but by the end of 1962 they had issued about 45 per cent of the total. The more pronounced growth at the large banks was also evident in the number of issuing banks in each of the four size groups. It was equally marked when the banks were grouped according to amount of certificates outstanding. (See Table 1 on the following pages.)

By contrast, growth at banks in each of the smaller size groups covered by the survey was slower. Nevertheless, at the time of the survey holdings at these smaller banks were sizable. For example, banks in the two smaller groups—that is, with deposits of $500 million or less—had issued more than a fourth of the total outstandings. Banks with deposits of less than $100 million had only a small part of the volume of CD's outstanding. Most of these were at banks with total deposits of $50 million or more, as few banks below this size were covered by the survey in most districts.

The pronounced growth of certificates at the large banks was partly a result of their having adopted so recently an activity that had long been practiced at many smaller banks. This was an influential decision that helped to create a new market for all CD's, including those of banks that had been issuing them for many years. It led in turn, however, to a sharp increase in the volume of CD's issued by the smaller banks as well. Thus, at the time of the survey, the largest banks still accounted for a smaller percentage of the CD's issued at all reporting banks (44 per cent) than of total deposits of these banks (52 per cent).

The participation of smaller banks is also suggested by the sizes of the certificates issued, relative to the size of the issuing bank. About 72 per cent of the issuing banks had CD's of $500,000 or more, which can usually be traded in the secondary market without great difficulty. And about 90 per cent of the issuing banks had outstanding CD's at least as large as $100,000, a denomination that is sometimes traded. Moreover, about 55 per cent of the banks with some CD's of $500,000 or more outstanding were banks that had issued a total of less than $10 million of such certificates. This pattern suggests a wide distribution of CD's among banks outside the major money market centers, even if many of the smaller

TABLE 1

VOLUME OF TIME CERTIFICATES AND NUMBER OF ISSUING BANKS

Date and denomination	Total reporting banks	Banks ranked by amount of—[1] Total deposits (millions of dollars): Under 100	100–500	500–1,000	1,000 and over	Total outstanding certificates (millions of dollars): Under 10	10–50	50 and over
	Amount (millions of dollars)							
Dec. 31, 1960:								
All denominations	1,095	139	366	477	114	306	329	461
Under $100,000	265	61	92	104	8	111	93	60
$100,000–500,000	328	49	118	138	23	107	99	122
$500,000 and over	450	28	156	235	31	85	137	228
Dec. 30, 1961:								
All denominations	3,223	151	690	804	1,578	430	710	2,083
Under $100,000	330	67	127	121	15	134	113	83
$100,000–500,000	614	57	205	234	117	151	193	270
$500,000 and over	2,156	25	354	449	1,329	144	400	1,613
Dec. 5, 1962:								
All denominations	6,181	296	1,400	1,744	2,742	839	1,336	4,005
Under $100,000	597	133	247	167	51	273	183	141
$100,000–500,000	978	94	321	352	211	240	309	429
$500,000 and over	4,606	69	832	1,225	2,480	326	844	3,435
	Number of banks							
Dec. 31, 1960:								
All denominations	182	64	83	25	10	124	38	20
Under $100,000	172	62	81	21	8	117	37	18
$100,000–500,000	144	42	72	21	9	91	35	18
$500,000 and over	95	17	51	18	9	44	33	18
Dec. 30, 1961:								
All denominations	232	72	105	35	20	151	49	32
Under $100,000	205	68	93	30	14	135	44	26
$100,000–500,000	192	51	90	34	17	115	48	29
$500,000 and over	153	21	78	35	19	72	49	32
Dec. 5, 1962:								
All denominations	270	82	128	40	20	182	56	32
Under $100,000	235	79	109	34	13	160	50	25
$100,000–500,000	224	57	110	38	19	138	55	31
$500,000 and over	194	31	103	40	20	106	56	32

TABLE 1—Continued

VOLUME OF TIME CERTIFICATES AND NUMBER OF ISSUING BANKS

Date and denomination	Total reporting banks	Banks ranked by amount of—[1]						
		Total deposits (millions of dollars)				Total outstanding certificates (millions of dollars)		
		Under 100	100–500	500–1,000	1,000 and over	Under 10	10–50	50 and over
	Percentage distribution of amount							
Dec. 31, 1960:								
All denominations	100.0	12.7	33.4	43.5	10.4	27.9	30.0	42.1
Under $100,000	100.0	23.0	34.7	39.2	3.0	41.9	35.1	22.6
$100,000–500,000	100.0	14.9	36.0	42.1	7.0	32.6	30.2	37.2
$500,000 and over	100.0	6.2	34.7	52.2	6.9	18.9	30.4	50.7
Dec. 30, 1961:								
All denominations	100.0	4.7	21.4	24.9	49.0	13.3	22.0	64.6
Under $100,000	100.0	20.3	38.5	36.7	4.5	40.6	34.2	25.2
$100,000–500,000	100.0	9.3	33.4	38.1	19.9	24.6	31.4	44.0
$500,000 and over	100.0	1.2	16.4	20.8	61.6	6.7	18.6	74.8
Dec. 5, 1962:								
All denominations	100.0	4.8	22.7	28.2	44.4	13.6	21.6	64.8
Under $100,000	100.0	22.3	41.4	28.0	8.5	45.7	30.7	23.6
$100,000–500,000	100.0	9.6	32.8	36.0	21.6	24.5	31.6	43.9
$500,000 and over	100.0	1.5	18.1	26.6	53.8	7.1	18.3	74.6
	Percentage distribution of banks							
Dec. 31, 1960:								
All denominations	100.0	35.2	45.6	13.7	5.5	68.1	20.9	11.0
Under $100,000	100.0	36.0	47.1	12.2	4.7	68.0	21.5	10.5
$100,000–500,000	100.0	29.2	50.0	14.6	6.3	63.2	24.3	12.5
$500,000 and over	100.0	17.9	53.7	18.9	9.5	46.3	34.7	18.9
Dec. 30, 1961:								
All denominations	100.0	31.0	45.3	15.1	8.6	65.1	21.1	13.8
Under $100,000	100.0	33.2	45.4	14.6	6.8	65.9	21.5	12.7
$100,000–500,000	100.0	26.6	46.9	17.7	8.9	59.9	25.0	15.1
$500,000 and over	100.0	13.7	51.0	22.9	12.4	47.1	32.0	20.9
Dec. 5, 1962:								
All denominations	100.0	30.4	47.4	14.8	7.4	67.5	20.7	11.9
Under $100,000	100.0	33.6	46.4	14.5	5.5	68.1	21.3	10.6
$100,000–500,000	100.0	25.4	49.1	17.0	8.5	61.6	24.6	13.8
$500,000 and over	100.0	16.0	53.1	20.6	10.3	54.6	28.9	16.5

[1] Banks issuing CD's were ranked according to their amounts of outstanding certificates in denominations of $100,000 or more. Although outstanding CD's in denominations under $100,000 were *not* included in determining a bank's ranking, these certificates *are* included in the amounts shown in the body of the table. The rankings by deposits and by certificates were as of Dec. 5, 1962.

NOTE.—In this and the following tables only outstanding negotiable time certificates are included. Details may not add to totals because of rounding.

banks may have issued only a few certificates in these large denominations.

The growth in CD's occurred in all Federal Reserve districts, but the rate of growth differed greatly from one district to another (Table 2). The smallest rate of increase occurred in the Dallas District, where use of CD's was already well developed by 1960. Indeed, member banks in the Dallas area accounted for about a third of all CD's outstanding at the end of 1960. In other districts the expansion started from a smaller base, and in each of these the volume at least doubled over the 2 years. In most of the districts it grew even more.

By December 1962, banks in the New York District had become much the largest issuers of CD's; they accounted for more than one-third of the total outstanding. The Chicago District was second, with less than a sixth of the total.

ORIGINAL PURCHASERS

Businesses were the original purchasers of 69 per cent of the total volume of CD's in denominations of $100,000 and over that were outstanding at the time of the survey (Table 3). The second largest purchasers—but much less important—were State and local governments. Foreign purchases, official and private, were much smaller, and individual purchases smaller yet.

Businesses were especially important as original purchasers at large banks. This was to be expected. Large national corporations, which tend to bank with the big money market banks, have also been among the heaviest investors in Treasury bills and other short-term market instruments. With the emergence of negotiable CD's as an alternative outlet for short-term funds, it is understandable that banks with total deposits of $1 billion or over have issued almost 80 per

TABLE 2

LOCATION OF TIME CERTIFICATES

F. R. District	Number of banks				Amount (millions of dollars)		
	Surveyed on Dec. 5, 1962	Reporting outstandings as of—					
		Dec. 31, 1960	Dec. 30, 1961	Dec. 5, 1962	Dec. 31, 1960	Dec. 30, 1961	Dec. 5, 1962
Boston	33	11	16	23	21	82	159
New York	37	14	26	33	132	1,117	2,217
Philadelphia	16	5	7	9	3	41	133
Cleveland	26	13	16	18	49	253	507
Richmond	21	9	13	14	59	113	137
Atlanta	34	10	13	18	50	103	193
Chicago	61	24	32	39	65	382	940
St. Louis	28	11	12	16	25	54	165
Minneapolis	20	2	4	4	....	30	192
Kansas City	51	22	26	28	64	98	158
Dallas	45	35	36	36	326	405	600
San Francisco	38	26	31	32	301	546	779
Total	410	182	232	270	1,095	3,223	6,181

See Note to Table 1.

cent of their total CD's outstanding to corporations and other businesses. At smaller banks, the business share was smaller—less than half of the total at banks with deposits of less than $100 million. A similar pattern emerges when banks are grouped by the amount of their outstanding CD's rather than by the amount of their total deposits.

As one moves from larger to smaller banks, business firms as original purchasers give way steadily to State and local governments. At banks with deposits of $1 billion or over these units accounted for less than 6 per cent of the total outstanding. In the smaller banks, however, they were somewhat behind business firms as original purchasers.

The remaining groups combined—foreign, individual, and other—were original purchasers of less than 20 per cent of

TABLE 3

ORIGINAL PURCHASERS OF TIME CERTIFICATES OUTSTANDING ON DECEMBER 5, 1962

Original purchaser	Total reporting banks	Banks ranked by amount of— Total deposits (millions of dollars)				Total outstanding certificates [1] (millions of dollars)		
		Under 100	100–500	500–1,000	1,000 and over	Under 10	10–50	50 and over
	Certificates of $100,000 and over							
Amount (millions of dollars)								
Total	5,584	163	1,153	1,577	2,691	566	1,153	3,864
Original purchaser:								
Businesses	3,851	78	690	963	2,121	309	699	2,842
Individuals	143	11	54	48	30	32	35	76
State and local govt.	867	65	303	350	149	174	321	372
Foreign official [2]	348	....	25	42	283	17	38	294
All other foreign	41	....	7	5	29	3	9	30
Other	335	9	75	169	82	31	52	252
Percentage distribution								
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Original purchaser:								
Businesses	69.0	47.9	59.8	61.1	78.8	54.6	60.6	73.6
Individuals	2.6	6.7	4.7	3.0	1.1	5.7	3.0	2.0
State and local govt.	15.5	39.9	26.3	22.2	5.5	30.7	27.8	9.6
Foreign official [2]	6.2	....	2.2	2.7	10.5	3.0	3.3	7.6
All other foreign	.7	....	.6	.3	1.1	.5	.8	.8
Other	6.0	5.5	6.5	10.7	3.0	5.5	4.5	6.5
Number of banks								
Total	238	59	119	40	20	150	56	32
Original purchaser:								
Businesses	226	52	117	37	20	139	55	32
Individuals	113	26	52	22	13	60	31	22
State and local govt.	139	32	66	31	10	76	41	22
Foreign official [2]	40	....	8	18	14	8	15	17
All other foreign	21	....	7	7	7	3	9	8
Other	91	10	48	22	11	41	29	21

Table continued on next page.

TABLE 3—Continued

ORIGINAL PURCHASERS OF TIME CERTIFICATES OUTSTANDING ON DECEMBER 5, 1962

Original purchaser	Total reporting banks	Banks ranked by amount of— Total deposits (millions of dollars)				Total outstanding certificates[1] (millions of dollars)		
		Under 100	100–500	500–1,000	1,000 and over	Under 10	10–50	50 and over
	Certificates of $500,000 and over							
Amount (millions of dollars)								
Total	4,606	69	832	1,225	2,480	326	844	3,435
Original purchaser:								
Businesses	3,261	31	508	746	1,965	175	526	2,559
Individuals	69	3	23	17	26	12	12	45
State and local govt.	624	32	222	274	96	105	231	288
Foreign official[2]	345	....	23	41	282	17	36	293
All other foreign	33	....	3	4	26	2	6	26
Other	275	3	53	144	75	16	34	225
Percentage distribution								
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Original purchaser:								
Businesses	70.8	44.9	61.1	60.9	79.9	53.7	62.3	74.5
Individuals	1.5	4.3	2.8	1.4	1.0	3.7	1.4	1.3
State and local govt.	13.5	46.4	26.7	22.4	3.9	32.2	27.4	8.4
Foreign official[2]	7.5	....	2.8	3.3	11.4	5.2	4.3	8.5
All other foreign	.7	....	.4	.3	1.0	.6	.7	.8
Other	6.0	4.3	6.4	11.8	3.0	4.9	4.0	6.6
Number of banks								
Total	194	31	103	40	20	106	56	32
Original purchaser:								
Businesses	170	21	93	36	20	85	53	32
Individuals	35	5	15	6	9	14	8	13
State and local govt.	99	13	52	25	9	43	36	20
Foreign official[2]	36	....	7	15	14	8	13	15
All other foreign	13	....	3	3	7	2	5	6
Other	43	4	18	11	10	13	12	18

[1] Banks issuing CD's were ranked according to their amounts of outstanding certificates in denominations of $100,000 or more.

[2] Foreign govts. and central banks and international financial institutions. See also Note to Table 1.

the total in any of the bank-size groups. Foreigners made almost all of their purchases at banks with deposits of $1 billion or over. They accounted for 10 per cent of the total outstanding at these large banks. Purchases by individuals were more significant at the smaller banks.

In general, business firms were more important purchasers of CD's of $500,000 and over than of denominations between $100,000 and $500,000. They accounted for about 70 per cent of the larger issues outstanding in late 1962 and only 60 per cent of the smaller denominations.

This pattern was not consistent, however, among banks of different deposit size. At

banks with deposits under $100 million, for example, corporations and other businesses were less important as purchasers of the larger denominations than of the smaller ones.

CHARACTERISTICS OF CD'S

For CD's on which interest is paid, the interest ceilings imposed by Regulation Q have made those with maturities of 6 months and over the most competitive.[1] The maximum rates permitted on these certificates in recent years have been as follows:

Maturity (Months)	*Effective Jan. 1, 1957*	*Effective Jan. 1, 1962*
	(Per cent)	
12 and over	3	4
6-12	3	3½
3-6	2½	2½
Under 3	1	1

Foreign official deposits were exempted from Regulation Q ceilings for a 3-year period beginning with October 15, 1962. After that banks could offer competitive rates on the shorter-term maturities preferred by these depositors. Foreign official deposits did rise after this change, although only part of the increase took the form of negotiable CD's. And it would appear that most of these were in maturities of 6 months or longer.

The schedule of maximum rates had made certificates of deposit maturing in less than 6 months unattractive to domestic investors. For example, since late in the year 1961 3-month Treasury bills have been yielding more than the maximum rate of 2½ per cent on time deposits. At banks with deposits of less than $100 million, only 6 per cent of the total outstanding on December 5, 1962, had maturities of under 6 months. And at the larger banks, CD's in these short maturities were less than 3 per cent of the total outstanding.

In the secondary market, on the other hand, investors have been able to acquire CD's with less than 6 months remaining before maturity at favorable rates. Purchasers of issues initially maturing in 6 months or longer can sell them later on the secondary market to investors who want shorter-term issues, say of 2 or 3 months. The seller will realize a capital gain on sale of the certificate, while the price to the buyer still enables him to realize a higher yield than on U.S. Government securities of comparable maturity and a higher yield than could be obtained by originally placing funds with banks at less than 6-month maturity.

The most popular maturity range to the original holder was 6-9 months. This group accounted for almost half of the dollar volume outstanding. The next most important was the 1-year maturity. Larger banks had, in addition, a heavy concentration in 9-12-month issues. Issues of 1-year CD's were much less important to larger banks than to the smaller banks.

Issues maturing after 1 year were moderately important to each of the bank-size groups; at banks with deposits under $100 million they amounted to about 15 per cent of total CD's outstanding. There were 18 of the banks with outstanding CD's with maturities longer than 2 years. Only one of these was a bank with deposits of less than $100 million; most of them had deposits ranging between $100 million and $1 billion.

[1] Over 20 per cent of the banks reported they had some outstanding CD's on which no interest was being paid. The dollar volume, however, was only $35 million, or less than 1 per cent of the total.

Most banks reported that they impose no formal restrictions on the resale of their certificates. Indeed, only 8 of the 270 issuing banks listed any such restrictions. Most of the issuing banks—199 of them—make certificates available only in "order" form, which makes them payable only to, or when endorsed by, the party named on the certificate. The others use both bearer forms and order forms; these banks were heavily concentrated in the larger bank-size groups.

Some banks also make it easier to redeem CD's at maturity by permitting holders to present them for redemption at a bank in another city. About a third of all banks with outstanding CD's offered this option to holders of their certificates. These banks accounted for a significant proportion of the total number of banks in each of the deposit-size groups.

FEDERAL RESERVE SURVEY OF NEGOTIABLE
TIME CERTIFICATES OF DEPOSIT

Name of Bank ______________________ Federal Reserve District ______________

City and State ______________________ Date ______________________

The following questions refer only to negotiable time certificates of deposit issued by your bank. Upon completion, please return this form to:

Mr. ______________________, Vice President,
Research Department,
Federal Reserve Bank of ______________________,
______________________, ______________________.

I. Does your bank issue time certificates of deposit in a form in which they can be sold by the initial purchasers (that is, in negotiable form)?

Yes ☐ No ☐

If the above answer is no, disregard the remaining questions and return this form to the Federal Reserve Bank.

II. Does your bank issue any time certificates of deposit in bearer form?

Yes ☐ No ☐

III. Does your bank impose upon initial purchasers of negotiable time certificates any direct restrictions or any implied understandings which would restrict their resale of such certificates?

Yes ☐ No ☐

If yes, specify kinds of restrictions ______________________

IV. Indicate dollar volume (and in the last column, the number) of negotiable time certificates of deposit in different denominations (face value) outstanding on the dates shown below.

	Dec. 31, 1960	Dec. 30, 1961	Dec. 5, 1962	
Less then $100,000	$	$	$	
$100,000 - $499,999				No.
$500,000 and over				No.

If a single transaction involves several certificates, count them separately.

NOTE: The remaining questions refer only to negotiable certificates in denominations of $100,000 and over outstanding on December 5, 1962. If your bank did not have such certificates outstanding on this date, disregard the remaining questions and return this form to the Federal Reserve Bank.

- 2 -

V. Indicate the total dollar amount, if any, of $100,000 and larger negotiable time certificates outstanding issued at a zero rate of interest $_______________.

VI. Indicate the dollar amount of $100,000 and larger negotiable time certificates of deposit outstanding with original maturity of:

Less than 6 months	$____________
Six months and over, but less than 9 months	$____________
Nine months and over, but less than one year	$____________
One year	$____________
Over one year	$____________

Specify the longest original maturity on any certificate outstanding____________

VII. Indicate the dollar amount of negotiable certificates of deposit outstanding according to original purchaser for the following two size brackets:

	$100,000-$499,999	$500,000 and over
Corporate and other business (financial and nonfinancial)	$____________	$____________
Personal	____________	____________
States and political subdivisions	____________	____________
Foreign		
Foreign governments, central banks, and international financial institutions	____________	____________
All other foreign	____________	____________
Other (incl. nonprofit)	____________	____________

VIII. Does your bank issue time certificates of deposit in denominations of $100,000 and larger in a form which permits redemption at maturity at a bank other than your own?

Yes ☐ No ☐

____
(Name of officer)

____
(Title)

Representative REUSS. I would ask Chairman Martin and the members of the Board if you would not seriously consider at an early meeting of the Board—debate it and vote it up or down, and I would certainly hope you could vote it up—an increase in the required reserve on negotiable certificates of deposit from 4 percent to the 6 percent which Congress has delegated to you as a figure which you can do under your own steam.

I can't believe that it would take your lawyers more than a few minutes to prepare the necessary documents so that if you wanted to make that decision you could.

And in my judgment, it would be a wholesome decision to make, and one which would partly get you out from the bind that you are in, because it would make certificates of deposit less fascinatingly attractive to the big banks.

As it is now, they are a wonderful thing for a bank to have, as they give a 25-to-1 reserve ratio. I think that this makes them unduly attractive.

I would like to have you consider making them less attractive by doing that which you can in terms of reserve ratio study.

Would you be willing to have the Board consider the possibility?

Mr. MARTIN. At your request, Mr. Reuss, I will see that the Board considers the matter.

Representative REUSS. I am grateful. At the same time you might consider what, if any, other steps need to be taken, perhaps requiring additional legislation to enable our financial system to rid itself of what I regard as an Old Man of the Sea around our necks. I think that from the standpoint of losing control of the lending capacity of the banking system, from the standpoint of discrimination between banking units, and from the standpoint of endangering the liquidity of the banking system, this problem has to be looked at. As a member of the Banking and Currency Committee I would certainly welcome any initiative that the Fed may choose to take in this.

Now, let me get to another problem, Mr. Martin.

Yesterday, and at other times, in speaking of our international balance of payments and the effect of interest rates on it, we have spoken of the effort of European bankers and central bankers to urge Americans to raise their interest rates here so that there will be less disequilibrium between the two.

You have referred to people who oppose that advice as being isolationist. Now, since I am one of those who does tend to resist that advice from various parts of Europe, and since I don't consider myself an isolationist, I would like to help define isolationism with you. I thought that isolationism was a refusal by Americans to go along with international policies which are in the interest of the free world. Thus, I should think that one does not make himself an isolationist by resisting attempts by Europeans to unduly raise our interest rate structure; really, the free world would be better off if Europeans used fiscal methods, taxing and spending techniques, to a greater extent in fighting inflation.

To call someone an isolationist for not going along with the Europeans is like calling Tom Jefferson an isolationist for not paying tribute to Barbary pirates. So, how about not using that word any more?

Mr. MARTIN. I am afraid you misunderstood me, Mr. Reuss. I did not accuse you or any people who are in favor of widening differentials as being isolationist. I simply read the same statement to you that I made to President Kennedy on a number of occasions and he ended up agreeing with me completely that we could not ignore interest rates in the flow of funds within the Western World. That is all I was saying. I was not in any way saying you were an isolationist.

Senator Proxmire, when we were talking about that earlier, said some of these things were in contradiction. These are policy decisions. I, yesterday, made the point that I wished our European friends were relying more on fiscal policy and less on monetary policy.

Representative REUSS. You don't think you were an isolationist for saying so?

Mr. MARTIN. Not the slightest. I merely posed the problem. I simply said we could not withdraw. I was not in any way imputing to you the term isolationist. I was simply saying we could not ignore this any more than we can be an isolationist in foreign affairs.

Representative REUSS. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. I would like to ask Governor Maisel about this executive branch staff paper which, as I understand the suggestions or discussions, is a mix of fiscal and monetary policy and which you said wasn't accessible to you, or you didn't have it at the appropriate time—this paper that would have been helpful to you in making your decision.

There was lack of coordination at least on this substantial information that the executive branch worked out that you might have had but didn't. Did I understand that correctly?

Mr. MAISEL. Might I state my point? I think I have been particularly unexpressive in making myself clear on this point. I raised the question originally, as Chairman Patman did, as to the proper coordination of fiscal and monetary policy. I attempted to make very clear my hope that we will not sacrifice the present procedures which I think are very valuable. I also want to make it clear that I agreed fully with Chairman Martin, that the Board as a whole cannot enter into these problems. I also want to make it clear I was not questioning the ability of the staff or the amount of staff information available to each member. I was raising the question of what is the proper balance between independent and interdependence of monetary and fiscal policy. It seems to me this is the critical question.

Senator PROXMIRE. I was asking you simply about that one issue. I think you have done an excellent job of discussing the general situation. I wanted to know whether this particular staff paper should have been developed but was not developed.

Mr. MAISEL. I was discussing the question of the information that was not available at times that are critical.

I do know that at the time of the 1963 agreement there was available a staff paper on the question of the discount rate change. It was prepared by the various agency staffs.

As I say, it was also my understanding—but this was purely through casual conversation—that prior to this present situation a similar type of document had been prepared giving the assumptions of the various staffs as to the situation at the critical times in the recent period.

As I said, I don't know what happened to that staff document. The ideas contained in it may have changed. Perhaps they were not agreeable to the various members of the Quadriad. I was simply saying this was the type of document which I know existed at least once in the past and which I believe to be necessary if one is to make a proper decision at a time such as this.

We are talking about the critical types of information which are necessary when critical decisions are to be made. I received the general knowledge that the action the Board was about to take was not approved by the other members of the Quadriad—the Council, the Budget Bureau, and the Secretary of the Treasury. But the general knowledge of their opposition was not sufficient to give me as an individual member of the Board a sense of what they felt was necessary or how we might adjust our policy to it.

I feel that in this type of problem you need all the information you can get at the time the decision is required. You need the very specific views of the other agencies. Since no such document or views were available, this was one of the critical reasons why I asked that we delay the decision. My previous statement mentioned that I later was told by a member of another agency that such a document containing roughly this type of information had been worked on.

All I know is that I did not receive during this period any document of this type.

Senator PROXMIRE. Let me shift right away, because my time is limited and I know it is late, to ask Governor Martin and other members if they would like to comment about whether there should be a greater degree of coordination, a greater degree of consultation.

I am not talking about independence, or more dependence, or taking orders, or taking directions. I am simply talking about the greatest possible amount of mutual information going both ways; frank, full, blunt discussion on the part of members of the Federal Reserve Board on fiscal policy and members of the administration on monetary policy, not with any feeling you are dictating to them what they should do, but making clear what is your best judgment, which is excellent and very valuable judgment to them. It should be.

I would like to get at whether or not you think it would be worthwhile considering one of the following four alternative methods of increasing coordination:

No. 1, regular meetings, weekly or monthly or four times a year, at any rate as often as possible, of all members of the Federal Reserve Board and some top members of these other agencies that are involved, the Budget Bureau, the Council of Economic Advisers, and the Treasury.

That is one possibility and maybe there are reasons why it can't be accomplished. What I am deeply concerned about is, Governor Martin, you have one vote, the other members have six votes. They have the ability, therefore, to determine policy, as you know. You are the chairman but, as I understand it, the law does not give you any extraordinary power except that you are the chief executive officer. There is no other influence you have that they don't have. The majority leader does not have any more influence in determination of policy than I have as an individual Senator. I think all members of the Board should have the greatest opportunity to be briefed. That is one alternative.

The second is the possibility of position papers prepared and circulated regularly with the arguments adduced from each of the other three important economic policy agencies. I can see that where would be problems involved here but I think it might be very, very helpful, particularly if they were kept in confidence and you had an opportunity to decide on a free and frank discussion that way in writing.

A third is for you to follow the same policy you do now but to keep a recorded transcript of the kind we have here of your discussions with the Council, Treasury, and Budget which would be made available in full promptly, the next day, to the other six members of the Board, and then maybe some opportunity for then to comment if they wish.

A fourth could be to establish a formal secretariat to work with all four agencies and to work directly with them to keep them all informed fully and to work for the greatest amount of understanding on the part of all members of the Federal Reserve Board and all members of these other three agencies not with a notion that the President would dominate or that the administration would dominate but that you would be fully and completely informed, not simply you but the other six members of the Board.

What is your reaction to these four possibilities? Do you think they might be considered and explored seriously?

Mr. MARTIN. I think we ought to explore carefully and conscientiously every avenue of improving coordination within the Government.

The independence we are talking about is independence within the Government, not independence from the Government. All four of these methods and several others that you have suggested have from time to time been discussed and evaluated and there are problems with all of them as you yourself recognized in outlining them.

I don't say that any one of them ought to be discarded, per se. I think our purpose ought to be to get better coordination throughout the Government not only in the Federal Reserve but in other areas of Government and the only thing that we ought to be careful about is that we do not substitute dictation for coordination.

Senator PROXMIRE. But you would feel that there might be further consideration, particularly since there is a feeling in the country I think, and some feeling in the Congress, that it may be a matter of misunderstanding?

Mr. MARTIN. Yes.

Senator PROXMIRE. That we could have a better coordination—and that one of your members, a new member admittedly, but obviously a very able member, has indicated he was shocked at what he felt was a lack of coordination. He said that yesterday.

Mr. MARTIN. Nobody regrets more than I do that Governor Maisel felt that there wasn't proper coordination. I think we ought to do everything we can to improve that coordination.

Let me say from the standpoint of people out in the country that I run into that it is not only in relation to the Federal Reserve but it is in relation to a great many areas of Government policy that there is question.

Senator PROXMIRE. You have a peculiar problem because you are set up as a quasi-independent agency. At the same time your policies, as I tried to bring out, later often seem to be in contradiction of the administration, and sometimes they are.

Mr. MARTIN. Yes. I am not criticizing anything when I say this, but on a recent trip I made I got more comments about failure of coordination in areas within the executive branch than I did between the Federal Reserve Board and the executive branch. These were just raised with me by people who were completely dispassionate but were critical of some actions that the Government was taking.

Senator PROXMIRE. My time is up, but let me ask, would it be possible in view of the fact that Governor Maisel has brought out this fascinating Brookings study in which a computer said that the effect of your increase in interest rates would be to raise prices—this was something I don't think you should pass up, after all, Brookings is a very responsible agency—would it be possible for a member of your staff—in view of the fact that the Board has brought this up—to give us some evaluation of whether or not this kind of thing can be useful?

It seems to me it could be enormously helpful if it can indicate anything like this.

Mr. MARTIN. I don't say this facetiously but I can assure you that it sounds like something we ought to read.

Senator PROXMIRE. Will you give the committee a memorandum of your reaction as to whether or not there is any way that computers can be used to give us a projection of the consequence of this kind of policy, your judgment as to whether or not this computer would be useful in this area?

Mr. MARTIN. We ought to have a little time to study it.

Senator PROXMIRE. Surely. I am not pressing it.

(The memorandum which follows was later supplied by the Federal Reserve Board.)

USES OF ECONOMETRIC MODELS IN FEDERAL RESERVE POLICYMAKING

Economic analysis during the past decade has made significant progress in quantifying relationship among economic variables. The special branch of economics dealing with this subject is known as econometrics, which may be defined simply as the application of statistical methods to economic problems.

Models of economic behavior estimated with econometric methods are of many different kinds. The Brookings Social Science Research Council quarterly model of the U.S. economy, used to estimate the effects of the recent Federal Reserve policy action, is a type of model designed to deal with interrelationships among aggregative economic variables—total employment, average prices of commodities, interest rates, wage rates, and so on. It is but one of a number of models of this kind that have been constructed, although it is one of the more ambitious undertakings in this field. Many other classes of econometric models have been constructed to deal with problems of a different character. Some examples would include models of the behavior of specific industries, or of the activities of an individual firm within an industry.

The development of high-speed digital computers has played an important role in giving impetus to this type of research. Econometric models often involve the performance of intricate mathematical computations involving large masses of data, and would not be feasible to construct without the aid of the computer. As a consequence, complex econometric models of economic behavior are relatively new, even though efforts to quantify economic analysis have gone on for many years. A very large portion of the work in econometric model building dates from the end of World War II; in fact, much of it has occurred within the past decade. Techniques of estimating the relationships among economic variables are, therefore, still in their early stages of development, and little experience has been gained thus far in the use of aggregative econometric models to predict the effects of monetary policy actions.

The Federal Reserve has been actively interested for a number of years in the use of the computer as a tool for economic research and analysis, as well as for routine data processing. A computer was first installed at the Board of Gov-

ernors a little more than 10 years ago, and within the space of about 5 years, each of the 12 Federal Reserve banks also had acquired its own computer facility.

The availability of these facilities, together with the progress that has been made in econometric methods, has resulted in a significant reorientation in the nature of much of the economic research in the Federal Reserve. Increasing emphasis has been placed on measuring the effects of monetary policy on commerical banks, on financial markets, and on markets for goods and services—with a view toward improving our understanding of how monetary policy affects economic activity. An illustration of the Federal Reserve's interest in the use of econometric models for this purpose is provided by its contribution to the Brookings SSRC model mentioned above. The Federal Reserve assumed responsibility for construction of the financial sector of the model, and one of the Board's staff members was principally responsible for the work done in that area.

Progress in the application of econometric methods to monetary analysis has been slow, but encouraging. Recently, the Federal Reserve has taken steps to accelerate its research effort in this field and to provide a more concentrated focus on the central problems of monetary policy. One of these steps was the creation of a more formal structure for conducting research into the links between monetary policy actions and economic activity, employment and prices. Several system committees have been established for this purpose, each with a designated area of research to pursue. The System also is sponsoring, jointly with the Social Science Research Council, an intensive investigation of the effects of financial variables on investment outlays by business and on State and local construction.

A second step undertaken recently was the initiation of efforts at the Board to construct an aggregative economic model similar in its general conception to other models of this kind, but designed more specifically to the special needs of monetary policy. A third step under contemplation involves experimentation with several existing aggregative models to gain experience with the use of this technique in predicting the effects of monetary policy actions on financial markets and on employment, output, and prices.

While the Federal Reserve is actively pursuing this line of inquiry—and also providing assistance to others engaged in this endeavor—it must recognize, nonetheless, that the use of econometric models for evaluating the effects of monetary policy is still very much in a formative stage of development. Substantial further research will be required before a high degree of confidence can be placed on the conclusions drawn from such models. In addition, the characteristics of economic behavior are exceedingly complex, and they change over time in ways that are difficult to represent within the constraints of formal mathematical models. The ability to draw conclusions from such models, consequently, will not dispense with the need for human judgment as to the probable effects of monetary policy actions on the economy.

The method of simulation used to estimate the effects of a monetary policy action with an econometric model often yields results that are valuable evidence to be considered in the decisionmaking process. The unique contribution of the model is in its ability to shed light on economic relationships and effects of policy actions that could not be anticipated by intuition. The effects of a policy action depend on responses of many different sectors of the economy, and the interaction of the various sectors, which the model is able to trace through systematically.

The usefulness of the results that are obtained from a simulation exercise, in terms of evaluating the probable future effects of a current policy action, depends upon the accuracy with which the model portrays economic relationships existing in the past, and the stability of these relationships over time. How well a model meets these tests cannot be determined until extensive simulation exercises and a variety of prediction tests have been undertaken to reveal the properties of a model and its weaknesses and strengths. Until that is done, judgments as to the reliability of estimates obtained from the model are difficult to make.

Chairman PATMAN. In the interest of concluding the hearings, I wonder if we can agree that any member of this committee may send his remarks at any point in the hearings and insert anything that he considers material; any such excerpts and extraneous matters that he

considers material to the discussion of any point that has been raised in these hearings.

Is there any objection to that?

No objection.

Now I just want to briefly bring up something, not in a partisan spirit at all, but it happens to pinpoint——

Mr. MITCHELL. Do we have the same right, Mr. Chairman?

Chairman PATMAN. Yes; you have the right to extend your remarks when you examine your transcript to explain anything that you think can be explained better and to enlarge upon anything.

Representative CURTIS. Mr. Chairman, I raise the point as to whether additional questions—of course we have to have a time limit on it—could be submitted to the members of the Board. When will this transcript be closed?

Chairman PATMAN. Well, we will say 10 days. If we were to submit questions in writing would you gentlemen try to get them back to us, and answers, for the transcript within 10 days?

Now that will be during the Christmas season. Let us make that January 1. Will that be satisfactory?

Mr. MARTIN. The staff will have to work on that because I am going to be away during Christmas.

Chairman PATMAN. Without objection it is so ordered.

The matter I wanted to bring up before and certainly not in a critical partisan spirit, is this: I notice that a so-called progressive Republican group met yesterday and they passed some resolutions, which, in addition to congratulating Mr. Martin and condemning the President, and rebuking me, said this:

> What President Johnson and many Democrats have forgotten is that the vote of the Federal Reserve Board was made under the independent status granted that Board by law.

They said this in a joint statement.

Now I respectfully ask the distinguished gentleman from Missouri, Mr. Curtis, who is the acting minority leader in this case and the minority leader in the House of Representatives to please indicate in the record the law that granted the Federal Reserve Board independence.

Representative CURTIS. The Federal Reserve Act of 1913, as amended.

Chairman PATMAN. The Federal Reserve Act of 1913, of course, established 12 autonomous regional banks and was not a central bank.

Representative CURTIS. It was amended in 1930.

Chairman PATMAN. In 1933 and 1935. That made it a central bank. But there was no mention of independence, no more than there is in the law establishing the Interstate Commerce Commission or the Tariff Commission or any of the rest of them. There is nothing in the law to indicate that the Federal Reserve Board is independent.

Representative CURTIS. I think all of those are independent agencies and are independent in that sense. One of the tests is the terms of office of the members, 14 years. This clearly puts them beyond power of any particular President. It was simply the mechanics for providing for appointment. That is the only reason at that time the Executive was involved at all. I think there has been a failure in a lot of our discussions of these independent agencies to realize they are

not part of the executive branch of the Government. We use the civil service system and other techniques, but the structures are essentially an arm of the Congress. They are part of our constitutional powers over regulating interstate and foreign commerce and the coining and maintaining of the value of money. This is our argument, Mr. Chairman.

Chairman PATMAN. Of course, you are basing your argument on the 14-year term. That doesn't help you build a very strong case at all.

Mr. MARTIN. Could I make a suggestion here in the same nonpartisan, nonpolitical spirit that you have introduced this?

Chairman PATMAN. Yes.

Mr. MARTIN. I would suggest that we take President Johnson's statement on the independence of the Federal Reserve at the time and during the course of the election campaign in 1964 and have that put into the record for analysis.

Chairman PATMAN. He did not say at that time the Federal Reserve was independent, and furthermore he has had some experience since that time.

Mr. MARTIN. If President Johnson wishes to change that, that is all right. But I think that this statement, which is very good, should be in the record.

Chairman PATMAN. It is possible that your interpretation is not the President's interpretation.

Representative CURTIS. Mr. Chairman, I would ask unanimous consent that that statement be included in the record at this point—the statement of President Johnson.

Chairman PATMAN. Certainly. You can put it in yourself.

Representative CURTIS. Certainly. I am asking to do it.

Chairman PATMAN. You may do so.

(Statement referred to follows:)

PRESIDENTIAL STATEMENT NO. 2 ON ECONOMIC ISSUES: MONETARY POLICY FOR STABILITY AND GROWTH. OCTOBER 26, 1964

1. Monetary policy is one of our crucially important tools for maintaining a healthy and noninflationary economy. The job is never easy. But the results over the past 4 years have been remarkable:

Ample but not excessive credit has been available to businesses, home buyers, and State and local governments.

At the same time, short-term interest rates have been pushed up to reduce capital outflows and help correct our balance-of-payments deficit.

Yet long-term interest rates, which are so important to domestic borrowers, have remainded moderate; in fact, home mortgage rates and the rates paid by State and local governments are lower today than in early 1961.

2. All this has been made possible by close ties between our monetary and our fiscal and debt management policies, and close harmony among the men responsible for these policies:

We have maintained the Federal Reserve's traditional independence within the Government.

Yet the Federal Reserve and the administration agree entirely on the practical need for informal coordination among the various economic programs of the Government.

The President meets periodically with a group consisting of Secretary Dillon, Chairman Martin, of the Federal Reserve Board, Budget Director Gordon, and Chairman Heller, of the Council of Economic Advisers, and they in turn are in close and continuous contact.

These efforts have resulted in government by consensus, not by conflict, in economic policy.

3. In the future as in the past, our monetary system must remain flexible, and not be bound by any rigid, mechanical rules:

In an atmosphere of private and public moderation, monetary policy has been steadily expansionary for 4 years.

With continued moderation, there can be the continued monetary expansion essential to economic growth.

But if inflation develops, or if excessive outflows of funds occur, the Federal Reserve System is in a position to do what is necessary.

Chairman PATMAN. Now, then, may I invite your attention to section 8 of the Constitution. I am reading this from Sol Bloom's book on the Constitution which I think is the best book ever published on it. Section 8 of article I, says the Congress shall have the power "to coin money, regulate the value thereof."

Now it does not say that the Congress shall have the power to farm this privilege out. Obviously, Congress could not execute the law in this respect. So it says, further on in the Constitution, also in article I, section 8, that Congress shall "make all laws which shall be necessary and proper for carrying into exection the foregoing powers."

Article II of the Constitution says:

The Executive power shall be vested in a President of the United States of America.

It is very plain to me that the framers of the Constitution did not contemplate that Congress would farm out this power to people who have a vested interest in the matter such as the banks and bankers. In other words, that would be like making the goose the guardian of the shell corn.

The Constitution is very plain. It says that the Congress shall pass a law to carry this provision into execution. Some people are arguing that this recent action of the Federal Reserve Board was taken under the independent status granted that Board by law. I want to know where that language is: "granted to the Board by law." I have never seen it. I have asked Mr. Martin about it, frequently. The word "independent" or "independence" does not occur in the act at all.

Now they talk about these things but I think the Board has just assumed this independent power. They don't have it legally. The Federal Reserve does not operate like the Tariff Commission and the Interstate Commerce Commission. These agencies are independent. But they are not independent of Congress. They have to go to Congress and get their appropriation—their operating money. That gives the people's representatives, who are charged with some responsibility, an opportunity to inquire into their activities and also they are audited by the Comptroller General—the General Accounting Office—which gives the people another chance to try to find out what is going on.

But this so-called independent agency, the Federal Reserve, has gotten itself outside the appropriation method of Congress. They don't come to Congress at all. Congress has no chance to interrogate them about their operations, or criticize their expenditure of funds and even block some expenditures of funds if necessary.

Mr. MARTIN. You don't call this an interrogation?

Chairman PATMAN. That is your personal observation. The Federal Reserve does not appear before the Appropriations Committee or submit to a GAO audit. This is a fact that can't be denied.

Representative CURTIS. The process of their appearing here before this committee?

Chairman PATMAN. I know, but it is not in the same manner that the other agencies get their money. Now we can talk a lot but we don't have the Federal Reserve's budget before us, we can't ask you about your budget, and what you spend the taxpayers funds for. In other words, you have gotten away from the normal appropriations processes and away from what the Constitution contemplated. The Constitution contemplated that anybody making an important decision for the Government shall be held accountable to the people who would have the right to pass on it. Should we have an elected Government where the people can vote on who makes these decisions, or a privately controlled Government—or I will say "Banker Government," in this case, since the banks control the Federal Reserve, in effect. Which are we going to have?

(The following material was later submitted by Chairman Patman as an extension of remarks:)

In order to place the conflict between the banking community and the elected Government of the United States over the nature of our central banking system in historical perspective, I will place in the record certain remarks made by our statesmen during the period of the creation of the Federal Reserve System.

The first of these, by President Woodrow Wilson—then Candidate Wilson—posed the basic problem of insuring unified public control over currency creation and regulation:

> Beyond all these, waiting to be solved, lying as yet in the hinterland of party policy, lurks the great question of banking reform. The plain fact is that control of credit—at any rate of credit upon any large scale—is dangerously concentrated in this country. The large money resources of the country are not at the command of those who do not submit to the direction and domination of small groups of capitalists, who wish to keep the economic developments of the country under their own eye and guidance. The great monopoly in this country is the money monopoly. So long as that exists our old variety and freedom and individual energy of development are out of the question. A great industrial nation is controlled by its system of credit. Our system of credit is concentrated. The growth of the Nation, therefore, and all our activities are in the hands of a few men who, even if their action be honest and intended for the public interest, are necessarily concentrated upon the great undertakings in which their own money is involved and who necessarily, by very reason of their own limitations, chill and check and destroy genuine economic freedom. This is the greatest question of all, and to this statesmen must address themselves with an earnest determination to serve the long future and the true liberties of men.[1]

As the discussion of banking reform intensified, during President Wilson's first administration, Representative Oscar W. Underwood perceived and clearly stated the position of the bankers:

> No group in the Nation was more anxious for reform than the bankers themselves. They "wanted a change," but they wanted the change so made that they might control.[2]

William Jennings Bryan, Wilson's Secretary of State, had this to say on the subject:

> I called [President Wilson's] attention to the fact that our party had been committed by Jefferson and Jackson and by recent platforms to the doctrine that the issue of money is a function of government and should not be surrendered to banks.* * *

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[1] Address at Harrisburg, Pa., June 15, 1911. "The Public Papers of Woodrow Wilson," vol. II, p. 307.

[2] This and the following quotations are from Baker, R. S., "Woodrow Wilson: Life and Letters."

I also pointed out my objection to a divided control and argued in favor of making the entire board of control appointive by the President, so that the Government would have complete and undisputed authority over the issue of the Government notes which, in my judgment, should be substituted for the contemplated bank notes.

Louis D. Brandeis, President Wilson's adviser on monetary and antitrust matters, forcefully and succinctly took the same position:

Conflict between the policies of the administration and the desires of the financiers and of big business is an irreconcilable one.

Power to issue currency should be vested exclusively in Government officials, even when the currency is issued against commercial paper, * * * the board should be distinctly a government body and the function of the bankers should be limited strictly to an advisory council.

The people can't pass on the banker government. They don't have a right to vote on it. I don't care what kind of mistake you make, nobody can reprimand you for it. You can't be removed. So you can be footloose and fancy free.

Representative CURTIS. What they can do is defeat Congressmen who insist on setting up and maintaining this independent system.

Chairman PATMAN. You don't get that kind of issue clarified.

Mr. MARTIN. May I make a suggestion, Mr. Chairman? I know that you are always downgrading your own interrogations but I think it would be well to read again into the record excerpts from the very fine hearing that you held in 1952 in which the points that you have just raised were answered at considerable length and we employed Professor Wilmerding of Princeton to comment on the point of the Constitution that you have in Sol Bloom's book. I think these points should be reconsidered. But I say that I have been up here I think on an average of a half dozen times a year before one committee or another and have been interrogated on these same points. So I congratulate you on the effective interrogation that you have conducted.

Chairman PATMAN. Thank you, sir. But I have not been satisfied with your reports or responses.

The matter of the so-called independence of the Federal Reserve Board has been debated over a number of years. The basic point is that the Federal Reserve Act, as amended, does not by word or implication grant any independent powers to the Board. The Federal Reserve Board like any other executive agency is charged with the responsibility of carrying out the law within the context of the social and economic objectives laid down by the President of the United States as the Chief Executive elected by the people.

Of this there can be no doubt. If there were any doubt it should have been dispelled by the passage of the Employment Act of 1946. This act, section 2, specifically requires the Federal Government, and the President as its Chief Executive—

* * * to coordinate and use all its plans, functions, and resources for creating and maintaining * * * maximum employment, production and purchasing power.

Marriner S. Eccles, longtime member and chairman of the Federal Reserve Board, testified during the Banking Act of 1935 hearings, page 363, that the President should have the right of appointment and removal of the Governor—now Chairman—of the Federal Reserve Board. It was inconceivable to Mr. Eccles that an administration could carry out its economic and social objectives without the Federal

Reserve Board operating in harmony with the President. The views expressed by Mr. Eccles on this point follow:

Following are two academic articles which in large part deal with the matter of the so-called independent status of the Federal Reserve Board. These articles, "Monetary Policy and the President" by Prof. Leo Fishman, and the "Structure of the Federal Reserve System," by Profs. Harvey Mansfield and Myron Hale, were prepared for the hearings on the "Federal Reserve System After 50 Years," conducted by the House Banking and Currency Committee, 88th Congress, 2d session, 1964.

The analysis by Prof. Fishman clearly establishes the fact that at no time, during consideration of the Federal Reserve Act of 1913, the act as amended in 1933 and 1935, or in consideration of the Employment Act of 1946 was it ever contemplated that the Federal Reserve Board would have the power to determine—

> * * * independently of the President, the principal objective(s) of public economic policy * * *

Professor Fishman concludes:

> It is impossible for the President to discharge the responsibilities assigned to him in the Employment Act of 1946 unless he exercises the power to coordinate national monetary policy with national fiscal policy * * *. The basis for such exercise of power by the President already exists both in statute and in historical precedent.

Professors Mansfield's and Hale's article dealing with the structure of the Federal Reserve System concludes, among other things:

(1) The New York Federal Reserve Bank due to its control of open market operations constitutes a strong influence on policy formation and execution for the entire System and Board.

(2) Due to the way in which directors are elected to the Federal Reserve district banks there is a—

> * * * built-in banker bias in the environment in which Reserve bank policy is made and facilities access for bankers' news.

(3) Because monetary developments have repercussion on all sections of our economy, it is out of the question for the Federal Reserve to do what it wants irrespective of the views of the administration and Congress—the duly elected representatives of the people.

Monetary Policy and the President

(By Leo Fishman, professor of economics and finance, West Virginia University)

(An analysis submitted for the record)

On February 26, the long-awaited, much-debated tax reduction bill, having successfully passed over all hurdles in both Senate and House, was finally signed by President Johnson.

Perusal of the debates in Congress preceding passage of the tax reduction bill and the comments on the bill in various influential and widely read newspapers and magazines indicates that on one point both the opponents and the proponents of the bill generally agreed. Those who favored the bill, those who believed it should have been modified considerably before passage, and even those who expressed opposition in principle to tax reduction at this time were almost unanimous in their belief that enactment of the tax reduction bill would result in a marked expansion of economic activity.

President Johnson himself in the Economic Report he submitted to Congress in January predicted that if the tax reduction bill were enacted speedily and without substantial modification the expansionary effect in 1965 would be be-

tween $35 and $45 billion; that is, he predicted that as a result of the passage of the bill, total output of goods and services (gross national product) would be $35 to $45 billion higher in 1965 than it would be if no such bill were passed.

But it is by no means certain that the new tax law will have the anticipated expansionary effect. Ignored or just glossed over lightly in most of the discussions preceding passage of the tax reduction bill was the inescapable fact that the potential effects of the bill on the general level of economic activity could be substantially modified or even reversed as a result of national monetary policy; i.e., policy having to do with the easing or tightening of credit.

Actual experience, as well as theoretical analysis of the way our economic and financial institutions function, indicates that restrictive monetary policies may dampen or completely inhibit expansionary economic tendencies. In fact, if it is sufficiently restrictive, monetary policy may set in motion forces leading to a reversal of the expansionary process and thus result in a downturn in economic activity.

This overt recognition by the President of the fact that monetary policy must be coordinated with tax policy, if the new tax law is to have the anticipated expansionary effect, however, should not be construed to mean that such coordination will actually materialize.

As matters now stand, it is quite possible for U.S. monetary policy to be oriented toward one set of goals, while fiscal policy (Government policy with respect to taxation, expenditures, and budgetary deficits or surpluses) is oriented toward goals, not only different, but actually incompatible with the goals of monetary policy.

The possibility exists because monetary policy, unlike fiscal policy, is not determined by the incumbent Federal administration. Instead it depends largely on decisions made by the monetary authorities of the Federal Reserve System. These authorities are the 7 members of the Board of Governors and the 12 Federal Reserve bank presidents. In practice, monetary policy is determined by the 12-man Federal Open-Market Committee which is made up of the 7 members of the Board of Governors and 5 Federal Reserve bank presidents. Presidents of the Federal Reserve banks serve on the Federal Open-Market Committee in groups of five on a rotating basis.

Monetary policy is generally carried out by means of three instruments; namely, open-market operations, reserve requirements, and the discount rate. The Federal Open-Market Committee determines its own monetary policies insofar as open-market operations are concerned. Insofar as reserve requirements and the discount rate are concerned monetary policy is detemined by the Board of Governors itself.

Federal Reserve bank presidents are appointed by the board of directors of their respective banks with the consent of the Board of Governors. The seven members of the Board of Governors are appointed by the President with the advice of the Senate to serve overlapping 14-year terms. However, although the Federal Reserve Act specifies that members of the Board of Governors are appointed by the President, the act does not specify that they are to be responsible to the President. For that matter, neither does the Federal Reserve Act specify that they are responsible to Congress. All that the Federal Reserve Act specifies on this point is that the Board of Governors shall submit an annual report of its activities to the Speaker of the House of Representatives.

Members of the Board of Governors and Federal Reserve bank presidents may, of course, be summoned before either House or Senate or before legislative committees or subcommittees for questioning, but the same is true of key officials in various Government agencies (such as the Department of Agriculture, or the Department of Commerce) although these agencies are directly responsible to the President, rather than to Congress.

With respect to matters of monetary policy, therefore, the Federal Open Market Committee regards itself as autonomous. On several occasions in recent years, various members of the Board have stated explicitly that they consider themselves independent of the Federal administration, and that in matters pertaining to monetary policy they act and will continue to act in a fashion consistent with this attitude toward their status.

Only a few days after President Johnson submitted his Economic Report to Congress, William McChesney Martin, Chairman of the Board of Governors of the Federal Reserve System, testified before the House Banking and Currency Committee that the Board of Governors and the Federal Open Market

Committee would not necessarily be guided by President Johnson's views on monetary policy. A report on these hearings published in the financial section of the New York Times, Sunday, January 26, stated that "Mr. Martin firmly insisted [that the tax cut] may hold 'inflationary dangers' that the Federal Reserve Board would strive to contain."

An objective review of monetary policy during the past 10 or 11 years reveals that the present concern of the Federal Open Market Committee with "inflationary dangers" is completely consistent with the concerns and attitudes that have furnished the basis of its policymaking decisions since 1953.

The Federal Open Market Committee has consistently regarded avoidance of inflation as the primary objective of monetary policy and has not regarded reduction of unemployment as an objective of comparable importance. In fact on several occasions the committee has instituted restrictive monetary policies which counteracted expansionary policies adopted by the Federal administration for the purposes of stimulating economic activity and decreasing unemployment.

This lack of coordination between monetary policy and administration economic policy has been commented on in rather forceful language in several reports of the Joint Economic Committee of the House and the Senate, and the committee has strongly urged the monetary authorities to desist from this practice and instead to coöperate with the administration. There is no evidence, however, that the Federal Open Market Committee has ever seriously considered modifying its attitudes and behavior in the fashion urged by the Joint Economic Committee.

The present situation, therefore, cannot properly be regarded as unique. It should, however, help to focus public attention on the nature of the present relationship between the Federal Reserve authorities and the Federal administration. It should also help to bring to the forefront of public consciousness such questions as whether that relationship is a sound one, or whether it should be modified, and whether it could be modified without drastically changing the nature of the Federal Reserve System.

Representative Wright Patman, chairman of the House Banking and Currency Committee, has been an outspoken advocate of the point of view that closer coordination between the monetary authorities and the administration is highly desirable. He has suggested that this might be achieved by making the Secretary of the Treasury a member of the Board of Governors of the Federal Reserve System, and hearings on this whole matter are currently being conducted by the House Banking and Currency Committee.

A legislator always has difficulty getting his bill approved by Congress, especially if the administration is not actively supporting it, and it seems highly doubtful that Representative Patman's approach will result in a speedy, satisfactory resolution of the situation.

It is highly doubtful that the Secretary of the Treasury on the Board of Governors would result in genuine coordination of monetary policy with other aspects of public economic policy, if the composition were not otherwise modified and if the powers of the Board as presently conceived, were not changed either.

Moreover, there is reason to believe that inclusion of the Secretary of the Treasury on the Board of Governors would lead to other difficulties. During the years 1914–35 (the first 21 years of the Federal Reserve System), the Secretary of the Treasury was not only a member of the Federal Reserve Board (the precursor of the present Board of Governors), but also its ex officio chairman.

Experience indicated, however, that it was desirable for the Federal Reserve System to function independently of the U.S. Treasury, rather than in a fashion subservient to the Treasury. Accordingly when the Federal Reserve Act was overhauled in 1935 and the Board of Governors was established to replace the earlier Federal Reserve Board, the new legislation did not require that the Secretary of the Treasury be a member of that body.

In view of this earlier experience it is not likely that Representative Patman will be able to muster very strong support for his proposal. Moreover, there is reason to believe that Representative Patman is attempting to achieve his true goal by an unnecessarily circuitous, as well as hazardous, route.

Independence of the Treasury is not synonymous with complete independence of the administration or of the President. The two should not be confused with each other or equated. In deliberately failing to include the Secretary of the Treasury as a member of the Board of Governors, even though he had previously been ex officio chairman of the Federal Reserve Board, Congress was not motivated by the desire to make the Board of Governors completely independent of

the President. Congress merely wished to free the Board from subservience to the Treasury. Carter Glass during a discussion of the desirability of this change said——

"* * * I know it to be a fact * * * that [the Secretary of the Treasury] exercised undue influence over the Board; that he treats it rather as a bureau of the Treasury * * *"

When deliberations on the 1935 legislation had been virtually completed and the final bill as approved by the Senate-House conference committee was being explained to the House of Representatives, Henry B. Steagall, a member of the conference committee, in referring to the broader implications of the amendment, observed, "The President of the United States is clothed with the power to reorganize the Federal Reserve Board. So as to bring the [Federal Reserve] System with its vast resources and powers into full harmony with the advanced policies of the present administration."

Marriner S. Eccles, first Chairman of the Board of Governors which, in accordance with the 1935 legislation, was established to replace the earlier Federal Reserve Board, regarded the Board of Governors as a part of the administration and himself as a member of the President's official family. Numerous references to this relationship during the 14 years that he served as Chairman of the Board of Governors may be found in his autobiography, "Beckoning Frontiers." At the same time, Eccles regarded the Board as a nonpolitical agency in the sense that its members would not participate in party politics or in political campaigns.

By word and by deed, President Franklin D. Roosevelt lived up to this conception of the relationship between the Board of Governors and his administration and the position of the Chairman of the Board in his official family. A close relationship between the Board of Governors and the President with respect to all important issues involving national economic policy was accepted as normal and proper during these years.

After Truman became President, however, the relationship between the Board and the President ceased to be so close and the Chairman of the Board was requested not to speak on behalf of the administration in appearances before congressional committees. Nevertheless, this cooling of the relationship between the President and the Board did not come about in such a way as to justify the claim that the Board is completely independent of the President and is not accountable to him when it chooses to exercise its monetary powers for the purpose of influencing the general level of economic activity and the general price level.

The Board of Governors during the past 10 or 11 years has conceived of itself as an agency completely independent not only of the Treasury, but also of the President, and has acted and expressed itself accordingly. But there is good reason to doubt the validity of this conception of the Board's powers, prevalent though it is at the present time.

The Board of Governors does not have an explicit mandate from Congress to use its powers in such a way as to influence the general level of economic activity or the price level. This fact has long been known to at least a few recognized authorities in the field of money and banking. Prof. G. Leland Bach who conducted the Hoover Commission study of the Federal Reserve System has written, "There is no clear-cut mandate or set of standards prescribed by [the Federal Reserve Act] for the exercise of the Federal Reserve's broad powers of monetary control." Senator Paul H. Douglas has pointed out more than once and in rather forceful language that the Federal Reserve System does not have a clear-cut directive from Congress with respect to monetary policy.

Nevertheless, William McChesney Martin, as Chairman of the Board of Governors snce 1951 stanchly maintains that the Board does have a mandate to promote broad national goals by the use of monetary policy. He has said so repeatedly during appearances before various congressional committees.

Unable to state that this mandate is explicit, Mr. Martin claims that there is an implicit mandate to this effect. Appearing before the Senate Committee on Finance in 1957, Mr. Martin conceded, "The Federal Reserve Act does not contain any provision specifically stating that the objective of the Federal Reserve System is to promote conditions that will foster sustained economic growth and stability in the value of the dollar [i.e., a stable price level]. "However," he continued, "this objective is implicit in the title of the act and * * * together with the declaration of policy contained in the Employment Act of 1946, it is clear that the promotion of credit conditions conducive to economic growth and the maintenance of the stability of the dollar is one of the most important objectives of the Federal Reserve System."

The substance of this statement, with minor variations, has been repeated on numerous occasions. Moreover, it is because the Federal Reserve System has been functioning in a manner consistent with this statement that there has been a marked lack of coordination of monetary policy and fiscal policy on several occasions during the past few years.

Reiteration of the Federal Reserve Board's belief, as expressed by Chairman Martin, that the Board has an implicit mandate to promote "credit conditions conducive to economic growth and the maintenance of stability of the dollar." and that in fulfilling this mandate it is independent of the President, has apparently been sufficient to convince many important Federal officials and Members of Congress that this is indeed so. Thus, in acting independently of the President, as it has in recent years, the Board of Governors has never seriously been challenged.

But a careful reading of the legislation referred to in the above quoted statement of Chairman Martin (i.e., that title of the Federal Reserve Act and the Employment Act of 1946) does not reveal any valid basis for the claim that the Board has an implicit mandate to modify credit conditions for the purpose of influencing the general price level and the general level of economic activity and that it can do so independently of the President.

The language used in the title of the Federal Reserve Act is simple enough. It states that the purposes of the act are to establish Federal Reserve banks, furnish an elastic currency, and afford means of rediscounting commercial paper. The exercise of monetary policy in a fashion consistent with Mr. Martin's statement is not implicit in the title of the act, nor is it implicit in any portion of the Federal Reserve Act, either as originally passed by Congress in 1913, or as subsequently amended.

The possibility that its monetary powers would be used by the Federal Reserve System for the avowed purpose of influencing the general level of economic activity or the general price level probably never occurred to those who helped to formulate the original Federal Reserve Act. Both Carter Glass and Woodrow Wilson were influential in determining the character of the Federal Reserve System which first came into existence in 1914, in accordance with the terms of the act which had been passed in the preceding year.

Use of the powers of the Federal Reserve System in the fashion indicated is completely inconsistent with the political philosophy and the values adhered to by these men.

Enough is known about the beliefs, the words, and the deeds of these men to make it apparent that, if they had ever contemplated the possibility that the Federal Reserve authorities would deliberately act in such a way as to influence the general level of economic activity and the general price level, they would have attempted to modify the act and the Federal Reserve System so as to deny any such exercise of power to the monetary authorities.

In 1935, when the Federal Reserve Act was substantially amended, Congress considered the possibility of granting broader policymaking powers to the monetary authorities and including a specific mandate to them. But Congress decided against doing so. Since Senator Glass helped to influence this decision, there is little doubt as to what his attitude was.

The bill initially approved by the House of Representatives in 1935 contained a provision stating that it would be the duty of the Board of Governors to exercise its powers "in such a manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action and credit administration."

In the view of the Senate, however, this provision went too far and it was accordingly deleted from the version of the bill approved by the Senate. The House-Senate conference committee followed the lead of the Senate, so that the version of the bill eventually enacted into law did not contain any such provision. Commenting to the House of Representatives on the proceedings of the conference committee, Representative T. Allan Goldsborough said—

"* * * there was a mandate in the House bill. When we got into conference we found that if we insisted on any sort of mandate at all we would get no bill."

In the light of these facts, the contention that the Federal Reserve authorities were given an implicit mandate in the Federal Reserve Act of 1935 to use their powers in such a way as to influence the general level of economic activity or the general price level does not appear valid.

The true situation appears to have been clearly understood in the period immediately following passage of the 1935 legislation. On several subsequent occasions legislation designed to accomplish, at least in part, the purpose of the deleted provision was considered in Congress, but no such legislation was ever approved.

The claim that the Federal Reserve authorities have an implicit mandate to use monetary policy for the purpose of influencing the general level of economic activity and the general price level generally included reference to both the title of the Federal Reserve Act and to the declaration of policy of the Employment Act of 1946. We have already seen that neither the title of the Federal Reserve Act nor any other portion of the act contains such a mandate, and that the absence of such a mandate was not the result of oversight on the part of Congress, but was instead the result of deliberation, argument, and consciously made in the course of the legislative process.

It remains to be seen whether the declaration of policy of the Employment Act of 1946 contains an implicit mandate to the Federal Reserve authorities to use their powers for the purpose of influencing the general level of economic activity and the price level and to do so independently of the President. The declaration of policy of the Employment Act of 1946 does set forth certain broad goals of national economic policy. However, neither the declaration of policy nor any other portion of the Employment Act of 1946 includes any mention of the Federal Reserve authorities.

During preliminary hearings on the legislation no member of the Board of Governors testified before any of the congressional committees involved. For about a year after the Employment Act of 1946 came into effect no reference to the legislation was made either in the Federal Reserve Bulletin, published monthly by the Board of Governors, or in the annual report of the Federal Reserve System. Not even the passage of the act was noted in these publications. In fact, until a number of years had passed there was no indication whatsoever that the Board of Governors considered that this statute had any particular significance with respect to the Board's exercise of its monetary powers.

The real issue, however, is not whether the Federal Reserve authorities can or should use their monetary powers to influence the general level of economic activity and the general price level.

Few, if any, responsible public officials or reputable economists would seriously argue that the Federal Reserve authorities cannot or should not be allowed to use their powers in such a fashion. The Federal Reserve Act as amended gives the Federal Reserve authorities certain powers for the purpose of accommodating business and industry and preventing various monetary and banking abuses which might hamper the smooth functioning of the economy. These include the power to regulate minimum reserve requirements for member banks, the power to regulate the discount rate (the rate of interest commercial banks must pay when they borrow money), and (most significantly) the power to engage in open market operations; i.e., the power to buy and sell securities, commercial paper, and foreign exchange in the open market.

Although Congress did not originally conceive of these powers in such terms or grant them for such purposes, it has become abundantly clear in recent decades that the exercise of these powers (especially the power to engage in open-market operations) may have a marked effect on the general level of economic activity and the general price level. If properly exercised they can be very useful tools of public economic policy.

The real question, most economists and responsible public officials would probably agree, is not whether these tools should be consciously used to achieve certain broad goals of public economic policy, but rather whether the Federal Reserve authorities are justified in using them independently of the President. In other words, do the Federal Reserve authorities have the power or should they have the power to determine, independently of the President, the principal objective(s) of public economic policy and the power to exercise monetary policy in a fashion consistent with their objective(s) even if this involves counteracting national economic policy as enunciated by the President.

The Employment Act of 1946, although it does not contain any mandate to the Federal Reserve authorities, does contain an explicit mandate to the President. It is his responsibility to coordinate the efforts of the various agencies of the Federal Government to achieve the goals set forth in the declaration of policy.

The declaration of policy states—

"that it is the continuing policy and responsibility of the Federal Government to use all practical means * * * to coordinate and utilize all its plans, functions, and resources * * * to promote maximum employment, production, and purchasing power."

Other portions of the act indicate more specifically that it is the President who has the responsibility of achieving the required coordination of all "plans, functions, and resources" to achieve these ends.

Perusal of the debates in Congress preceding passage of the Employment Act of 1946 should be sufficient to resolve any lingering doubts on this matter. It was the deliberate intent of Congress to strengthen the role of the President with respect to the determination and implementation of national economic policy. On the other hand, no reference was made in these debates to the powers of the Federal Reserve authorities, nor was any mention made of their right to exercise their powers independently of the President. In fact, on one or two occasions it was observed that monetary policy would be used by the President to promote the purposes of the legislation.

When the legislation had been revised for the last time and the Senate was about to vote on it, Senator James H. Murray pointed out that the bill made it clear that "the basic responsibility for developing the employment program within the executive branch is that of the President. * * *" "The effect of this act," he continued, "* * * is to underscore the responsibility of the President as the elected representative of the entire country, and as head of the executive branch of the Government."

In recent years many well-informed citizens as well as Members of Congress, other public officials, and professional economists have come to recognize that the two most important sets of tools that can be used in determining and implementing public economic policy in the United States are the tools of fiscal policy and the tools of monetary policy. Somewhat less well known is the fact that certain tools of monetary policy are apt to be speedier and more flexible than any of the tools of fiscal policy. The tools of monetary policy are particularly likely to be efficacious when used in restrictive fashion. If used for restrictive purposes, they cannot fail to counteract, at least to some extent, the effect of any fiscal policy deliberately adopted for the purpose of stimulating an expansion of economic activity.

It is impossible for the President to discharge the responsibilities assigned to him in the Employment Act of 1946 unless he exercises the power to coordinate national monetary policy with national fiscal policy. Moreover, it is possible for the President to exercise this power without the passage of new legislation or a change in the composition of the Board of Governors, as proposed by Representative Patman. It may be desirable to have additional legislation in order to clarify the situation. But the basis for such exercise of power by the President already exists both in statute and in historical precedent.

The Structure of the Federal Reserve System

(By Profs. Harvey Mansfield and Myron Hale, Political Science Department, Ohio State University)

STAFF MEMORANDUM

To a degree perhaps unique among major Federal agencies the Federal Reserve System is self-made. Its prime objectives, its principal instrument for reaching toward them, its manner of disposing of its huge earnings, and its central governing body for deliberation and decision, are all largely of its own devising. This study is an inquiry into the working constitution—what may be called the structure of influence, as distinguished from the formal structure—of the System. The distinction is important, especially from the viewpoint of the Congress, which launched the System into being, which in theory can alter it at will, but which in fact has disarmed itself and intervenes only sparingly. The Atomic Energy Commission, the Defense Department, the State Department, well might envy the status the Federal Reserve has achieved as master in its own house.

This has not come about because the statute spelled out the System's organization and duties so clearly as to leave it only ministerial tasks to be performed according to rule. The Federal Reserve Act as amended—the System's "constitution"—runs to a little over 100 octavo pages of official print, to be sure, and it

has been amended more than 100 times in minor ways. Yet, like the Federal Constitution, it conveys a very incomplete and imperfect understanding of the operative structure of the institutions it established. That structure has been both praised and severely criticized; and in the course of a half century it has indeed been significantly modified. Only one of the amending laws, however, the Banking Act of 1935—passed nearly three decades ago in extraordinary circumstances—played a signicant part in the structural changes; and some of the most criticized features have remained, in outward appearance at least, unaltered from the beginning. Most of the significant changes have come about by processes of internal adaptation to unforeseen conditions, to newly discerned needs, and to reappraisals of prevailing forces in the System's environment. Since the tie between the statutory base and current practice is often tenuous, it is instructive to ask how official discretion has come to be so relatively untrammeled by superior authority, as well as to trace the directions it has taken and the articulation of the component parts of the System.

As the System began, its founders viewed it, in Goldenweiser's words, as "a cooperative mutual aid enterprise among member banks, under general supervision of the Government.[1] It became a central bank in 1935 and achieved its present independence from the administration in the 1951–53 period. The immediate objects of the framers were to provide an "elastic currency," to "afford means of rediscouting commercial paper," to effect at once a pooling and a distribution of bank reserves in a number of regional Reserve banks, and, in the interests of greater safety both for banks and for their depositors, to "establish a more effective supervision of banking." The statute said nothing explicit of the further aims these objects were intended to serve, beyond authorizing the Reserve banks to charge discount rates "which shall be fixed with a view of accommodating commerce and industry" (sec. 14(d)). But the stated functions have long since come to be taken largely for granted and reduced to routines, many of them mechanized and partly automated. The policy concerns of the System are addressed instead to objectives not merely beyond the ken of the framers but beyond what they would have supposed was within the orbit of deliberate human influence—employment levels, price levels and aggregate economic growth rates, here and abroad.

This enlargement of horizons cannot be explained by the modest increases in direct statutory responsibilities since 1913, nor even by the Employment Act of 1946. It is traceable rather to the vast increase in the financial resources at the disposal of the System, together with a more sophisticated understanding of the potentialities and consequences of their use—to its financial power, that is to say—and to the intangible attributes of legitimacy and prestige accorded to it. Concretely, the main source of the System's present power is its ability to engage in and give unified direction to large-scale open market operations. In its train, the exercise of this power has enforced a wider concept of responsibility.

The authority for open-market operations dates back to the original act, though in practice they were then confined—in accordance with prevailing central banking theory—to commercial paper almost entirely. Each Reserve bank was given power to buy and sell Government securities and commercial paper. Unified or coordinated trading by the 12 Reserve banks was not authorized by the 1913 act. Thus, as initially established, the Federal Reserve consisted of 12 regional banks, each with independent and potentially rival central banking powers. Not until 1935 did Congress convert the Federal Reserve System into a central bank. Statements made by Carter Glass and others in support of the Federal Reserve Act of 1913 often are cited today to buttress the argument for an independent central bank. It is, of course, not appropriate to do this since under the 1913 act the economy did not have a central bank. A central bank was established in 1935 and the principal power it was granted was the power to conduct open market operations. The assets that now furnish the wherewithal for open market operations are almost completely U.S. Government securities. This development had its origin in World War I when the Reserve banks used their money-creating powers to help finance the war. The Government securities which the Reserve banks "bought" over the years have, of course, made them "independently wealthy"; and, with riches and a growing skill in using them came a growing influence. In fiscal 1917 the Reserve banks together for the

[1] "American Monetary Policy" (New York, 1951), p. 81.

first time earned a surplus above expenses, dividends and a franchise tax; it amounted to $1.1 million. In 1920 the annual surplus reached $82.9 million. During the war the System's assets grew tenfold, from $2.5 to $25 billion. In 1942 the annual surplus was $3.6 million, and in 1946, despite the low interest rates prevailing in World War II, it was $81.5 million. By 1962 the System's assets included some $30.8 billion in Government securities. It is interesting, if idle, to speculate on what would become of the System's influence if its income from U.S. Government securities were ended. One immediate consequence would be the disapearance of the System's main source—some 99 percent—of its earnings; and with it, the System's ability to provide, free of charge, its principal service to member banks, the clearance of checks. Lacking another source of earnings, its free services to banks like check clearing would be either eliminated or paid for by the commercial banks and their customers.

Despite its affluence the System would hardly have reached its present position of independence and influence if it had not managed, despite its mistakes, to avoid the main poliitcal blame for economic disasters occurring over the years. The System has had two close calls, and both left their marks. This is not the place for a reappraisal of its performance on either occasion. It is enough to note first, that in the aftermath of the collapse of stock market and commodity prices and widespread unemployment that began in June 1920 the Federal Reserve was bitterly attacked, especially in the farming areas, for its action in raising discount rates that spring, and in keeping them up for over a year when heavy liquidation was proceeding. A congressional investigation followed, and legislation in 1922 that enlarged the Federal Reserve Board to make room for a farmer but otherwise left the formal structure intact. The internal responses of the System during the ensuing 2 years, 1922–24, were more significant. The first Open Market Committee of Governors was formed in 1922 under the leadership of Governor Strong of the New York Reserve Bank. At the same time the Reserve Board brought in Walter W. Stewart to head its Division of Research and inaugurate of new era in the gathering and mobilization of economic intelligence in the service of monetary and credit policy. In 1923 the Board asserted its jurisdiction to control open-market operations, and by 1924 the Open Market Committee, at least, had come to a dawning realization of the economic function it was really performing by influencing the amount of member bank reserves. These 2 years were a formative period in the progress of central banking theory and practice.[3]

The second and more serious occasion was of course the great depression following the stock market crash in 1929. The Board had been indecisive in 1928–29, a majority taking the position that it was not responsible for speculative excesses financed with funds from other sources than Federal Reserve credit. The Open Market Committee had been restrictive since the fall of 1927. In consequence, the volume of money had not increased since late 1927. After the crash it did too little too late. In fact, in 1931 credit was temporarily tightened when the Reserve banks became concerned about their own reserve positions, in the face of threatened gold withdrawals by the Bank of France. And banks went under because statutory restrictions and prevailing concepts limited the help the Reserve banks could give them to the amounts that could be covered by eligible paper. When all banks closed in March 1933 the one event that the Federal Reserve Act was supposed to have made impossible nevertheless occurred. The main blame, however, fell on Wall Street, politically speaking. The Federal Reserve emerged shaken and utimately reorganized, but with its powers rather increased than diminished. Technical amendments to the statute, hurriedly passed in 1932 and 1933 broke the shackles of orthodoxy by making Government bonds acceptable as collateral for advances to member banks and as a backing for the issuance of Federal Reserve notes. The Governor of the Federal Reserve Board became the first Chairman of the Reconstruction Finance Corporation, to give infusions of Government credit in situations beyond the Reserve banks' powers. Finally in 1934 the Reserve Board was given vigorous new leadership with the appointment of Marriner Eccles as its Governor, to whom the President pledged full support for an overhauling of the Federal Reserve Act and a reconstitution of the Board.

[3] Ibid., ch. 8; L. V. Chandler, "Benjamin Strong, Central Banker" (Washington, D.C. Brookings Institution, 1958), ch. 6.

The Banking Act of 1935 authorized Reserve bank advances to member banks on short-term notes "secured to the satisfaction of" the Reserve bank, and it gave the Board a range of discretion over reserve requirements. Among its structural changes it removed the Secretary of the Treasury and therefore, at his insistence, the Comptroller of the Currency also, from the Board and lengthened the terms of Board members. But it is chiefly remembered for its assertion of the nominal if not actual primacy of Washington over Wall Street. The title of Governor, a symbol of prestige in European central banking which the Reserve bank directors (in a curious inversion of American political usage) had conferred on their chief executive officers, was taken away from them and appropriated to the Reserve Board, renamed the Board of Governors. The heads of the Reserve banks were instead to become presidents, their appointments subject to the approval of the Board in Washington. Along the same line, the Open Market Committee—renamed the Federal Open Market Committee—was reconstituted to consist of the seven Board members and five Reserve bank presidents. The Federal Advisory Committee was left unchanged on paper, but Eccles put a stop to its practice of issuing anti-New Deal public statements without consultation with the Board. He also secured the discharge of the System's legislative committee, previously headed by the Governor of the New York Reserve Bank. Lastly, the confirmation of Eccles' appointment by the Senate and the ultimate passage of the act were political defeats for George Harrison, then Governor of the New York bank.[3] These were material changes, and imposed on the System from above.

In the aftermath of World War II the postwar depression that many expected did not materialize; instead, strong inflationary forces persisted through 1947. After 1947 to mid-1950 when the Korean war began, there was no inflation; in fact in 1949 there was a recession. Inflation renewed with the outbreak of war in Korea. This produced a crisis for the System, but of a different sort. From June 1950 until mid-1951, Federal Reserve authorities continued to support Government bond prices, a policy that the Treasury continued to insist on. During the first 6 months of the Korean war indexes of commodity and wholesale and retail prices nevertheless increased at a faster rate than they had during World War II. Many called for monetary restraint. The critics who advocated credit restraint were not, by and large, seeking congressional intervention, though the Douglas subcommittee of the Joint Committee on the Economic Report held hearings in 1949 and 1950.[4]

Instead of new legislation this time, therefore, the result was a clash between the Treasury and the Federal Reserve, kept more or less behind the scenes until Eccles—by then no longer Chairman but still a Board member—brought it into the open on his own motion early in 1951. The upshot was the "Accord" in March, announced as such without immediate elaboration. As it turned out, this meant that the System, by a series of technically ingenious maneuvers, saw the Treasury through the nearby program of refundings without loss of face, and thereafter regained its freedom of open market action. Chairman McCabe resigned from the Board almost at once, and Eccles shortly after him. The System moved toward its fifth decade under new leadership, with a scope of discretion for the exercise of its powers that it had not had for the previous 20 years.

The reemergence of monetary policy as a separate instrument coincided with a reemergence of a widespread faith in its potency as a major and manageable influence on the economy. It concided also, roughly, with the reemergence of a dominantly conservative mood in American politics that prevailed on the whole through the 1950's. It led to no overt changes in the System's structure, though there were internal shifts in the weight of influence. It perhaps led to the overt acknowledgement of a broader range of concerns, including an expressed concern for the goals of the Employment Act of 1946. It provoked two notable outside efforts at reappraisal of the performance of the System, by the Patman subcommittee of the Joint Committee on the Economic Report in 1952[5] and by

[3] See Marriner Eccles, "Beckoning Frontiers" (New York, 1951), pp. 165–229.
[4] Subcommittee on General Credit Control, Joint Committee on the Economic Report, hearings, "Monetary, Credit, and Fiscal Policies" (1949), and "Monetary, Credit, and Fiscal Policies, a Collection of Statements," S. Doc. 132, 81st Cong., 2d sess. (1950).
[5] Subcommittee on General Credit Control, Joint Committee on the Economic Report, "Monetary Policy and the Management of the Public Debt, Replies to Questions (Compendium)," S. Doc. 123, and report, S. Doc. 163, 82d Cong., 2d sess. (1952).

the Commission on Money and Credit.[6] It also provided the first example in the System's history of the survival of the Board Chairman, by successive reappointments, from the administration in which he was first appointed through the next succeeding one—indeed, through two and into the third—with their changes in party control.

Confidence in the efficacy of monetary policy was challenged again in the early 1960's. A creeping but persistent rise in unemployment, and dissatisfaction with the low annual rate of growth in the economy—as compared with conditions in some other countries—appeared to call for increasing the rate of growth of the volume of money, on the one hand, while on the other hand alarm over the large and equally persistent deficit in our balance of international payments seemed to dictate higher domestic interest rates. Characteristically, the response of the System to this tension, once more, was not to seek legislation involving added powers or structural changes, but rather to work out the problems through internal adaptations. On the structural side, these consisted chiefly in developing closer coordinating ties with the Treasury, joining the Treasury in a new network of agreements with major foreign central banks and the International Monetary Fund for borrowing and swapping each other's curencies in large amounts, and building up the New York Reserve Bank's staff as the operating agency both for these transactions and for carrying out the System's new policy of open market operations in foreign exchange. A new era of good feelings between the two agencies, Treasury and Federal Reserve, enused. Significantly, in 1951 President Truman and Secretary Snyder had moved Assistant Secretary Martin over to head the Federal Reserve. Now, in 1961, President Kennedy turned to the leading professional among the New York Reserve Bank vice presidents, Robert V. Roosa, to find his new Under Secretary of the Treasury for Monetary Affairs and Debt Management.

Looking back from 1963 to 1913, some general trends in the structural evolution of the Federal Reserve System are plainly evident. The influence of member banks on Reserve bank policies in the several districts has diminished. What is another way of saying much the same thing: the influence of Reserve bank directors on Reserve bank presidents has diminished. But they still exercise some influence and reinforce clientele interests. The room for divergent policies among the several Reserve banks has diminished. The ability of the Federal Advisory Council to act in public as a quasi-official critic of Government policies has vanished; it must work through inside channels or not at all. The influence of the Reserve banks—i.e., of their presidents—collectively on System policies has diminished; and conversely, the influence of the Board of Governors on these policies has increased. The influence of the New York Reserve Bank, however, remains high. The influence of the Board Chairman on System policies and Board actions has on the whole increased, though this is a function of personalities in part; it was at a peak in 1963. His influence in the wider economic councils of the Government has fluctuated; it varies directly with the standing he holds in the confidence of the President and the Secretary of the Treasury, and with the importance attached to monetary policy in the economy at different times; i.e., it is lower in wars and depressions when overriding considerations determine that policy, and higher in more "normal" peacetime conditions when there is more latitude for discretion. The influence of the Congress over the System, finally, has diminished.

Whether these trends are in the right direction, whether they have gone too far or not far enough, are matters of dispute and of longstanding argument. Running through the discussions they have provoked, several persistent issues recur: (1) the nature and sources of the System's mandate; i.e., who defines its goals, and on what criteria; (2) the proper relationships of the System to its banking clientele, to other agencies of Government, and to foreign central banks and governments; (3) the internal balance between the Board and the Reserve banks, and more especially the New York Reserve Bank; (4) the form and degree of public accountability, and the System's claims to privacy; and (5) the gains and costs involved in changing outward structural features to accord more closely to present-day purposes and functions. These issues warrant a little elaboration.

[6] "Money and Credit: Their Influence on Jobs, Prices, and Growth" (New York, 1961).

BASIC ISSUES

The statutory mandate and its ambiguities

The original Federal Reserve Act contemplated a number of fairly concrete and immediate purposes and functions for the system it established, and gave more or less specific directions for their conduct; for example, regarding the issuance of Federal Reserve notes, the discounting of eligible commercial paper, the maintenance of reserves, and the examination of banks; a lengthy list of this sort could be compiled. Many of these instructions later became outmoded and either were ignored as dead letters if they were harmless or were repealed, circumvented, or amended if they got in the way; many more have been added to the list by subsequent legislation, such as the Bank Holding Company Act of 1956.

These service and regulatory activities occupy most of the time and energies of most of the people, as well as most of the physical facilities, employed in the System. The service activities have taken on very large-scale proportions. Upward of 4 billion checks a year, for instance, are cleared, free for member banks. Over $30 billion in coin and currency are handled annually and, in 1962, some $640 billion in Government securities were issued and redeemed. Statistical staffs gather, interpret, and disseminate masses of information widely used by analysts and others outside the System as well as within it. The regulatory activities help reassure the country that banks are sound, and the adjudications of merger and branching applications, etc., settle local competitive disputes. These cases are often controversial, and time consuming for Board members. But the Board's jurisdiction in both sorts of regulation is interstitial, hemmed in by the overlapping responsibilities of the Comptroller of the Currency for national banks, of State authorities for State-chartered banks, of the FDIC for insured banks, and of the Attorney General and the SEC. Even where jurisdiction exists, the Board's discretion is further limited by the statutory direction to Federal authorities to follow State policies in matters of branching and the like. Piecemeal action and shifting viewpoints and personalities in the numerous agencies concerned preclude the systematic use of these regulatory powers for broadly conceived program purposes. Settling one local case does not control the outcome in the next.

Large as the service and regulatory functions bulk in the day-to-day operations of the System, they bear only indirectly on its longer range purposes. They are consonant with a narrow conception of a "cooperative enterprise among banks," though not necessarily with the broadest conception of national monetary management. Even to say—taking account of the development of open market operations—that the main function of the System is to influence the availability and cost of money, does not answer the question of the longrun goals.

The longrun goal most congenial to Federal Reserve authorities, as well as to their banker clientele, is what is euphemistically referred to in campaign speeches as a sound dollar; that is, price stability, which means in practice, higher interest rates as other prices go up. This is a congenial goal because it is an easy one for the central bank to do something about, by restricting the supply of money, and because its immediate effect is to improve bank earnings. But it is by no means the only or the ultimate goal that is desirable for the national economy. In real terms, full employment, an expanding output of goods and services adequate for a growing population, the abolition of pockets of poverty, contributions to the strength and development of underdeveloped lands abroad, and other economic goals may be equally important. Moreover, they are not all attainable at once without conflict among them; in the short run, surely, emphasis on one may be at the expense of progress toward another. So choices must be made, trading off advances along one line against the costs of stagnation along another.

The question of goals is clearly within the province of Congress, yet it is remarkable how little clarification Congress has given it in legislation, however sharp the views of individual members or committe majorities have sometimes been. The original Federal Reserve Act was strictly instrumental in the list of purposes stated in its preamble, and with apparently deliberate ambiguity used merely the phrase "with a view of accommodating commerce and business" as a guide to the extension of credit and fixing of discount rates (secs. 4 and 14(d)). Amendments in 1923 added agriculture to these objects of solicitude but did not change the passive attitude implied by "accommodating." Amendments had also been hurriedly adopted in 1917 to enable the System to accommodate the Treasury's need to finance the huge Government outlays for World

War I. At the expense of some previous theory, the law was changed to make loans secured by Government bonds eligible for discounts and advances, like commercial paper. A preferential discount rate at the Reserve banks for such loans, and installment terms of payment for the bonds, encouraged purchasers to borrow, and banks to lend, the funds required to oversubscribe successive Treasury issues—at successively higher rates. The temporary subordination of other objectives to the Treasury's needs was not written into the law; it was taken for granted.

After the war the Reserve banks themselves introduced some quite parochial criteria, now long since abandoned. Early in 1920 they adopted a tight money policy largely out of anxiety to maintain their own reserve positions, which were threatening to drop below the then legal minimums of 40 percent against Federal Reserve notes and 35 percent against deposits. The result was depression which was especially severe in farm areas. They were to do this again in even more distressingly wrong circumstances in the autumn of 1931 after England went off the gold standard.[7] On the other hand in 1922 they contributed unwittingly to easier monetary conditions when they bought Government securities on the open market for the first time on a sizable scale, in order to improve their own earnings, which had been impaired by the wholesale liquidation of the previous 2 years. In the aftermath of this experience the Federal Reserve Board, prodded by the Treasury took a hand in policymaking. In April 1923 it asserted its jurisdiction over the newly reconstituted Open Market Investment Committee and directed that the Committee's actions "be governed with primary regard to the accommodation of commerce and business, *and to the effect of such purchases or sales on the general credit situation.* [Italic added.] This language, in substance, was carried into the law in 1933 when the Open Market Committee gained statutory recognition (sec. 12A(c)): The added phrase suggested a less passive role for the System but it left the Committee a wide-open discretion in its decisions.

The initiative of Governor Strong, of the New York Reserve Bank, introduced a new international perspective on System goals in the mid-1920's. His energetic activities to promote financial reconstruction and stability in Europe, in cooperation with Governor Norman, of the Bank of England, helped in the adoption of the Dawes plan, the return of the British (and later other countries) to the gold standard, and the floating of foreign loans in New York. These steps appeared at the time to be to the longrun advantage of the American economy. But the English economy experienced severe unemployment in the mid-1920's as a result. Official Washington was committed to stay aloof from negotiations between governments on these matters, and from participation in the League of Nations. Agreements between central banks were something else again. In the circumstances, the New York Reserve Bank became a quasi-official internationalist actor while the official government remained isolationist. When the ventures so undertaken collapsed with the collapse of the gold standard in 1931 the Reserve Board turned on the New York Bank, and the law was amended in 1933 to assert explicitly the Board's power to control foreign dealings by Reserve banks (sec. 14(g)). International cooperation was in abeyance from then until 1940. In the new era of financial interdependence that began in World War II and that received congressional sanction in the Lend-Lease Act, the Bretton Woods Agreement Act, the Marshall plan, and a host of other laws, the lead has usually come from the Treasury or other executive agencies rather than from the Federal Reserve. But the New York Reserve Bank, both through its voice in the Federal Open Market Committee and as agent for the System and the Treasury, has remained close to the center of policy formulation as well as its execution. And it is now a commonplace that the international aspects of monetary questions are key considerations in determining System policy, though there is little evidence that monetary policy has major impact on the U.S. balance of payments.

The revolution in economic thinking during the 1930's repudiated, among other things, the limited conception of central bank responsibilities that had been orthodox until 1929. So when the Banking Act of 1935 was under consideration, the House version contained a declaration of policy directing the Board of Governors "to exercise such powers as it possesses in such manner as to promote conditions conducive to business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employ-

[7] Chandler, op. cit., pp. 184–185; Goldenweiser, op. cit., pp. 158–159.

ment so far as may be possible within the scope of monetary action and credit administration."

At the insistence of Senator Glass, however, this effort to broaden the System's mandate expicitly was stricken from the bill in conference.[8] Nevertheless, when the system in 1939 published the first edition of its now familiar official handbook, "The Federal Reserve System: Purposes and Functions," it proceeded to describe its objectives as—

"to contribute, with other agencies, to economic stability"—

And—

"to maintain monetary conditions favorable for an active and sound use of the country's productive facilities, full employment, and a rate of consumption reflecting widely diffused well-being."

The Employment Act of 1946 did not mention the Federal Reserve when it declared—

"the continuing policy and responsibility of the Federal Government to use all practicable means * * * to promote maximum employment, production, and purchasing power."

Board spokesmen, however, have repeatedly affirmed that the goals of that act are also System goals. Certainly they should be.

Subsequent attempts in Congress to amend the 1946 declaration, to make it more explicit, or to add further objectives have all been defeated. But the Board has gone right on revising its own understanding. The 1947 edition of the handbook introduced price stability specifically, and qualified "full employment" to "sustained high employment." The 1954 edition added "growth" to the goals. The 1961 edition elaborated on growth and qualified stable prices with "relatively."[9] The 1963 edition brought a further element into its succinct statement:

"Today it is generally understood that the primary purpose of the System is to foster growth at high levels of employment, with a stable dollar in the domestic economy and with overall balance in our international payments (1963 ed., p. 2)."

The System has come a long way from "accommodating commerce and business."

It is questionable how much importance to attach to the shifting emphases in these successive policy statements. The absence of mention of balance-of-payments objectives prior to the 1963 edition, for instance, had not kept the System from anxiety or action on that score from the time when it became an acute concern in 1959 and 1960. What is more to the point here is the assumption that the several objectives listed are simultaneously compatible. However this may prove to be in the long run, nothing is more clear from recent history than that the short-run truth is to the contrary. In the context of official decision and action, some part of one objective must be sacrificed or jeopardized for progress toward another. The price of the trade-off is the crucial issue in each case. Neither the statute nor the handbook forecloses the decisions that matter on that issue. Realistically regarded, accordingly, the Federal Reserve's mandate not only is largely self-made; it is also continuously in the making. Is the System so much the master of its own course because it has demonstrated that it is better qualified than anyone else to determine where it should be going—and so deserves to be let alone—or because it has managed to put itself beyond the reach of effective control from outside? Should not Congress and the administration decide whether to trade, say, 2 million unemployed for a 1-percent per annum rise in the wholesale price index?

The independence of the System

The issue of independence has been argued at length on many occasions. It has two broad facets: The System's relationships with banks and bankers, and reflections of these in its internal structure; and its relationships with other governmental agencies. On both counts, outward appearances do not necessarily mirror working realities.

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[8] "Beckoning Frontiers," p. 228.

[9] L. S. Ritter, "Official Central Banking Theory in the United States, 1939–61; Four Editions of the Federal Reserve System: Purposes and Functions," reprinted in Joint Economic Committee, hearings, "State of the Economy and Policies for Full Employment," 87th Cong., 2d sess. (1962), pp. 982–997.

(1) The nature of the relationship with banks starts with the fact that membership in the System is voluntary for State-chartered banks: the costs and burdens entailed must not indefinitely appear in the aggregate to exceed the benefits derived. Evidently the advantages are so overwhelming as to make membership virtually compulsory for large banks; and doubtful or negative for small ones. Of the 13,400 commercial banks in the United States in 1962, about 6,000, somewhat less than half, were members (4,500 national and 1,500 State) but they accounted together for about 85 percent of deposits. The total number of banks has remained quite stable in recent years. Nevertheless, of 183 new ones formed in 1962, only 67 entered the System; and 25 existing members dropped out while only 15 nonmembers joined. The absence of so many small banks does not materially affect the influence of the Reserve banks over the total volume of bank credit. But it is, perhaps, a restraining influence against the imposition of additional reporting requirements or substantive restrictions on member bank activities. And it is also testimony to the conclusion that the intimacy of relations between the Reserve banks and member banks varies directly with their proximity and volume of business. The largest banks are the largest users and beneficiaries of Reserve bank facilities and services, and have the best access for bringing their viewpoints and interests to bear on Reserve bank thinking.

A different sort of relationship, of a disciplinary nature, derives from the responsibilities of the Reserve banks for examining member banks and for intervening in cases of trouble. But most of these responsibilities, as already noted, are the primary concerns of other agencies, State as well as Federal. The Reserve banks are only in a residuary degree the watchdogs of the integrity of member bank transactions.

A third relationship stems from the member banks' ownership of stock in the Reserve banks, and their election of six of the nine directors of each. This feature, that in the early days of the System seemed to warrant Secretary McAdoo's reference to the Reserve banks as "private corporations," has become an intellectual tie rather than a business partnership. As such it hinders the development of a wider responsiveness among the Reserve bank directors to the multiplicity of interests in the economy. But it plainly does not enable member banks to control Reserve bank policy.

On the other hand it assuredly reinforces the built-in banker bias in the environment in which Reserve bank policy is made and facilitates access for bankers' views. This is not control but it is influence, or a favorable situation for persuasion.

In this complex of relationships between the Reserve banks and the member banks, the stakes on the System's independence have been summarized by the Commission on Money and Credit in these words:

"The agency-clientele relationship, between a Government agency and the business concerns it both serves and regulates, is almost always, almost inevitably, close; and the more so after it has matured for decades. There are public advantages in this: regulation can be knowledgeable, its inconveniences can be minimized, personal working relationships can be easy. But the hazards of too close a relationship are also well known; conflicts of interest tempt individuals on either side of the public-private line to consult private advantage too far; organized interests among the regulated may first infiltrate and then paralyze their public regulators; even legitimate transactions and contacts risk misconstruction; *parties on both sides come to take too parochial a view of the national interest* (report, pp. 91–92, italic added)."

(2) The independence of the System from or within the rest of the Federal Government has been an article of faith for some, and a topic of ideological debate for a generation. Those who wish to insulate the central bank in particular from the political effects of unpopular moves, have sometimes—though not so often since 1954—invoked the image of a "supreme court of finance" as a symbol of their ideal. It would be profitless to pursue the argument in such rhetorical terms. The orthodox traditions of 19th-century central banking are irrelevant to an era in which the Board of Governors acknowledges the objectives of the Employment Act of 1946. The System operates in a field where other agencies, notably the Treasury, have important complementary and overlapping powers and responsibilities that are not likely to be taken from them soon. Independence in the sense of isolation was pushed to an impractical degree in the provisions of the Banking Act of 1935 fixing the terms of members of the Board of Governors. Because monetary developments have repercussions on all sectors

of our economy, it is out of the question for the Federal Reserve to do what it wishes irrespective of the views of the administration and Congress—the duly elected representatives of the people. At best this arrangement can produce "happy accidents" wherein the policies of the independent Federal Reserve are consonant with the rest of the Government. But, if the Federal Reserve pursues its own goals, conflicts are certain to occur. These clashes may be settled by revising fiscal policy—for example, a tight monetary policy may be offset by increased Government expenditures or a tax cut. At times, however, the conflict can be bitter and personal. To illustrate, we have only to recall the fate that lately befell the Governor of the Bank of Canada, who was dismissed from office in 1961 for pursuing a course in defiance of the Finance Minister. (See testimony of Scott Gordon, pp. 943–945 (Feb. 11, 1964).)

For positive ends, independence needs to be coupled with influence in the high councils of government, and influence diminishes with isolation. Paradoxically but realistically, then, the surest prescription for strengthening the central bank's voice in the shaping of national economic policy is to bring it into the partnership of councils centering on the Presidency. One condition of that prescription is the continuing confidence of the President in the Board's Chairman.[10] As a corollary, the Chairman and a majority of his colleagues must find the economic goals and policies of the administration palatable.

Except in an occasional challenge of a merger decision or similar regulatory move, the Board's actions are in practice immune from judicial reviews. Federal agencies do not settle their jurisdictional differences in lawsuits, and the exercise of the System's monetary powers does not give rise to cases between the Reserve banks and member banks or outsiders that can be litigated in the courts. So the System is more independent of judicial control and spends less time in court than any other important regulatory agency.

Congressional controls rest lightly on the System, too. In law the Congress can abolish the System, or alter it in any way. In practice the System can safely disregard these contingencies, unless it should behave very foolishly, or unless in circumstances of general economic distress that have not been seen in the past 25 years. In the past the Board has had sufficient friends on both sides of the aisles in both Houses to prevent floor consideration of unwanted changes in its statute, so the minor amendments that have been adopted are changes the Board has consented to in advance. Conversely, however, without the active support of the Treasury and the White House, the Board has been unable to secure legislative additions to its powers if any material objection is raised. So, for example, the Board's annual reports for the past 6 years have repeated an unheeded request for added authority under the Bank Holding Company Act (1962 annual report, pp. 131–133). More characteristically, and traditionally, the Board has simply been unwilling to seek any important legislation—partly, because it has learned that it is unlikely to succeed in getting any, and partly in order to avoid compromising its policy of aloofness. Also, since the Board has no need for appropriations, it avoids both the controls inherent in a budget review and the risks of legislative riders on money bills. This leaves the legislative committees and their staffs to reckon with, and the Joint Economic Committee.

These committees can summon any official of the System or other agency for questioning, but the questions can be evaded by answers such as, "you and I don't read economic history the same way." They also can call for the production of records and other information. But here they may be rebuffed. For example, minutes of Open Market Committee meetings have been called for but not sent. Congressional committees can, of course, conduct studies on their own or with the help of outside consultants, hold panel discussions with experts, publicize their findings and views, and exercise the arts of persuasion. The committees have done all of these things, and some modifications in System policy and practice have probably resulted. But there are distinct limits to these committee influences. If the System has remained unpersuaded, it has been able to stand its ground, and the committees have found no further recourse.

System officials appearing as congressional witnesses are regularly asked, and cheerfully agree, to repeat the timeworn formula that the Federal Reserve is an

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[10] The shrewdest summary argument of this view is the testimony, still cogent after a dozen years, of Harold Stein before the Patman subcommittee in 1952, hearings, "Monetary Policy and the Management of the Public Debt," 82d Cong., 2d sess. (1952), pp. 757–761; see also the testimony of G. L. Bach, ibid., pp. 748–752, and Commission on Money and Credit, report, ch. 10.

"agent of Congress" or a "creature of Congress" and as such "responsible to Congress." Experiences like the one just mentioned show concretely the half-truth in this comforting but essentially meaningless ritual. System members can readily acknowledge the existence of a power they can be confident will not be exercised, while refusing to take direction from the power they actually confront. Strictly speaking, the System is a creature of Congress in the same sense that the Treasury is—both created by statutes—but much less responsible to it than the Secretary of the Treasury. He is beholden not only to statutes but also to committees and individual members whose continuing support both he and the President need. The Federal Reserve can get along very well with the statute it already has. And as a System that acts by vote it can avoid being committeed by its members speaking individually. Realistically, the necessary prerequisite for Federal Reserve responsibility to Congress would be responsibility to the President, as the cases of the Secretary of the Treasury and other Cabinet officers illustrate. Responsibility to the President would give the Congress leverage over the Federal Reserve; it would be desirable also because it would enable the President to exert a coordinating authority to keep monetary policy and administration policy in harmony.

The Board's independence of the President is protected in law by the length and staggering of the terms of its members, who can be removed only for "cause"—and so presumably only after a specification of charges and a hearing; the case has not arisen. It is fortified by tradition. President Wilson is recorded as having declined to meet with the Board on the ground that to do so would invite the suspicion that he was trying to influence it. President Hoover had some fruitless phone communications with the Board in the crisis conditions of the last hours of his term. President Truman summoned the entire FOMC to a meeting in his office on the last day of January 1951, in an apparent plea for cooperation, shortly before the accord was negotiated.[11] Evidently, these were exceptional occasions. The usual practice of nonintercourse is no doubt reinforced, too, by the fact that the President is not nominated or elected to his office on account of any prior special knowledge of monetary matters he brings; he will rarely have personal acquaintance with any Board member but the Chairman. The FOMC, also a statutory body, is a stage further removed since the President has no hand in selecting the Reserve bank Presidents, all of whom participate, five on a voting basis, in FOMC proceedings. They are appointed by the Reserve bank directors with the approval of the Board, and the Board, and the directors in turn are partly elected by member banks and partly Board appointed. So the FOMC, which wields the System's most important power, with the widest latitude of discretion, is in an almost fully independent legal position.

The actual distance between the President and the Reserve authorities therefore depends chiefly on the standing of the chairman in the confidence of the President; and—in a different way—with the financial community. If the President is at odds with bankers and financiers, as Roosevelt was, he needs a strong ally on the Reserve Board, as Eccles was. If the President has other things on his mind, as Truman in 1948 did, the Reserve Board Chairman can be moved aside, as Eccles was. But if the President sides with his Secretary of the Treasury in a dispute with the Reserve System, as Truman did in 1950, he runs the risk that leaders in the Board or the FOMC may administer shock treatment and then resign as in 1951 McCabe and Eccles did. No wonder, then, that proposals to alter the status of the Federal Reserve, in whatever direction, invariably focus mainly on its relation to the President.

The Treasury-Federal Reserve relationship, as already noted, is partly that of principal-and-agent; in that realm the closest cooperation prevails and highly refined techniques to sustain it have developed. In the field of debt management and monetary and credit policy where both agencies have discretionary powers the relationship is a partnership—one that goes well or badly, depending on personalities and harmony of views, but one that is essentially indissoluble. Harmony is easier to come by in some circumstances than others. After the accord it was under some strain in the spring of 1956, when discount rates were raised again in April, following several successive rises in 1955. The newspapers carried reports that Secretaries Humphrey, Weeks, and Mitchell disapproved of the rate increases. Before the action was announced, Humphrey asked Chairman Martin to come to see him. Martin send word that he

[11] "Beckoning Frontiers," pp. 486–490.

was willing to come but was going to make the move anyway; he asked whether Humphrey wanted to be publicly rebuffed—since it would be impossible to keep a meeting secret from the press and Humphrey then abandoned the idea of a meeting. But by June, as an upsurge in business developed, the administration's objections to the Federal Reserve action quieted down and disappeared. This was unfortunate because the upsurge was ephemeral. Less than a year later the economy turned down.

Since 1960, harmony between the Federal Reserve and the Treasury has reached new heights, reflecting the mutual concern over the continuing balance-of-payments deficit. Under the stimulus of this concern closer communications, joint understandings and innovative technical operations have supported novel measures to influence exchange rates, gold flows, and international credit movements. "Swap" arrangements have been negotiated under Treasury leadership and open market operations in foreign currencies conducted by the Federal Reserve to a common end.

Proposals to alter the structural basis of the Treasury-Federal Reserve relationship have taken two diverse directions in principle. One looks toward formal recognition of a dominant position for the Treasury. A mild form of this approach, harking back to the original Federal Reserve Act, would restore the Secretary to a place on the Board; a more thoroughgoing version would transfer the policy powers of the Federal Reserve to the Treasury. Either move would fit the general prescription of the first Hoover Commission for centralizing and clarifying responsibility and authority, though that Commission chose to ignore its own teaching when it came to this particular problem. In behalf of this approach it can be argued that full Treasury responsibility for general monetary control would broaden its characteristically parochial view of debt management, while the Federal Reserve as agent rather than partner would be freer—because relieved of political responsibility—to advocate the use of monetary controls for stabilization objectives. Moreover, if the Treasury were in charge, the Congress would probably have a larger hand in shaping current policy, as it does in other Treasury concerns.

A contrary solution, in some respects doubtless more attractive to the financial community, was proposed to the Commission on Money and Credit.[12] This would assign to the Federal Reserve all Government dealings in Government securities with the public, integrating open market operations with new issues and refundings and making the Federal Reserve, like the Bank of England, the Government's sole and entire underwriter, with a mandate to minimum the cost of managing the public debt to the extent consistent with stabilization and balance-of-payment objectives. The Treasury would furnish to the Federal Reserve a supply of Government securities tailored to the latter's specifications, sufficient to meet Treasury cash needs at all times. The Federal Reserve would sell to and buy from the public such of these, at times and in quantities of its own choosing, as it determined would best fulfill its mandate. Thereby it would get a more complete control over monetary and credit policy. But such a transfer is hardly conceivable without formal alteration in the terms of its political accountability.

The ultimate effects of either plan depend on intangibles hard to assess in advance. The well-known principles of preferring the ills we already have to those we know not of, and of not disturbing arrangements that are working tolerably, though perhaps only temporarily, suggest that the Treasury would relish the second no more than the Federal Reserve would welcome the first. Both have political backing too strong to be overborne without their consent in ordinary circumstances. The potentialities of deadlocked disagreement are a strong incentive to both parties to accommodate their policies in ways that will continue to make the existing partnership workable.

There are other domestic Federal credit agencies with substantial resources and powers in particular sectors of the economy that operate independently of direct policy controls from the Treasury or the Federal Reserve: the Farm Credit Administration complex outside the Department of Agriculture and the Farmers Home Administration and the REA within that Department, the Home Loan Bank System and HHFA in the housing field, and the TVA, to mention some of the more prominent. Except for the first of these, the Gov-

[12] James Tobin, "An Essay on Principles of Debt Management," in William Fellner et al., "Fiscal and Debt Management Policies" (Englewood Cliffs, N.J., 1963), pp. 194–195, 212. Tobin was arguing for tidier management not to enhancing Federal Reserve powers.

ernment Corporation Control Act requires them to get Treasury clearance for public offerings of securities in excess of $100,000. The Treasury routes their requests to the Federal Reserve Bank of New York, for the attention of the manager of the system open market accounts, to make sure that the timing and terms of the offerings do not disturb the market on the offering dates; this is a technical rather than a policy control. A tidier plan would put the lending policies of all these agencies under a central supervision. But the very reason for their autonomy is the political strength of their organized clienteles. By contrast, the lending agencies in the foreign fields, the Export-Import Bank and the U.S. participation in public international credit institutions, are far more firmly under Treasury influence; and in this field the Treasury and the Federal Reserve work hand in glove, at least for the moment.

In summary, then, the System enjoys a virtually unique status of independence, power, and prestige within the structure of our Government. Its relations with the States are limited to minor concerns. It is rarely in court. Its spokesmen are frequently before congressional committees, but usually to answer questions only, without committing themselves; they do not need to make or defend appropriation requests, they seldom seek additional legislation on their own account, and they have little trouble in warding off unwelcome proposals from other quarters that would directly alter the System. With the executive agencies the situation is more complicated. The partnership with the Treasury is inescapable, and in operations close and cordial; in high policy matters alternately congenial or uneasy, though to date always outwardly characterized by mutual respect. Direct contacts with the President are exceptional but Executive Office staff viewpoints have been regularly urged in recent years in negotiations with both the Treasury and the Federal Reserve in which members of the Council of Economic Advisers and sometimes the Budget Director participate. The issue of independence turns on the viability of arrangements that leave the Federal Reserve, with so little formal accountability, the master of its purposes, powers, and policies. In the past these arrangements have often worked. But more than once they have made it impossible to coordinate monetary and fiscal policy and difficult to assign responsibility for economic instability.

The internal balance

The Federal Reserve Act as finally passed in 1913 differed from the Aldrich Committee version that was favored by leading bankers in two principal respects: it established a regional system with several reserve banks instead of a single central bank, and it gave more supervisory authority to the Federal Reserve Board than bankers relished. The statute thereby indicated an initial resolution of this facet of two larger and longstanding rivalries for influence over the American economy, between Main Street and Wall Street, and between New York and Washington. But statutory arrangements are inherently provisional. These underlying issues of internal balance have persisted through a half century of practice, and have been joined by a third, the issue of bureaucracy, of lay versus professional influence within the System.

The early course of development emphasized decentralization. Twelve Federal Reserve banks were established, the maximum number the statute allowed, to accommodate as many claims as possible. The locations of at least two of them appear to have been politically determined—of Richmond over Baltimore by the influence of Carter Glass, and of Kansas City over Denver, the only instance of two Reserve banks in one State, by the influence of Senator James A. Reed—and New Orleans was lost in the shuffle. During the first decade each Reserve bank was in business for itself. They were not equal in resources when they started and time has not equalized them. The table below shows their relative shares of their combined paid-in capital, $467 million, and of their combined total assets, $56 billion, at the end of 1962. The New York bank accounts for about a quarter of the whole, and with Chicago and San Francisco the three largest account for over one-half.

Percentage distribution of paid-in capital and total assets, all Federal Reserve banks, Dec. 31, 1962

Federal Reserve bank	Paid-in capital	Total assets	Federal Reserve bank	Paid-in capital	Total assets
Boston	4.7	5.8	St. Louis	3.4	4.0
New York	26.8	24.2	Minneapolis	2.4	2.3
Philadelphia	5.8	5.8	Kansas City	4.3	4.2
Cleveland	9.2	8.3	Dallas	5.8	3.9
Richmond	4.7	6.7	San Francisco	13.3	12.6
Atlanta	5.6	5.9			
Chicago	14.1	16.5	Total	100.1	100.0

Source: Computed from statement of condition, table 2, Annual Report, 1962, pp. 146–149.

In an economic sense the experience of 50 years has frustrated the expectations of the framers of the act regarding the autonomy of the individual Reserve banks. For all significant policy purposes and for all its service functions the System is unified. Its operations could proceed with little alteration if the banks were consolidated, their boards of directors disbanded and their presidents converted to branch managers, as economists have sometimes suggested. One collateral bit of evidence for this conclusion is the absence of any controversy over district boundaries.

The boundaries of sovereign States rarely change, because people will usually fight to preserve their native soil against forcible change, and the readjustments in prospect are too upsetting to negotiate peaceably. No such explanation will account for the stability of district boundaries which the Board of Governors has from the beginning been free to change at will, and which may—and in more than a dozen cases do—cut across State lines. Nor can it be argued that all the Federal Reserve cities deserve a premier ranking, economically or politically, or that their tributary areas have all remained tributary. Only six of the banks are located in the Nation's 12 largest cities. Within their districts Los Angeles is larger than San Francisco, Baltimore and Washington than Richmond, Houston than Dallas, and Denver than Kansas City. The University of California at Los Angeles long ago outgrew its former title, the "Southern Branch," but not the Los Angeles Branch of the San Francisco Bank. Arizona, come of age, has fought California—and Los Angeles in particular— for water, but its banks are content to be members of the Los Angeles Federal Reserve Branch. Florida has grown phenomenally, but Miami banks are still members of the Jacksonville branch of the Atlanta bank. Why do these anomalies persist without challenge? Plainly because in a unified system they do not really matter. In the early days the Board detached Fairfield County, Conn., from the Boston District and added it to New York; in 1954 some branch territorial lines were redrawn; and in 1959 Alaska and Hawaii were formally added to the 12th district where they had already been in fact. Along district boundaries there are instances where the armored trucks of one Reserve bank will service member banks across the line in an adjacent district simply because highway routes make such an accommodation more convenient or expeditious. These amicable adjustments would seem trivial indeed, in comparison with the economic transformations that have taken place, if the individual Reserve banks could really go their own ways and maintain differing credit conditions.

A more significant sort of adjustment occurs now and then when the Board's periodic (3-year) review of classifications of cities as Reserve cities or country bank places leads to a redesignation one way or the other, for this changes the reserve requirements of the banks affected. It might be supposed that a member bank would welcome a country bank status, since that increases its loaning capacity; but the contrary is usually the case. The status of Reserve city bank carries a higher prestige, attracts correspondent accounts, and is a prerequisite for the membership of the bank's principal officers in the Reserve City Bankers Association.

The unity of the system was brought about basically by the ease with which its facilities enabled funds to be transferred from one district to another, thereby arbitraging differentials. This means, among other things, that the discount rate is in practice related to New York money market rates rather than to the widely varying rates that member banks charge their customers; and that open-market transactions, wherever initiated, immediately affect member bank re-

serves in New York City. The unity of the system was legally confirmed by the decision in 1927 that the Board has the final power to say what discount rate each Reserve bank shall charge; and by the statutory injunctions that "No Federal Reserve bank shall engage or decline to engage in open-market operations * * * except in accordance with the direction of * * * the Committee," and that "The Board of Governors * * * shall exercise special supervision over all relationships and transactions of any kind entered into by any Federal Reserve bank and any foreign bank * * *."

Despite their economic unification and common subordination to uniform national policies, the Reserve banks retain a degree of individuality. They enlist the participation of prominent bankers and businessmen for service on their boards of directors. They have a realm of discretion in administering discounts and advances that does not affect the general supply of credit but gives them a guardian's familiarity with the conduct of member banks. Most important, the participation of their presidents in FOMC meetings keeps regional considerations nearer to the forefront of the Board of Governors' consciousness than field office managers of lesser status could hope for. This is not necessarily a good thing; our economy's growth depends on interregional flows, and this, in turn, is best assured by a nationally oriented monetary policy.

There is little evidence, however, to suggest that regional interests lead to the formation of sectional coalitions of influence within the FOMC or between the bank presidents and the Board. The divisive issues of monetary and credit policy are national or international in scope and run rather along ideological than sectional lines. This is apparent in the voting record of the FOMC for 1963, when the dilemma between tightening money to help the balance of payments, or easing it to help reduce domestic unemployment, produced an unusual number of split votes. The New York bank's president consistently favored the former course, and was supported by two Board members, Canby Balderston, of Philadelphia, and Charles Shepardson, of Texas, the "farm" member. The latter course was usually favored by Board Members George Mitchell, of Chicago, a recent appointee, and James Robertson, son-in-law of former Senator Norris, of Nebraska, and longtime Washington resident. A majority of the voting bank presidents, except on one occasion, followed Chairman Martin in an intermediate course. It is hard to find a sectional pattern in this record, other than the characteristic sensitivity of the New York Reserve Bank to international considerations. Clearly, the regional organization of the Reserve banks is an economic anachronism.

The New York bank is special in several ways. It is the largest, by a wide margin, in resources and volume of business. It is the agent both of the FOMC and of the Treasury for open-market operations both in Government securities and in foreign currencies, and a custodian of gold for the Treasury as well as the System. It holds earmarked gold and maintains deposit accounts of foreign central banks and foreign governments. It maintains the largest and most highly specialized staff and pays the highest salary scale. It is in the closest contact with the principal money and securities markets and most of the largest banks in the country. Its president is vice chairman of the FOMC and holds the one permanent seat there among those allotted to Reserve bank presidents. It has a tradition of leadership among them, and has always had vigorous leadership itself. It is a natural channel for a two-way flow of influence between Wall Street and Washington.

The time has nevertheless long since passed when it could be said that the New York bank dominated the System; since 1936 there has been no doubt that the Board in Washington, and especially its Chairman, have had the controlling voice. Tensions have arisen from time to time over narrower issues. One such had to do with the place of the New York bank in the chain of command from the FOMC to the Managers of the System Open Market Account. The Manager is an officer of the bank, appointed by the bank's management and carried on its payroll; his duties are to carry out the committee's instructions, which necessarily involve a considerable leeway for discretion. During the early and middle 1950's some members of the Joint Economic Committee, notably Senator Paul H. Douglas, picked up a recommendation of a so-called ad hoc committee of the System, urging that the Manager should be directly employed by the FOMC—which, however, under existing practice had no separate budget. Chairman Martin expressed sympathy with this objective; the New York bank resisted

it as an encroachment on its operating responsibilities.[13] This issue appears to have been accommodated by a fuller and more frequent reporting system, but it is an evidence of the power of the New York bank that it was able to retain control of the Manager's office. During the same period President Allan Sproul, of the New York bank, was often at odds with the passive implications of the "bills only" policy in open-market operations, which was mainly devised and defended by the Board and its staff in Washington; Sproul favored more active intervention. This issue disappeared when the "bills only" policy was abandoned in 1961. Sproul, broken in health, had in the meantime resigned in 1957; and thereupon the Board in Washington, in a rare exercise of its authority to do so, vetoed the initial selection of his successor proposed by the New York bank's directors—not, however, to secure a more docile appointee, but to bring in an outsider.

Lay and professional

Central bankers were nonexistent in the United States when the Federal Reserve came into being. Of the five appointive members President Wilson put on the original Board, the three strongest were W. P. G. Harding, a Birmingham, Ala., banker who presently became Governor of the Board; Paul Warburg, of the investment banking firm of Kuhn, Loeb, who was German-born, of a wealthy banking family and thoroughly acquainted with European banking traditions and practices; and Adolph Miller, an academic economist. Able as they were, none understood what was later to become the System's principal function. The governors of the 12 Reserve banks were commercial bankers. The leading academic experts on banking, whose views were influential in the formative years of the System—Willis, Sprague, Kemmerer—were all committed to doctrines about it (e.g., that it had solved the problem of recurring bank liquidity crises for all time) that the depression experience presently proved to be fallacious.

The development of central banking as a profession with an outlook, a body of principles, and a set of loyalties distinct from commercial or investment banking, came slowly. Its beginnings can perhaps be traced to the emergence and self-education of Benjamin Strong, governor of the New York bank during the 1920's and to the establishment, at about the same time, of the Research and Statistics Division on a professional basis in the office of the Board in Washington. Over the succeeding 40 years, but particularly since World War II, the professionalization of the System has come a long way, and with profound effects on its working. Outward evidence of the transformation can be seen in the extent to which the System has become the prime source for the recruitment of its own leadership. The evidence is plain even in the composition of the Board of Governors, who are Presidential appointees requiring Senate confirmation; it is overwhelming in the selection of the Reserve bank presidents and in the long service and low turnover rates of other Reserve bank officers.

Of the eight men on the Board of Governors during part or all of 1963, the two newest, Mitchell and Daane, were both economists and professional products of the System, one with a decade and the other with two decades of service in a Reserve bank. Vice Chairman Balderston, former dean of the Wharton School, had been a director of the Philadelphia Reserve Bank. Two others, Shepardson and King, had been directors of Reserve bank branches, at Houston and New Orleans, along with their business concerns. Robertson had been a career official in the Office of the Comptroller of the Currency since 1933 and was Deputy Comptroller, in charge of national bank examinations, when he was promoted to the Board. Chairman Martin had grown up in a Federal Reserve atmosphere; his father was the chief executive of the St. Louis Reserve Bank from its founding. Only Governor Mills, a civic leader from Portland, Oreg., was a commercial banker.

Of the 12 Reserve bank presidents in 1963, no fewer than 9 rose to their posts from a decade or more of Reserve bank employment, 7 of them in the same banks they came to head and 2 by transfer from another Reserve bank. Six of the nine were economists and advanced by way of the research divisions of their banks. Two lateral entrants, one an economist and the other a lawyer, came from business firms to their Reserve bank presidencies only after 3-year apprenticeships as senior vice presidents of their banks. Only one came directly from

[13] Hearings, "Nomination of William McChesney Martin, Jr.," Senate Committee on Banking and Currency, 84th Cong., 2d sess. (1956), pp. 39–42.

the outside; but this one, significantly, was President Hayes, of the New York Reserve Bank, who moved into the most important operating post in the System from a Wall Street commercial bank, where he had headed its foreign department.

Professionalization means orderly routines in procedure and hierarchy in organization, and an ethical code of commitments to professional standards and to organizational objectives—the characteristic virtues of bureaucracy. The Federal Reserve exhibits these virtues. But in the current context, professionalization also means institutional inbreeding, and, in turn, the growth of dogmas and a tendency to propagandize. The Federal Reserve exhibits these flaws. Furthermore, it is an old adage that experts, even the inquiring sort, should be on tap, not on top. Final decisions on important matters affecting the welfare and prosperity of the people are political decisions. They should be made after listening to expert advice, but they should be made by officials who are politically responsible. In a democratic country—not a technocracy—the consent of the governed is as necessary as professional competence.

So far as its immediate clientele, the financial community, is concerned, the System has had its difficulties on this score in the past, but none of serious consequence since World War II. In part, its good public relations with bankers may be laid to the participation of member banks in the election of Reserve bank directors; but this did not save it from bankers' criticisms on controversial occasions in earlier years. In part, the personal prestige of top officials in the System helps win consent. The main reason for its solid support among bankers, however, is no doubt the happy blend of conviction and prudence that has kept it from asking for additional powers over banks, or using those it already has in ways that would arouse their intense opposition. Moreover, a decade of slowly rising interest rates and significant reductions in reserve requirements has helped to improve the profitability of banking. Profits for banks make for support from bankers.

In the wider political arena the System enjoys the general advantages that go with a reputation for expertise in an occult craft, so long as all goes well. The technical merits of monetary and credit policy are beyond the attention or comprehension of the lay citizenry. Myths and slogans—a "sound dollar"—are readily available to brush aside serious questioning of System policies before lay audiences. In these circumstances the Federal Reserve commands an easy consent from the general public for the measures it takes during prosperous times. No affirmative marks of approval need to be obtained, no elections need to be won.

But in adverse times, if widespread distress stirs inarticulate doubts about the wisdom of System policies, a very heavy burden of political responsibility will fall on the Chairman of the Board of Governors. The tasks of political leadership—of defining and defending goals and policies, of rallying and mobilizing outside support for them—are his necessarily, for want of anyone else to sustain them. The President, the Secretary of the Treasury, or individual Members of Congress may come forward to his aid; or they may prefer to stand aside, uncommitted. The New York Reserve Bank President, who holds the other place of political leadership in the System, may rally the financial community but he is too close to Wall Street to carry persuasion to the general public. The financial community nevertheless is a potent political force, and the New York bank president, speaking for it, has many indirect means of exerting its influence, including automatic access to the leading metropolitan newspapers and the financial press. The other members of the Board of Governors, to whom a measure of consent can be imputed by reason of their senatorial confirmation, do not have the political stature required. The other Reserve bank presidents are unequipped, indeed positively disqualified, for political roles by their status as bureaucrats and by the standards for their selection. The striking contrast between the short term of Chairman McCabe and the longevity in office of Chairmen Eccles and Martin is in large degree a measure of the differences in their political talents and skills. Eccles and Martin, however, exhibit very different styles of political operation. Eccles freely resorted to public statements. Martin, on taking office told a Senate committee: "* * * I should never, as Chairman * * * go to the people with an issue." [14]

[14] Hearings, "Nomination of William McChesney Martin, Jr.," Senate Committee on Banking and Currency, 82d Cong., 1st sess., Mar. 19, 1951, p. 13.

Public accountability

Central banks the world around, even when they have been thoroughly integrated into their governments, are traditionally and notoriously closemouthed about their policies, their negotiations with each other, and their market operations. Among central banks the Federal Reserve stands out, by contrast, as rashly candid in the detail and promptness with which it discloses information about its affairs. In the world of American government and politics, however, where all agencies disclose more of what they do than their counterparts in other countries, the Federal Reserve is not noted for baring its secrets. How much privacy it is entitled to has been a perennial subject of controversy; and the System, confronted with the argument that monetary policy in a democracy is a legitimate topic of public debate which, to be fruitful, must be fully and currently informed, has usually been on the defensive. It has given ground on some matters, slowly and with apparent reluctance; on a few it has been adamant.

One branch of controversy relates to housekeeping affairs and the bounds of legislative control: how much is spent for what and paid to whom in the course of System operations? The annual reports give summary aggregates for broad categories. What details will be disclosed or withheld? What form of audit shall suffice? The Board's expenses are covered by semiannual assessments on the Reserve banks. These assessments together with the other—and far larger—expenses of the Reserve banks are deducted and paid from their revenues before their profits are paid over to the Treasury. In law, the Board has a virtual carte blanche to decide these matters, and "assessments shall not be construed to be Government funds or appropriated moneys" (sec. 10).

In practice the Board employs a private firm of accountants to audit its own accounts. The Board's examining staff audits the accounts of each Reserve bank and reports the audit results to the bank's directors (or a committee thereof), as well as to the Board; some argument has arisen over the question whether the audit report should first be discussed with the Reserve bank President. As a result of congressional committee pressures, the Board has also taken to employing private accountants to accompany Board examiners to one Reserve bank each year, to comment on the adequacy of audit procedures. After some pushing from the House Banking and Currency Committee the Board on at least two occasions has allowed limited access to the auditors' reports and notes for committee members and staff, including, in 1963, GAO auditors borrowed temporarily to assist the committee. But the Board has drawn the line against public disclosure, pleading a right to privacy for loans to individual member banks that would thereby be revealed, and it has refused to submit to a GAO audit, pleading a statutory immunity. These aspects of accountability remain is dispute.

A second branch of controversy draws a wider audience. How much of the FOMC's deliberations and of its directives to the Manager of the System Open Market Account should be disclosed, and how soon after the event? And how explicit can, and should, the directives be? These questions have already been noted above, as raising issues of congressional control over the FOMC, in the light of the 1935 amendment to the statute, which requires the Board to "keep a complete record of the action taken * * * upon all questions of policy relating to open-market operations and shall record therein the votes taken * * * and the reasons * * * in each instance * * * and shall include in its annual report * * * a copy of the records required to be kept * * *" (sec. 10).

But other interests are involved. Within the System, the directives are still too vague to guide the Manager unless he attends FOMC meetings and hears the discussions preceding their formulation; yet as a market operator he feels the need for some discretionary leeway, to be guided by daily reports and consultations. To the extent that he has discretion there is room for FOMC members to feel that the intent of a directive has been missed in execution. Within and outside the System, economists trained to seek quantitative solutions find the qualitative nature of the directive unsatisfactory, while the Manager stresses the importance of intangible factors and the need for intuitive skills in assessing the "feel" and "tone" of the market.

Vagueness is only part of the complaint. The other part of the complaint pertains to the FOMC's secrecy. It would be largely alleviated if the directives were published immediately or soon after the meetings at which they are adopted; and more so if the underlying minutes, rather than brief condensations, were also published. Open policies openly arrived at, the argument runs, would be better policies both because they could then be intelligently criticized and because they

would be more in keeping with the premises of responsible government; directives published promptly would minimize the advantages otherwise given to insiders and specialists in the Government securities markets. The Board gave a little ground to this line of argument in February 1964 when it released the record of FOMC actions in 1963 to the congressional committees some 6 weeks in advance of the scheduled appearance of its annual report. But it has held to its stand against the releast of FOMC minutes. In part, the refusal appears to be grounded on the proposition that the market's response to an announced policy is likely to be different from the response to tacit or masked actions; allegedly, the latter is more easily controlled while the former may be perverse but the opposite may well be true. In part, the Boards position is a claim for privacy in deliberations preceding action. In the words of the Chairman Martin, publication of the minutes would be "virtually certain to result either in weakening internal debate for the sake of the public record or in weakening the record for the sake of the debate." [15]

But Martin's view is dubious as will be clear to anyone who reads the Congressional Record, for example.

And on the general issue of public statements of policy the instinctive preference of the System was succinctly put in his words some years ago:

"The theory and practice upon which the Federal Reserve has acted has been that it is actions and not statements that determine policy. * * *" [16]

Of course this is true. We must believe what the Fed does, not what it says. Put otherwise, one must judge the Fed's policies by what happens to such targets as the money supply and, in turn, employment and prices. But though we must judge the Fed by results, we still would like to know what it intends or, at least, intended.

Representative CURTIS. Mr. Chairman, could I ask two unanimous consent requests?

Chairman PATMAN. Yes.

Representative CURTIS. One is that I put in the record, at the proper point of my interrogation, the Fortune article I was referring to. (See p. 236.)

Second, and on this I will require some help from the staff, I have been informed that the President through Mr. Moyers about 10 days ago actually issued a statement saying that the expenditure level for 1966 fiscal year would be between $105 and $107 billion. I think the actual press release should be there.

Chairman PATMAN. Without objection it is so ordered.

(The materials below are the basis for Mr. Curtis' statement. Mr. Moyers, however, is not named in either article as being the source of the information:)

[From the Washington Post, Nov. 28, 1965]

SPENDING TOPS $100 BILLION FOR FIRST TIME

(By Carroll Kilpatrick)

AUSTIN, TEX., November 27.—Federal expenditures in the current fiscal year will be between $105 and $107 billion, the first time in history that they have gone over $100 billion.

Federal revenues for the current fiscal year—the 1966 fiscal year which ends next June 30—will be at least $96.5 billion, leaving a deficit of somewhere between $8.5 and $10 billion.

Those are the estimates Budget Director Charles Schultze, and Deputy Director Elmer Staats gave President Johnson during a budget conference at the LBJ Ranch yesterday.

A White House spokesman reported the figures to newsmen today. He said that Schultze thought the revenue estimate of $96.5 conservative and believe it was possible the deficit would be as low as $7 billion.

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[15] Letter, Martin to Patman, Sept. 11, 1962.

[16] Hearings, "Nomination of William McChesney Martin, Jr.," Senate Committee on Banking and Currency, 84th Cong., 2d sess., Jan. 20, 1956, p. 8.

In January, Mr. Johnson estimated 1966 expenditures at $99.7 billion and revenues of $94.4, with a deficit of $5.3 billion but that was before the big increase in American troops in Vietnam.

The biggest Federal budget in history was in fiscal 1945, the last full year of World War II, when expenditures totaled $98.3 billion. The deficit that year was $53.9 billion. The biggest deficit of all was in 1943, when it reached $57.4 billion.

The biggest peacetime deficit was $12.4 billion in the recession year 1959.

The President is spending a considerable amount of time at his ranch working on the budget and next year's legislative program.

On Sunday, the President and Mrs. Johnson plan to fly to Houston to attend an afternoon revival meeting in the Houston Astrodome conducted by the Reverend Dr. Billy Graham. The evangelist was a houseguest at the Johnson ranch last Saturday.

The principal reason for the higher budget estimates for 1966 is the Vietnam war. Last January, the President estimated that Defense Department expenditures in 1966 would total $49 billion. Now the estimate is that they will be $52 or $53 billion.

The President already has received from Congress an additional $1.7 billion for Vietnam costs. He will ask for another supplemental appropriation in January, the exact amount still to be determined.

NO ESTIMATES ON 1967

No estimates were given regarding the 1967 budget, which the President will submit to Congress January 17. But it obviously will be larger than the 1966 expenditures unless there is peace in Vietnam.

The 1967 budget, for the year beginning next July 1, will also reflect the major impact of Great Society programs. Expenditures could easily be in excess of $100 billion despite the President's directive to all Cabinet officers and agency heads to cut unnecessary spending.

As the White House spokesman said, "The bee is on their backs to do this year what the President himself did last year in making the budget realistic."

In reporting on Defense Department expenditures, the spokesman said that in addition to the Vietnam costs the new military pay bill in 1966 will cost $875 million and in a full year over $1 billion.

LARGER INCREASES VOTED

The President had asked for increases that would have cost $240 million in 1966 and $450 million on a full-year basis. But Congress voted a larger increase.

Other increases in expenditures have been the result of what the spokesman called uncontrollable expenses. He listed these as higher interest rates, higher farm price-support payments, the pay raise for Federal civilian workers, cost-of-living increases for veterans' compensation and pensions, and the space program.

The President is very much disturbed by the trend to higher interest rates, the spokesman said. Mr. Johnson estimated in January that the cost of financing the Federal debt, which is now $319 billion, would be $11.6 billion this fiscal year. Now it is estimated that the cost will be in excess of $12 billion.

The President has seen figures showing that moneylenders are receiving 72 percent more on short-term Treasury bills than in 1961, the spokesman said. The average interest rate on short-term bills in 1961 was 2.378 percent; the rate was 4.097 the week of November 20, the spokesman said.

FARM PRICE SUPPORTS

In agriculture, the administration estimated in January that farm price-support costs would be $3.65 billion; now, with a larger crop than predicted, the costs are expected to reach $4.1 billion.

The space program was estimated to cost $5.1 billion, but because of a faster production rate than predicted the costs probably will go to $5.6 billion, the President was told.

All other Federal expenditures taken together will be about $500 million less than the President estimated in January because of belt tightening and because some of the Great Society programs did not get started as early as expected, the spokesman said.

While expenditures are up, so are revenues, because of the booming economy. In January, the President estimated expenditures at $99.7 billion and receipts at $94.4 billion. Now he estimates receipts at $96.5 billion and believed that they could be higher.

Receipts have risen despite excise tax reductions in July and the further reductions scheduled for January 1.

Federal spending in fiscal 1965 totaled $96.5 billion; receipts totaled $93 billion.

[From the New York Times, Nov. 28, 1965]

FEDERAL SPENDING TO TOP $105 BILLION; DEFICIT RISING, TOO

U.S. Aids Say Outlay Will Exceed $100 Billion Mark for First Time in History

VIETNAM CHIEF FACTOR

War accounts for most of the $5 billion rise in estimates—gap of $7 billion seen

(By Robert B. Semple, Jr.)

AUSTIN TEX., Nov. 27—White House sources disclosed today that Federal spending in the current fiscal year—now nearly half over—would rise to a high of between $105 and $107 billion.

This means that Federal outlays will exceed by from $5 to $7 billion the original estimate of $99.7 billion made by the administration last January.

It also means that for the first time in history, Federal expenditures will exceed $100 billion. This had been widely anticipated in Washington.

The extraordinary increase in expenditures, according to officials here, will be offset in part by an increase in revenues amounting to about $2 billion and possibly more. The January budget predicted receipts of $94.4 billion. The new revised estimates call for receipts of $96.5 billion or more.

MORE LIKELY $8 BILLION

Accordingly, the budget deficit for the fiscal year 1966, which ends next June 30, will be substantially larger than the January estimate of $5.3 billion. If expenditures reach the top predicted figure of $107 billion, and receipts are $96.5 billion, the deficit will exceed $10 billion.

However, sources here said that they had been conservative in figuring receipts, and that in their view the deficit would probably turn out to be somewhere between $7 and $8 billion, although it could go higher. They also emphasized that these figures were preliminary, rough, and susceptible to change.

These sources said that much of the increase in expenditures—but by no means all—was attributable to the war in Vietnam and the accompanying rise in defense expenditures. There were other areas in which the Government spent more money that it had anticipated, and in some cases it acually managed to save through "belt tightening" and other factors.

Officials here would no speculate about next year's budget, which President Johnson is now in the process of drawing up and which he will present to Congress in January.

BUDGET OF $100 BILLION

However, it seems clear, judging by today's figures, and also the built-in costs of Great Society legislation enacted this year, that Mr. Johnson's budget requests for the fiscal year 1967 will exceed $100 billion.

The general opinion among officials is that, in view of the war in Vietnam, the rise in the deficit may have been larger without energetic attempts to cut costs elsewhere, and that the deficit has been held to a "relatively modest amount."

There were three main categories, according to these officials, in which spending has risen above previous estimates.

The first is military spending, estimated to total $49 billion in the January budget. The war in Vietnam—which entails extra costs in military hardware and personnel—the increase in military assistance in Vietnam and elsewhere, and a large increase in military pay voted by the Congress, all contributed to an increase in military outlays of between $3 and $4 billion over the January figure.

Of these three factors, Vietnam is certainly the most costly, but no breakdown was given. Sources here did point out, however, that the Congress had voted military pay raises that will cost $875 million in the current fiscal year and $1 billion on a full-year basis—more than double the administration's request.

UNCONTROLLABLE EXPENSES

The second category is described as uncontrollable expenses. The four such uncontrollable expenses that showed significant increases amounting, all told, to about $1.5 billion are:

A rise in Commodity Credit Corporation outlays, which the Federal Government spends to support farm prices.

In January, the administration estimated it would spend $3.65 billion on farm supports. This expenditure—always a difficult one to predict in any budget—is now estimated at $4.1 billion. The increase was attributed here to a rise in farm production and crop yield, which means, in effect, that the Government had to "buy" more crops to support the price.

A rise in Federal outlays to service—or to pay interest on—the national debt: interest charges were estimated in January at $11.6 billion; the cost is now expected to exceed $12 billion.

Officials explain this increase by saying that interest rates generally have risen, making it more costly for the Government to service the debt. The Treasury is constantly retiring old securities and issuing new ones, and the new ones have to be issued at the going rate of interest, which has been going up in the last 5 months.

The President is said to be particularly concerned by the rise in interest rates, which has been caused primarily by a strong increase in demand for securities issued not only by the Federal Government but also by State and local governments.

Officials here say the average rate of interest on short-term Treasury money bills in 1961 was 2.378 percent; for the week ending November 20, the rate was 4.097 percent. The interest paid on the debt in 1961 was $9.1 billion in the fiscal year 1961. The size of the debt is now $319.1 billion.

The interest rate on long-term issues, they say, was 4.35 percent for the week that ended November 13—later figures are not yet available—as compared to 3.9 percent in 1961.

One reason for the President's concern, officials say, is that higher interest rates are making it more difficult for States and localities to finance necessary projects. The interest rate for municipal bonds, they note, is now 3.45 percent, as opposed to an average 3.22 percent in 1964.

There was no hint that Mr. Johnson planned to put pressure on the Federal Reserve Board to lower interest rates. The Board has been reluctant to do so on the ground that any lowering of rates would stimulate inflationary pressures by making money more easily available.

However, the great attention being given interest rates here does appear to amount to a reassertion of firm administration pressure on the Board, as well as a clear warning not to raise rates any higher.

The enactment by Congress of a pay raise bill for civilian employees of the Federal Government that far exceeded the administration's request. The administration bill would have cost $200 million in the current fiscal year; the bill passed by Congress will cost $480 million.

A rise in cost-of-living benefits under the veterans compensation and dependents program, which will mean an increase of $500 million over January estimates of $5.1 billion for this program.

$1.5 BILLION ADDED

All told, the "uncontrollable" increases added another $1.5 billion or so to the overall rise in expenditures.

The third and last category is an unexpected increase in the cost of the space program, which is likely to add as much as $500 million to the January estimate of $5.1 billion. Sources here say that space contractors have been able to make or exceed their contract schedules faster than expected, which means they are getting paid for their work faster than anticipated. There has also been less "normal" slippage in contract obligations than in previous years.

Officials say that in some cases the Government has been able to save money partly through economizing and partly because some of the new programs got a late start and, therefore, had less impact on the budget than expected. The higher education bill, for example, was not enacted until the last week of the congressional session.

These savings, officials say, amount to $500 million.

The increase in receipts of about $2 billion over the January estimate, officials say, is due to the growth in the economy as a whole, which in turn has meant higher tax collections. This growth in receipts they point out, has occurred despite a substantial cut in excise taxes enacted this year.

EARLIER REVISION NOTED

The outlook for revenues has already been revised once this year. In March, officials said that budget receipts would rise from the January estimate of $94.4 billion to about $95.5 billion. Today's figure of $96.5 billion, therefore, simply increases the projected total by about another $1 billion.

Unless the pace of the war in Vietnam shows unexpected increases, the deficit does not appear likely to exceed the $12.4 billion deficit of the fiscal year 1959. It will, however, be well above last fiscal year's deficit of $3.5 billion. The deficit in the fiscal year 1964 was $8.2 billion and $6.4 billion in the fiscal year 1943. It amounted to $57.4 billion.

Sources here said they did not consider the projected deficit to be a major inflationary threat at this time, although the President and his advisers would continue to watch the situation carefully.

In addition, according to these sources, Mr. Johnson has instructed his Budget Director, Charles Schultze, who has been at the ranch for the last 2 days conferring on budget matters—as well as other key Government officials, to try to absorb the increases "to the fullest extent possible" through cost-reduction and management improvement programs in Federal agencies.

Chairman PATMAN. With that understanding, then, we will try to close up shop. We do not intend to call you gentlemen back unless something should arise that we feel is absolutely necessary to clarify things. We hope you all have a fine Christmas.

Mr. MARTIN. May I wish you a very happy New Year, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

Without objection we stand in recess until 10 o'clock in the morning in this room.

(Whereupon, at 5:10 p.m., the committee was recessed, to be reconvened at 10 a.m., Wednesday, December 15, 1965.)

(Results of executive session held to decide question of further witnesses follows:)

JOINT ECONOMIC COMMITTEE DECISION ON CALLING ADDITIONAL WITNESSES

THE JOINT ECONOMIC COMMITTEE POSTPONES INVITATION TO ADMINISTRATION OFFICIALS UNTIL JANUARY

The Joint Economic Committee met in executive session at 2:30 p.m., this afternoon, Wednesday, December 15, 1965, to consider further witnesses and procedures in its current hearings into the recent action of the Federal Reserve Board. Two resolutions were offered, one by Senator William Proxmire, the other a substitute by Senator Jacob K. Javits. The substitute offered by Senator Javits was defeated and the motion of Senator Proxmire was approved. The two motions and the votes thereon are given below:

RESOLUTION OF SENATOR PROXMIRE

(Adopted)

The administration requested the Board of Governors of the Federal Reserve System to delay until January action changing monetary policy and raising interest rates. This request was made in order to insure that whatever monetary policy was adopted would fully reflect the Board's consideration of the administration's forthcoming budgetary proposals for fiscal years 1966 and 1967, as well as any other economic proposals the administration might develop. In the face of the administration's request, the Board voted 4 to 3 to act at once without waiting for the full information that would be available in January.

The minority members of the Joint Economic Committee now demand that this committee invite administration officials to testify at once on these matters in public session. The majority members cannot agree with a proposal that would amount to changing the dates set by law for submission of the budget, the Economic Report, and for hearings on them by this committee. The most alarming aspect of the Federal Reserve Board's action in raising the discount rate and the rate on time deposits was its failure to wait until it could consider the spending and tax proposals of the administration. Testimony in these hearings to date amply demonstrates the importance of this additional fiscal information in making monetary policy decisions.

We are convinced that the Joint Economic Committee would be derelict in its duty if it countenanced an attempt to pressure the administration officials into testifying now on matters that plainly are not yet fully formulated and which by law are scheduled for consideration by the Congress in January. This would completely disrupt the orderly preparation and presentation of the Nation's budget and economic policy.

The vote on the above motion was as follows:

In favor	*Opposed*
Representative Wright Patman	Senator Jacob K. Javits
Representative Hale Boggs	Senator Jack Miller
Representative Henry S. Reuss	Senator Len B. Jordan
Senator Paul H. Douglas	Representative Thomas B. Curtis
Senator John Sparkman	Representative William B. Widnall
Senator J. W. Fulbright	Representative Robert F. Ellsworth
Senator William Proxmire	

RESOLUTION BY SENATOR JACOB K. JAVITS

(Defeated)

I move that the chairman invite the Secretary of the Treasury, the Chairman of the President's Council of Economic Advisers, and the Director of the Bureau of the Budget to appear before the committee at the current series of hearings for the purpose of testifying on the administration's position regarding the action of the Federal Reserve Board and the reasons therefor; on specific problems of the coordination of the activities of the Federal Reserve Board, with that of the executive branch; on the timing of this decision as it affects administration policy; and on the administration's estimate of the danger of inflation which is the basis for the Federal Reserve Board majority's decision as testified before us.

The vote on the above motion was as follows:

In favor	*Opposed*
Senator Jacob K. Javits	Representative Wright Patman
Senator Jack Miller	Representative Hale Boggs
Senator Len B. Jordan	Representative Henry S. Reuss
Representative Thomas B. Curtis	Senator Paul H. Douglas
Representative William B. Widnall	Senator John Sparkman
Representative Robert F. Ellsworth	Senator J. W. Fulbright
	Senator William Proxmire

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