307

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 2

December 15 and 16, 1965
and Appendix

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RECENT FEDERAL RESERVE ACTION AND ECONOMIC POLICY COORDINATION

WEDNESDAY, DECEMBER 15, 1965

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

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

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

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.

Today the committee is privileged to hear from two distinguished economists, Prof. John Kenneth Galbraith of Harvard University and Prof. Henry C. Wallich of Yale University. Both of these economists have given us very able advice on past occasions. Dr. Galbraith is an eminent teacher, a former ambassador to India, an author and one of America's most stimulating thinkers.

Dr. Wallich is an outstanding professor of economics, and a former member of the Council of Economic Advisers. Gentlemen, we are very glad to have you with us this morning to hear your testimony on this important subject of public policy.

Dr. Galbraith, are you ready to proceed, sir?

STATEMENT OF PROF. J. KENNETH GALBRAITH, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Dr. GALBRAITH. Thank you very much, Mr. Chairman.

I am happy to respond to your request to comment on the recent action of the Board of Governors of the Federal Reserve System in raising the rediscount rate from 4 to 4.5 percent without the advice and against the wishes of the President.

Three questions arise concerning the action: These are: its legality; its economic consequences; and the resulting propriety and wisdom. The legality of the action is above question. The immediate economic consequences are unpredictable for that is the nature of this instrument of economic policy. The circumstances surrounding the action arouse serious misgivings. In consequence, one must conclude that the action was improper and unwise. To believe otherwise requires considerable education in accepting the implausible.

Let me comment at no undue length on each point and then say a word as to preventive or remedial action.

THE HISTORICAL BACKGROUND OF THE AUTHORITY

The Federal Reserve Board had full legal authority to act as it did. It is important, however, to see this authority in its full historical setting.

The Federal Reserve Board was founded, as all know, just prior to World War I. These were the closing moments of 19th century capitalism. It was then believed, and especially by banks and corporations, that Government should, at all costs, be kept weak. Were it strong, it might threaten the power that these institutions had so long exercised as a matter of right. And in any case, democracy was not to be trusted. To entrust the central bank, with its power over bank borrowing rates and reserves, to the state seemed especially dangerous. In accordance with these attitudes the system was established with power, for all practical purposes, residing with the member banks.

So in the 1930's the dominant instrument in the system is not the Federal Reserve Board itself at all, it is the New York Federal Reserve Bank. The New York Federal Reserve Bank was an instrument of the member banks in the New York area—in the New York region.

Practice—that is to say, of putting the central bank beyond the reach of Government but within the reach of the banks—in other countries had been similar.

Governments had not yet assumed responsibility for the level and stability of production and employment or even, fully, for prices. Accordingly, Federal Reserve policy did not have to be coordinated with other economic policy. There was none, or very little. For this further reason the central bank could be a special preserve insulated from the risks and responsibilities of democratic government.

The world in which the Federal Reserve System was born, apart from some romantic echoes in the rescripts of the modern conservatives as they are called, is now gone and forever. We now agree that whatever the evils of democracy they are less than entrusting power to private authority.[1] The Government now acts to insure expanding output and stable prices. The central bank plays a subordinate but integral role in this policy. To such coordinated management—to a tax and expenditure policy designed to accord the proper support to aggregate demand, to a moderate (thought not low) level of interest rates, to firm administration of wage and price guideposts—we owe the steady expansion and the steady prices of the last 5 years.

It is important to understand the causes of economic misfortune. It is equally important to know the causes of good fortune.

[1] One recent fantasy, which seems hardly worthy of mention before an adult audience, is that the central bank must be independent because the judiciary, including the Supreme Court, is independent. There is no parallel whatever. The Federal Reserve was originally established as an independent agency to protect the member banks from unwelcome regulation and to secure their own influence over an essentially public power. The judiciary is independent in order to protect the citizen (including the banks) from the arbitrary exercise of public power. Another well-established protection is to exclude the delegation of public power to private bodies.

The imperatives of coordinated economic administration have required all countries to bring their central banks fully under government control. This, of course, has been true of the United States; indeed we have been a leader in developing the policy.

Men who prefer shadow to substance still speak of the independence of the Federal Reserve System. It hasn't existed for years. For years Mr. William McChesney Martin has been attending meetings on Government policy. There, along with numerous other questions, the interest rate has been discussed. For years he has been accepting the decision of these meetings. This decision he has imposed on the Federal Reserve Board. Perhaps it is permissible, since the history has been well published, to say that he has been accepting these decisions reluctantly. Normally, he has urged higher interest rates than his fellow managers have thought wise.

When the Chairman of the Board of Governors of the Federal Reserve System participates in meetings with other officials, yields to their judgments, accepts the resulting decisions and passes them through his Board, it is impossible to speak of an independent Federal Reserve System. Or it takes a certain exercise of mind. Nor would an acceptable economic policy have survived the independent and uncoordinated action by the Federal Reserve. This is the only way it could have been.

Most Americans regard successful management of the economy as an imperative. They do not react well to unemployment, depression, or stagnation. The right of the Federal Reserve to independent action has survived only because it has not interfered with that management—because it has not been used; as with the British House of Lords and the Canadian Senate, historic grandeur survives precisely because prerogatives are unexercised.

Other countries have followed a different course. They have taken the measure of the modern role of their central bank and reformed its powers accordingly. In the United Kingdom, the Commonwealth, and, by more informal means, in most of the countries of Western Europe the central bank has been made fully subject to executive authority.[2]

Even in Switzerland where popular legend accords the financial community unparalleled immunity and prestige, the Government has unqualified power to prescribe central bank policy and does.[3]

Although the Federal Reserve System was extensively modernized in the thirties, the formal right to independent action was not eliminated. For a long while this seemed an unimportant omission.

For a long while, for example, Marriner Eccles, Chairman of the Board, conceived of himself as an integral part of the Roosevelt administration.

If the power is not used, why worry about it? Moreover, men will often fight for symbols after the substance has gone. The independence of the Central Bank was a reminder of the great days of

[2] Cf. "Comparative Features of Central Banks in Selected Foreign Countries." Joint Economic Committee. Washington, 1963. In the United Kingdom the "Treasury has authority 'from time to time to give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest'," p. 6.

[3] "Influence of the [Swiss Federal] Government [on the central bank] is considerable and from time to time the Cabinet has prescribed monetary policies for the bank to follow." Ibid., p. 6.

financial preeminence in American politics. We are a practical people. We say, should we waste energy on a struggle over a seemingly harmless totem?

Now this anachronistic authority has been used. Since it is an authority that has existed because it was not used, it is an authority that will have to be removed if it is used. But before I assess the extent of this danger, let me comment on the economic effects of the recent action.

THE ECONOMIC CONSEQUENCES

It would be silly to suggest that the recent increase in the interest rate will do irreparable damage. The man who appears before a congressional committee and ascribes limitless disaster to a half percent change in the rediscount rate merits as little attention as the one who, by a process of priestly incantation, persuades himself—and seeks to persuade you—that it is an act of infinite wisdom.

One of the prime dangers of monetary policy is the uncertainty of its consequences. That is precisely why we debate them so much. If we knew, we would not have to argue. And knowledge is not increased by accepting office, with long tenure, on a public board. None of our folk habits is more endearing than that which causes us to endow public officials with special insight by fact of taking office. My most enchanting discovery on becoming Ambassador to India was that, automatically, I had become an expert on the caste system, the motivations of Mr. Krishna Menon, and the sexual symbolism of the ancient Sanskrit classics. But however agreeable this concept of instant insight, it is not something on which we should rely—especially where important matters such as money are involved.

Economists can say, with some certainty, what the effect of wage and price restraint will be. They can estimate with some accuracy the effect of a change in public expenditure. They can so, also, a tax change. None can estimate the effect of a change in the rate of interest. None will say that it is likely to be the same as between periods of expansion or contraction or even any two different periods of expansion and contraction.

The stock market was uncertain as to the effect of the recent action. First there was a slump; then a strong recovery. Only bank stocks responded reliably, a point of some interest to which I will return. The Federal Reserve Board is composed of excellent and honorable men. This I stress. But on these matters they are as uncertain as the outsiders.

The uncertainty of the effects of the interest rate change is why it should be used sparingly. Unlike taxation or spending, this is an exceedingly easy spigot to turn; the problem is that no one knows how much water will flow. By far the best policy is a moderate level of interest charge and a minimum of change.

So there is a presumption against the change that took place the other day. However, there are four further factors which cast doubt on the economic wisdom of this recent change. These are:

First, though no monetary action can by nature be really informed, this one was visibly uninformed. Only Mr. Martin, perhaps supported on rare occasions by a deputy, has participated in economic policymaking in recent years. Other members of the Board have not

been present. This is for purely practical reasons. The whole Board cannot debouch into a meeting, marching like a platoon with Mr. Martin leading the others in echelon right and left. So members learn of issues at second or third hand, therefore.

To this general handicap was added, in this instance, more specific ignorance. We learn from the President that the Board had not yet received intelligence on next year's spending totals and deficit. No other data are so important. That a majority of the Board should have been willing to act without this information is incredible. This willingness is even more incredible when one reflects that these data will be available within days.

And the haste becomes impossible to understand now that Mr. Martin has told an audience of life insurance executives that he does not think we were having an inflation although the action was taken to arrest inflation. Given the handicaps of the Board why not wait, why act in the best of what is very bad knowledge?

Why the hurry?

One is always fascinated when one comes to Washington with the intelligence that circulates among the many knowledgeable and deeply disillusioned men who grace this city. These men have assured me that the hasty action was quite explicable. And I see it now said in the press. The imminent retirements from the Board made it unlikely that a majority could thereafter be mobilized for an increase in the interest rates. I find this hard to believe. I am content to suggest this haste—this unseemly haste—in the absence of inflation and in advance of the vital yearend information, fits poorly with the picture of solemnity and deliberation which we associate with the greatest of central banks.

Second, 2 years ago, in a precedent breaking action, the Congress reduced income taxes in order to expand purchasing power. This year it additionally eliminated excise taxes mostly on luxury products for the same purpose. The major benefit of the tax reduction, especially the income tax, was to people in the upper income brackets. Such is the magic of equal percentages that those with incomes in excess of $100,000 had an average reduction of $7,130. Those with incomes of from $5,000 to $10,000 had an average reduction of $159. Those with incomes of from $10,000 to $15,000 had reductions averaging $283.[4]

The spending resulting from these reductions is, in effect, now regarded by the majority of the Federal Reserve Board as excessive. Mr. Martin has been admirably explicit on the point; he has said with emphasis that the present danger is from an excess of demand.

Not from cost-push but from too much demand. So we now cut back on the spending released by the tax cut by raising interest rates and thus discouraging borrowing and spending by, among others, the homeowner, installment buyer, and the man who must hit his bank or finance company for a personal loan.

And also the farmer and small businessman. I am not here to sing a political requiem for the little man. But we must bear in mind that the large corporation is far more likely to have access to internal sources of funds from retained earnings than the small operators. And we

[4] Calculations after Joseph A. Pechman. Individual Income Tax Provisions of the Revenue Act of 1965. Brookings Institution, Washington, D.C., 1965.

must have also in mind an even more elementary truth. This is that the man who borrows money is likely to have less of it than the man who lends money.

The economic policy which this course of action implies is unpleasantly clear. We reduce taxes with primary benefit for those in the high-income brackets. And we offset the effect of this by raising interest rates on those who must go into debt. Mr. Martin has also made clear his hope that the President will take a tough stand on public spending—which means spending for welfare purposes. At a time when there is so much concern for minorities, perhaps it is natural that there should be a special concern for the rich. They are a minority, too. But I wonder if such tenderness cannot be carried to extremes. I wonder, without wishing to say anything smacking of politics, if this policy of reducing taxes on the well-to-do and raising interest rates on the indebted is one which the average Congressman will wish to feature in his campaign literature next autumn.

Let us be clear that spending in the American economy will, on occasion, require restraint. And we always face the danger of the old-fashioned speculative spree. We must never imagine that Americans have permanently escaped from their oldest and most dangerous illusion: which is that they were uniquely endowed with the right to get rich sitting down and with the personal insight to accomplish this in the stock market.

The facilities for propping up the American economy are now better than those for restraining it.

But restraint when applied should be effective as well as equitable. The effect of raising interest rates, as we have seen, is inherently uncertain or ineffective and highly inequitable. Since, if there is a danger of speculation it is in the stock market, the effective and equitable policy is to raise corporation taxes. In the last 5 years, the inimical policies of Democrats toward business notwithstanding, corporation profits after taxes have nearly doubled—they were $26.7 billion in 1960 and I may say those were not poverty stricken levels, even then, and they are at an annual rate of $44.8 billion in the last quarter of this year.

No other kind of income has shown a comparable increase. This is the cause of some euphoria in the financial markets. With such euphoria Mr. Martin is, I thing, rightly concerned. But if the stock market is the focus, and profits the cause, the right course is to raise the corporate income tax, That attacks the problems at their roots. The effect of such an increase, as every noncaptive economist will agree, would be far more predictable than an increase in interest rates. Those who have done best would pay most—an old-fashioned, and by no means obsolete, rule. Nor would the stock market, I venture to think, have trouble interpreting this action.

Third, an increase in the interest rate always involves—as I think more people are coming to recognize—a most troublesome admixture of motives. One can never know whether it is inspired by a high-minded desire to control inflation or a highly commonplace yearning by those who lend money for more income.

The central problem of modern economic policy arises from the policy, the tendency of savings to be excessive. And the central strategy of modern economic management is to see that excessive

savings are offset by investment or compensatory spending. If intended savings are not so offset, output and income will fall and unemployment will rise.

That, I may say, Mr. Chairman, is not a complete statement of modern strategy of modern economic policy but the best that can be compressed in two sentences.

Since savings tend to be excessive in the modern economy, interest rates tend to be low. This is a simple manifestation of the law of supply and demand; it is, perhaps, the one manifestation of that stalwart law that those with money to lend like to the least:

> The most stable, and the least easily shifted, element in our contemporary economy has been hitherto, and may prove to be in the future, the minimum rate of interest acceptable to the generality of wealthowners.[5]

Not liking low-interest rates, those who receive them press the Federal Reserve for more. This advocacy is persistent. In no year, in the last 10, has this need not been pressed and by the most majestic voices in the financial world. If inflation did not seem a plausible danger, higher rates were urged to improve the payments balance. This is also an ex antes antipersuasion. This urging always comes before. Nobody ever looks back to discover whether or not the increase in the interest rate improved the payments balance or not. This would be less encouraging.

And if this argument were momentarily out of fashion, then higher rates were urged to prove we had no penchant for soft money. But no one with money to lend, one notices, ever calls for a drastic cut in rates to expand investment and employment.

There is nothing wicked about this advocacy. A desire to make more money is not un-American. I, personally, would hate to see it become unfashionable. What is regrettable, in a nation that prides itself on its homely candor, is the sanctimonious tendency to disguise an honest desire for more income behind an elevated public purpose. When a worker wants more wages it is because he wants the money. When a farmer wants a higher support price it is because he wants the money. When the aluminum or copper companies mark up their prices it is because they want the money. But when a banker wants a higher rate of interest he is showing a statesmanlike concern for the salvation of the country.

I do not wish to be unfair to these excellent and indispensable gentlemen. Perhaps they have persuaded themselves that the money is, in their case, unimportant. But it should be observed that an increase in interest rates is the only form of inflation control that ever appeals to the financial spokesman. Increased taxation is not urged. The wage and price guideposts evoke no applause. And also, alas, one must notice that the stock market did not misunderstand the recent increase in interest rates. It promptly marked up banks' stocks on the over-the-counter market. If I am wrong, if the banks are only interested in higher interest rates for their public benefit, these capital gains must be most embarrassing.

Fourth, the final reason for doubting the economic wisdom of the recent action follows directly from the foregoing. Wage and price restraints are absolutely essential if we are to combine high employ-

[5] John Maynard Keynes, "The General Theory of Employment 'Interest' and Money" (New York, Harcourt Brace, 1936), p. 302.

ment with stable prices. But if the Federal Reserve Board, itself an arm of the Government, is to yield to the desire for higher interest rates—however cosmetically disguised and in whatever admixture with more high-minded motives—the Government will have difficulty defending firm restraint on the steel, auto, aluminum, copper, and other companies, and the unions involved.

THE PROPRIETY AND WISDOM OF THE ACTION

The conclusion to be drawn from this review will be evident. The action of the board was legal. It was also unwise. Its portents—rejection of a coordinated economic policy; action in ignorance of highly relevant facts which would shortly become available; commitment to a policy of compensating for tax reduction on the rich with higher interest rates on the less-rich and the poor; concessions to the omnipresent pressure for higher interest rates; and a more amiable policy toward those who seek a higher price for money than toward those who seek a higher price for aluminum—are all disquieting.

The question now is whether steps should be taken to remove the anachronism in our banking laws which places the rediscount rate and related market operations outside of the reach of Presidential authority.

Could one assume that the recent action was an isolated breach of established working relationships; that the Federal Reserve will resume the cooperative and comparatively disciplined role it has played in these last 5 years, there would be no need for action. Nor should one invite a battle if the perception of modern economics and the fire of popular concern are not strong enough then in the Congress to win it. My own inclination is to believe that the matter should now be cleared up. This should be done, I think, not by a massive reconstruction of the banking laws. Rather, it should be done by a simple resolution stating the concern of the Congress that there be a coordinated economic policy and affirming the ultimate authority of the President for the rediscount rate and open-market operations as for other elements of that policy.

The Federal Reserve would, of course, remain fully in charge of day-to-day operations and with full right to urge the course of action on the President that it deemed best.

There would be opposition to such a resolution. We would have resounding speeches about the impossibility of entrusting the President with such delicate and important power—speeches which, if carried to their logical conclusion would also have to deny him authority over such vastly delicate and more important matters as nuclear weaponry, Negro rights, and relations with the Soviet Union. But modern men will not object to an action which brings our law abreast of that of the United Kingdom or Switzerland and—more to the point—which brings it abreast, moreover, of our own well-proven practice.

Chairman PATMAN. Thank you, Professor Galbraith. We will now hear from Professor Wallich of Yale University. Professor, you may proceed in your own way.

STATEMENT OF HENRY C. WALLICH, PROFESSOR OF ECONOMICS, YALE UNIVERSITY

Mr. WALLICH. The recent action of the Federal Reserve in raising the discount rate and the time deposit interest ceiling must be viewed in the light of (1) its economic justification, (2) its timeliness, (3) its likely effects, and (4) its meaning for the future independence of the Federal Reserve.

(1) ECONOMIC JUSTIFICATION

The principal problem before the economy is how to shift from an expansion combining recovery plus growth to stable growth close to the economy's capacity ceiling.

Since 1961, the economy has undergone a twofold development: (*a*) it has recovered from the high rates of unemployment and industrial excess capacity then prevailing, and (*b*) it has greatly increased its labor force and industrial capacity, i.e., has enjoyed a high rate of genuine growth. The combination of recovery plus growth has made for a higher rate of expansion than will be sustainable hereafter. The problem is how to effect the transition smoothly instead of bumping hard into the capacity ceiling, under the peculiar difficulties arising from the Vietnam buildup.

That a shift of this kind is inevitable can be seen from the decline in unemployment over the past 5 years. The economy has gone from almost 7 percent to little more than 4 percent unemployment, an improvement of one-half of 1 percent per year or a little better. Recently this improvement has accelerated; over the last half year alone unemployment has fallen by about one-half of 1 percent. If we were to project either the recent or the longer term trend for a year or beyond, we would arrive at unemployment rates of less than 5 percent. While I think this would be technically not impossible, it would not be consistent with stable prices or even with continued stability of the expansion itself.

The recent accelerated drop in unemployment, desirable as it is, shows that we have already entered an area of instability. A given reduction in unemployment has produced less of an increase in GNP than in the past. The statistical rule developed by Dr. Arthur Okun of the Council of Economic Advisers, according to which a 1-percent reduction in unemployment yields a 3-percent rise in GNP, a rule which in the past has proved very reliable, has malfunctioned. A similar discrepancy shows up in the forecasts that the Council made last January for GNP and employment: while GNP seems likely to be no more than about $10 billion, or 1½ percent, above the midpoint of the Council's estimated range, the decline of a full percent in unemployment seems very substantially better than the Council's nonquantitative forecast of "some decline."

The reasons for this change in the relation between rising output and declining unemployment are as yet obscure. They probably have to do with a decline in productivity gains, and perhaps with labor force developments. Whatever the reasons, the lesson is clear: we must shift to a lower rate of expansion if we want to avoid significant wage and price controls.

Such a slowing seemed likely a few months ago. Projections of GNP for 1966 then centered in the neighborhood of $700 billion, a relatively small increase over the $670 billion expected in 1965. There was legitimate reason to be concerned about how to keep the expansion going after mid-1965. Since then the standard forecast for 1966 has changed drastically, to $715 billion and perhaps more. Responsible for this is in part the expectation of a larger Vietnam buildup. Strong consumer plans indicated by surveys, the easy absorption of excess steel inventories, the continuous upgrading of plant and equipment spending plans are perhaps even more important. A GNP forecast of $715 billion for 1966 means as fast a rate of expansion in 1966 as in 1965.

Such an advance will generate considerable pressures upon capacity in many directions. These may be relieved, in some areas, by the additional capacity generated by rising investment. We are fortunate also in that fewer large wage negotiations are coming up in 1966 than in ordinary years. But there is danger that the transition to a smooth expansion along the capacity ceiling will not be made, that bottlenecks and imbalances will arise, and that we shall bump into the capacity ceiling and perhaps relapse. The situation clearly seems to call for a policy shift toward restraint.

The same conclusion emerges when we look at the balance of payments. The third quarter again produced a large deficit. We are relying very heavily already upon direct controls. The success of the negotiations for an improved international monetary and credit mechanism depends in good part on our ability to bring our accounts into balance. Unless we do that, we shall continue to negotiate from weakness.

Into this situation of threatening domestic overexpansion and continued foreign deficit we have been moving with a monetary policy that, until the recent discount rate increase, gave indications of becoming easier rather than tighter. Monetary ease or tightness is not measured by interest rates alone. It is necessary, also, to look at the expansion of money supply and credit. Interest rates were advancing moderately before the discount rate action. But money supply, time deposits, and bank credit had begun to expand at accelerating rates. Particularly dramatic has been the rise in time deposits in commercial banks, which has been going at an annual rate of over 16 percent. Part of this increase represents certificates of deposits held by large corporations which in their effect upon future expenditures hardly differ from demand deposits. The combined increase in currency, demand deposits, and time deposits, referred to by some as money supply broadly defined, has been at a 9-percent rate. Currency plus demand deposits have advanced only at a rate of about 4.5 percent, but this statistic, which does not include corporate holdings of certificates of deposits, also has accelerated over earlier years. Increases in money and credit at rates so much in excess of the rate of GNP growth, and still accelerating, are not a good way of smoothing the transition from recovery to stable growth.

Even the increase in interest rates before and after the discount rate action is less than meets the eye. A sophisticated investor takes into account the outlook for inflation. If inflationary expectations are guided by the movement of the price indexes, they must have increased

during the last year as these indexes have accelerated. At a 2-percent annual price increase, the rate of interest net of inflation—the real interest rate, as economists call it—is not the market rate of 5 percent. The real interest rate is 3 percent. For investors who are not tax exempt it is even less, since they pay taxes upon that part of the interest that merely serves to offset inflation. For an investor paying a 50-percent marginal rate, the return after taxes is 2.5 percent, and net of inflation 0.5 percent. While I do not believe that investors make these calculations very explicitly, neither do I believe that the calculus can be altogether disregarded. There is much evidence in other countries showing that inflation pushes up interest rates. If expectations of inflation have risen lately, as seems likely, so probably has the inflation premium concealed in interest rates.

The reason for the accelerated monetary expansion seems clear. The rise in capital expenditures and associated needs for working capital have caused the financial needs of business to exceed even their much enlarged internal cash flow. Greater demands upon the bond market drove up interest rates there. This caused demand to be concentrated on the banks, where the rate had remained approximately stable except for minor adjustments. The Federal Reserve, in turn, in an attempt to keep rates from being forced up by strong demand, has supplied enough reserves to make an accelerated expansion of bank credit possible.

The basic fact that the Federal Reserve has facilitated an accelerating expansion of bank credit must not be allowed to be obscured by the movement of free reserves. Free reserves went from positive to negative during the year, although in the last few months they have again come up a little. But numerous analysts, including those within the Federal Reserve System, have shown that "free reserves" are not a sound standard by which to judge monetary policy. When the banks are under great pressure to lend, they will borrow from the Fed. They thus raise the negative free reserve figure. If the Fed tries to push negative free reserves closer to zero, it will be pumping in reserves which the banks use up by expanding their liabilities. This tug of war between the banks and Fed—the banks trying to borrow more and the Fed supplying them with reserves so that they can reduce their indebtedness—can lead to continuing expansion of money and credit unless the discount rate is raised to make the banks' borrowing from the Fed less profitable.

What basically seems to have happened is not altogether unlike what occurred during the early phase of the Korean war, before the Federal Reserve-Treasury "accord." What the Federal Reserve has been doing has come very close to pegging; pegging of interest rates and pegging of free reserves. During the preaccord period, the Fed pegged the long-term bond rate at 2½ percent. This compelled it to supply excessive reserves to the market and facilitated excessive expansion of money and credit. In 1965, the Fed again found itself trying to maintain a level of interest rates and free reserves that was lower than market balance would have permitted. To do this, it had to feed in reserves, with the result that money and credit expansion accelerated. The rise in the discount rate has been an effort to break away from this situation.

The situation has been aggravated by the squeeze on certificates of deposit. The interest rate banks could pay on them had reached its ceiling under regulation Q. It was not clear how the banks would be able to renew maturing CD's in the face of strong yearend needs for cash on the part of their holders. To let matters take their course might have led to a sharp credit squeeze. To avoid a squeeze it would have been necessary for the Fed to supply an additional large volume of reserves. Once the critical period was past, these reserves would have facilitated further rapid expansion. As contrasted with the credit squeeze that would have developed in the absence of such a bailout operation, the lifting of the interest ceiling under regulation Q was an expansionary action.

This suggests that the squeeze on CD's could perhaps have been handled by raising only the interest rate ceiling. The discount rate might have been left where it was. But this probably was not a sustainable solution. The discount rate would have stood in increasing disproportion to other market rates. Demands for cheap rediscounts would have mounted. Speculation would have developed on a rise in the discount rate in the near future. Nor would this action have dealt with the broader problem of how to limit the acceleration of bank credit that had been going on since earlier in the year.

(2) TIMING

From a purely economic point of view, the discount rate increase has come late rather than early. Monetary policy works with a lag. Within 6 months only part, perhaps the lesser part, of the total effect of a policy action is felt. In appraising timeliness, therefore, the effects of the move next spring rather than now must be had in mind.

The effects of the recent rapid expansion of money and credit have not yet been fully felt. Very probably these effects cannot be reversed—the borrowers have placed their orders, started their projects, the disbursements have already begun. To keep the credit expansion more in line with earlier years, and with the desirable path of the economy, earlier action would have been necessary.

From the point of view of the strategy of the measure, it would have been far better if a way could have been found to take it in a coordinated manner, by agreement with the administration. Whether waiting 1 month, until the budget had been announced, would have produced such coordinated action there is no means of knowing. That the Fed should have been lacking essential information prior to the budget announcement is not very plausible. Surely the shape of the budget is now known to within a couple of billion dollars or so. But by acting alone, the Fed sacrificed the appearance and the reality of coordination which has been a valuable asset of our policymaking mechanism.

On the other hand, if at budget time the administration had refused to agree to a discount rate increase, the action would have become more difficult. It would then have appeared as an outright criticism of the budget, stigmatizing it as inflationary.

At a technical level, an article in the "American Banker" states that the Fed was hard pressed to find a time when the action could be undertaken without interfering with Treasury financing operations. Major financing operations require the Fed to keep the market on an "even

keel." With heavy financing during the fall, and more ahead during the winter, reportedly there were not many interstices in which the Fed could have placed its discount rate increase.

It has also been argued that the discount rate increase would have been hard to effectuate in January because of the heavy return flow of funds from circulation into the banks, which requires the Fed to absorb excess reserves. The validity of such points can best be appraised by market technicians. Certainly, however, the squeeze on certificates of deposits would have had to be given some other solution had the discount rate increase been postponed until January or later.

(3) ECONOMIC EFFECTS

From what I said previously about economic justification of the action, it appears to me to have the character more of a defensive effort to prevent money and credit from accelerating further, than of an aggressive attempt to curb the boom. Far stronger doses of restraint would be needed for that than a one-half-percent rise in the discount rate, accompanied as it was, moreover, by an expansionary raising of the deposit interest ceiling.

Monetary policy, used in moderation, is not a very powerful instrument. Many experts question that it has much effect at all, although personally I do not share that view. One of the principal functions of monetary policy is to prevent major imbalances from arising between the supply of goods and the supply of money and credit, which could become disturbing. That monetary policy should be able to control and guide economic activity very closely is something that has not been demonstrated.

If monetary policy is to prevent imbalances, it must be changed from time to time. If monetary policy was right at the beginning of the year, when unemployment was close to 5 percent and when measures were about to be taken that were expected to bring the balance of payments into equilibrium, it can hardly remain unchanged after unemployment has dropped close to the interim goal of 4 percent and the deficit in the balance of payments has opened up again. It has well been said that the demand for an ever easy monetary policy is the logical counterpart of the demand for an ever balanced budget.

Obviously monetary policy should always be as easy as stability of the economy permits. Cheap and expanding credit is better than dear and restricted credit. Coordination with fiscal policy can do much to help monetary policy stay easy. A mix of easy money and tight budgets does more for economic growth than the reverse mix. In recent years, we have been hampered in pursuing such a mix by the balance-of-payments deficit, which has impeded very low rates. There has been a conflict, in other words, between domestic and international considerations.

This conflict, I believe, has now largely disappeared. Internal as well as external considerations require a more restraining policy. Later on, if the balance of payments improves, and if circumstances permit the task of domestic restraint to be exercised via the budget, an easier monetary policy will again become possible and desirable. Aside from its effects upon overall economic activity and upon the balance of payments, the effects of the discount rate and interest ceil-

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ing rise upon the distribution of income must be considered. Some borrowers will now pay somewhat more. Ordinarily, the impact of more costly credit is felt most severely in the housing area. At present, there is no need for restraint in this area. Until very recently, fortunately, mortgage rates were stable or declining. In the last few months they have come up a couple of basis points. Mr. Robert Weaver has predicted that there will be no significant increase in the cost of housing credit. I hope that he is right.

That higher interest rates aggravate the inequality of the distribution of income is frequently assumed, but to my knowledge has never been proved. Large businesses are often borrowers, and the interests of their shareholders are those of borrowers. Small savers usually are not shareholders but earn interest on savings deposits; that is, they are lenders. Banks may be supposed to be the most likely beneficiaries of higher interest rates. But thanks to the rapid increase in interest paid on time deposits, this probably is not the case now. Without having made a study of it, it is my impression that many bank stocks have remained well below their highs for a number of years while the rest of the market has been rising.

(4) FEDERAL RESERVE INDEPENDENCE

The independence of the Federal Reserve is of a peculiar kind. Its independence is within the Government, not from the Government.

The conflicts of opinion that have arisen from time to time between the Fed and the executive branch are of a sort that may also arise within the executive branch itself. They are likely to be differences about means, not ends. This I believe to have been the case also in the latest disagreement. The difference is that if the Federal Reserve had been set up as a regular Government department, or as part of an existing department, the President could resolve such conflicts.

Lack of unified command, however, is not unusual in our presidential system of government. The President has no means of controlling fiscal policy either, taxes and expenditures being determined by Congress. President Kennedy's request for some administrative discretion over tax rates, which would have given the President a tool for stabilization policy comparable to monetary policy, was not accepted. Unified control over most economic policy instruments is usual in countries with a parliamental form of government. But even in some of those, and not the economically least successful ones, the central bank has been given a certain independence. In our own system of checks and balances, there seems to be no anomaly in the kind of independence that the Federal Reserve enjoys.

The justification for some degree of central bank independence seems to me twofold. One is to take the unpopular task of occasional credit tightening out of the political arena. The other, which has become more important since prices ceased to have flexibility downwards, is to give decisions that have long enduring effects to any agency with a greater degree of continuity than that of a regular Government department. Business cycles come and go, but a price increase, once it has occurred, is virtually irreversible under today's conditions. In decisions affecting the price level a very long-term point of view should be taken, and an agency with some independence is best qualified to do that.

It is probably true that in such decisions, if there is a difference of opinion, the central bank is more likely to be on the side of price stability than the executive branch. But as I look at the price record of our economy over the years of the Federal Reserve's existence, I do not have the impression that the defenders of price stability have had an unduly strong voice. Such voice as they have I should like to see preserved.

Thank you, Mr. Chairman.

Chairman PATMAN. Thank you, sir.

You mentioned there at the end of your statement, Professor Wallich, about the differences in various Government agencies, particularly with the Federal Reserve. You seem to think it is set up a little different. You state the difference is that if the Federal Reserve had been set up as a regular Government department the President could resolve such conflicts as the one that has just occurred.

What difference is there between the Federal Reserve System, the Interstate Commerce Commission or the Tariff Commission, and the Federal Communications Commission?

Mr. WALLICH. Those are broadly similar. I had in mind departments like Treasury and State where the President appoints a Secretary who serves at his pleasure. Now as far as the Interstate Commerce Commission and similar regulatory agencies are concerned, the parallel to be drawn is between their regulatory functions and the regulatory functions of the Federal Reserve, which I know you are very familiar with, such as mergers and bank examinations.

Chairman PATMAN. You are referring to the fact that it is a little different from the kind of independence which the Federal Reserve enjoys; the degree of continuity. You also say such an agency having some independence is best qualified to do that; referring, of course, to the Federal Reserve.

Then you state that if there is a difference of opinion the central bank is more likely to be on the side of price stability than the executive branch. May I invite your attention to the fact that during World War II, when inflationary forces were very strong, this Nation, through proper coordination, contained these forces in a most effective way.

I think the executive branch did an excellent job in preventing inflation and maintaining price stability during the war period; as good, or better, than any other branch of Government. Certainly the central bank was not as active in that direction, although I will say that Mr. Eccles, who was Chairman of the Federal Reserve Board and who was a good, patriotic, public-spirited man, was working in the interest of the country. I invite your attention to the fact that under his leadership from 1939 until 1951—12 years—the Federal Reserve Board kept interest rates at 2½ percent, no higher than that for long-term interest rates.

They didn't go higher than that any time during those 12 years. Anybody who wanted the money for a bond could get it at par. The price of the bonds was protected. I think that is as good a record as any country on earth, because during that time we experienced the tail end of a depression, then a full-scale war economy, then postwar letdown, followed by the Korean war.

During the war, we had a situation where people were making lots of money and they were accumulating that money in bank accounts and in their own pockets, because they could not spend it for automobiles, appliances, and other durable goods. It was the greatest potential for inflation, perhaps, that any country on earth ever experienced.

Now, going through those 12 years, hard times, good times—sometimes we were shooting away a quarter of a billion dollars a day on the battlefield—just looking back it looked impossible to provide the proper monetary policy mix, but it was done by proper cooperation and coordination. A Federal Reserve Board working with the Government in coordination with the administration in power, which is charged with the duty of protecting the people, can accomplish this same objective of cooperation and coordination at any time if it could do it then.

I am apprehensive that that course is not being followed now. Certainly I look with disfavor on the greed of the banks, and the Federal Reserve which represents the banks; at the start of another emergency, when lots of money will have to be raised, it looks as if they want to get in on the take, and make sure that they have higher interest rates so as to benefit as much as possible at the expense of the rest of the people of the Nation.

I can't agree with you that the Federal Reserve is any different from any other agency of Government. Now in the Federal Reserve Act, of course, in 1913, the word "independence" is not mentioned. There is not anything there that indicates it should be different from any other agency, which under the Consitution is created by a legislative act by the Congress, which law is administered and executed by the President of the United States.

There is nothing in the basic act or amendments indicating that it is any different from any other agency of our Government. It looks to me like they are "claiming" that independence and have seized it.

The Federal Reserve have found a way to buy Government bonds and keep the bonds after they have been paid for once, and on the interest they get they pay their operating expenses. Therefore, they can thumb their noses at Congress—pay no attention to Congress.

Furthermore, they are not subject to audit by the Comptroller General—the General Accounting Office. I think those two differences are vital. So that not only are they claiming to be independent but they are also claiming the right not to be audited or to have their budget looked over by Congress as, for example, the Federal Home Loan Bank Board. The Federal Home Loan Bank Board does not get its money from Congress because, of course, the savings and loan associations of the Federal Home Loan Bank structure provide for the collection of the money to sustain it. But the Federal Home Loan Bank Board must get their approval from Congress of their budget. Don't you think it would be right and proper if Congress applied the same rule and the same standard to the Federal Reserve, Dr. Wallich?

Mr. WALLICH. I think, Mr. Chairman, that the independence of the budget of the Fed is part of its general independence. Whether that word is mentioned in the Federal Reserve Act or not is less important than the fact that the act was set up as it was. Very clearly, it was intended to be independent because terms were given to the members

of the Board. The legislative history of the act shows it because a very careful study was made by the Congress of central banks around the world. They took the best everywhere that they could find and in some respects improved upon it. Everywhere around the world at that time the central banks were independent.

Chairman PATMAN. What year are you talking about now, professor, 1913?

Mr. WALLICH. Yes; at that time.

Now today in what way is an independent budget an accouterment of the independence of an agency? If the agency could be assured of adequate research funds—and one of the principal activities in the monetary field is careful study of what goes on in the economy—then there might be no objection to having the budget under congressional control like that of most other agencies.

If I don't sound out of place in saying so, I think it has been hard sometimes for executive agencies to get money for research staffs. I have found this in my own modest experience. The Federal Reserve was the first agency to be able to build up a large research staff because they had the budget. As a result, a great deal of good work of that kind has come out of the Federal Reserve, among other things the first production index. They had no business making it, but did it because nobody else in the Government had the money to do it.

Today I continue to think the same. If their salaries got out of line, if they competed unfairly for staff with the rest of the Government, it would be a problem. In my past experience with these things, salaries at the local banks have been lower than in the Government at the levels of the research staff, where it really counts. I would like to see the freedom of hiring and expending staffs maintained.

Chairman PATMAN. My time has expired. When it gets back to me I want to interrogate you further on this. I want you to comment on the power of the Comptroller General to audit the books. I call your attention to the fact that the act of 1913 did not create a central bank. We didn't have a central bank in this country until about 22 years later or about 1933. At that time, an attempt was made to establish one, but a mess was made of it, and it had to do it all over again in 1935. But we did not have a central bank in this country until 1935. That is my viewpoint.

Senator Javits?

Senator JAVITS. Thank you very much, Mr. Chairman.

Mr. Chairman, I would like to state that it seems to me that the testimony we have had already, including the testimony of these two witnesses, now emphasizes the point which was made by the minority, which I wish to repeat and with which I wish to identify myself, that is the seeming boycott of these hearings by administration witnesses.

It seems to me, Mr. Chairman, that everything we have heard indicates that the administration will profit greatly by this debate in framing the budget and in framing the Economic Report, precisely because of the central issues which are here at stake.

Now, Mr. Chairman, I wish also to make clear that I hope very much, and I gather there has been some thought of that, that the Chair will give us an opportunity in a meeting before these hearings

end to invite specifically as a committee the administration witnesses. The minority may be voted down but I think it is important that we be given that chance. (See p. 305, pt. 1 of these hearings.)

Also, I wish to point out that it seems clear already that arrangements for coordination between the Federal Reserve Board and the rest of the Government, charming as they may be, at luncheons and other meetings, are by no means perfect, and that we find that there were discussions on this matter as early as October 6 to which Chairman Martin testified, again on November 23, at the very least, and then an actual confrontation on December 3 resulting in this very sharp diversity, at least in announced policy, but in the absence of administration testimony we can only go by newspaper reports and speeches as between the administration and the Federal Reserve Board. There was excellent cooperation between 1962 and 1964 and I regret very much to see it wrecked.

Personally, I shall look into the situation and will introduce legislation, and hope others will join, to tighten up this question of coordination which seems to me to have been shown to be very deficient.

On that subject, I would like to question Professor Galbraith; and may I say that I thought both statements presenting relatively diverse points of view, were excellent and I compliment both of you gentlemen. You justify our confidence in having called you among the very few experts who were called.

Professor Galbraith, I notice with very great interest your strong feeling about the independence of the Board as being out of date—that is, the Federal Reserve Board. Now would you apply the same standard to other boards with similar authority which have tenures—that is, stated terms—the Federal Trade Commission the Federal Aviation Administration, the Federal Communications Commission, the Interstate Commerce Commission, and all those cases where entirely independent action subject to court review is entirely possible. Yet, as I understand it, those were, speaking as a liberal, myself—I know you are—those were the institutions which liberals have valued the most as a result of development of the past decade.

Mr. GALBRAITH. Senator Javits, I think we would both agree on setting on one side boards that have a quasi-judicial function. I don't think anybody argues the Federal Reserve has a judicial function. The Federal Trade Commission quite clearly does.

So that it would be wrong to apply the same standards to a board which has such semijudicial character as to a body such as the Federal Reserve.

Secondly, one of the easiest ways of achieving coordination would be to reduce the terms of the members of the Federal Reserve Board to approximately the length of those in the Federal Communications Commission or on the Federal Aviation Agency. Were that done—were they further made subject to removal for cause—there would no longer be any great danger of action independent of the coordinated policy of the administration.

I am not sure this is the way to do it. I think it can be more easily accomplished by a simple instruction of the Congress.

Senator JAVITS. I am inclined to agree with the instruction of the Congress. That is what I shall look into. I would hope that the minority as a whole might consider that; perhaps the majority, too, in

terms of legislation. But I cannot see too much difference between the policymaking function of the Federal Reserve Board and the very real policymaking function, for example, of the Federal Trade Commission by which a great element of American business is run, which issues rulings and regulations, expressly making policy.

Now, one other question since my time is limited. I see you recognize that the central core of this question is the danger of inflation, and you charge that Mr. Martin did not say that we had inflation. Therefore, you negate his action because if we don't have inflation then he shouldn't have done what he did.

Well, that is not his argument. So I would like to hear your answer to his argument. His argument is not that we have inflation. Certainly he said that we don't have inflation, in his speech before the Life Insurance Association of America. What he did say and I quote, is: "To me the effective time to act against inflationary pressures is when they are in the development stage." What he said is that by this action, which you both agree is fairly minimal and by no means all encompassing—that is a very interesting point of agreement—what he did say is that the danger of inflation he saw as accelerating essentially because of the increase in the price indexes and therefore he felt that this minimal action was required in order to head off that danger.

It seems to me that that is the question to which you should reply. He was trying to avoid what you call for. You say in your statement:

> Wage and price restraints are absolutely essential if we are to combine high employment with stable prices—

and so on.

He says:

> I am trying to avoid wage and price restraints, that is controls, therefore I take this minimal way to erect a barrier to a danger of inflation.

Now it seems to me that is the central issue. I would greatly appreciate your answer.

Mr. GALBRAITH. Let me clear up one point. I don't think that Mr. Martin would agree with you that we don't have a policy of price and wage restraints. I am sure he reads the papers along with everybody else. The administration, working with the unions—and on aluminum price, copper price, steel prices, on all the key commodity prices—has for years now been taking a very active role to limit price increases so that they are consistent with what have come to be called guideposts.

Now let me speak with reference to Mr. Martin's comment that we are not presently having inflation. The context in which I addressed myself to that question was the timing by the Board, why the Board had to act now in advance of the budget data, in advance of the meeting down at President Johnson's ranch in Texas. Why, in short, it had to act with such haste. Were prices going up at a rapid rate, were we in a period of active inflation, then conceivably one could have argued the need for acting this week rather than a month hence.

In the absence of inflation, obviously his case for urgency collapses and collapses completely.

This is all I was addressing myself to.

Senator JAVITS. Thank you. My time is up. I will come back.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Professor Wallich, you say, "A mix of easy money and tight budgets does more for economic growth than the reverse mix," yet it is clear that we have been having a reverse mix. We have been having a mix of relatively restrained money and a clear fiscal expansion, a push.

Professor Buchanan, whom you may know, as head of the University of Virginia's Economics Department, says this is the kind of thing we will be plagued with for a long time. Reducing taxes is always popular. Increasing services is popular.

On the other hand, increasing interest rates and keeping prices down is not nearly as unpopular because it does not affect the public as directly or immediately. It is a subtle, an intellectual matter on which economists disagree. Yesterday we had a very interesting statement by Governor Balderston. He indicated he thought that the administration had the function of promoting economic growth and the Federal Reserve Board was the watchdog of the dollar and it had the main function of preserving the integrity of the dollar and keeping prices from going up.

It seems to me if this is true we have a very serious problem here of sacrificing growth because of very bad institutional organization and arrangement. It seems to me that as long as we have the kind of separation we now have, of fiscal policy in the hands of growth-minded politicians and monetary policy under the control of price conscious financial specialists, we know there will be a continued tendency for loose fiscal policy and compensatingly high monetary policy.

Now my desire is—to follow up part of what Senator Javits suggested—to see a great improvement in coordination even if we can't have a radical revision of the Federal Reserve Act, which may be difficult to achieve in the Congress.

This was emphasized when a letter appeared in the New York Times this morning from your colleague at Yale and a former member of President Kennedy's Council of Economic Advisers, Professor Tobin. He said the Federal Open Market Committee, the real authority on monetary policy in the country, does not let the Secretary of the Treasury and Chairman of the Economic Advisers inside the door to explain the administration's economic outlook and strategy. (See p. 342 for reprint of letter referred to.)

You conclude your statement with this observation:

> The argument has been that the defenders of price stability have had an unduly strong voice. They have not. Such voice as they have I should like to see preserved.

If that voice of price stability is to be effective it seems to me it should be heard; it should be heard in the administration's economic councils more vigorously than it is. I would like to have your suggestions on how we can do that in view of the fact that Chairman Martin testified here that he feels he is not qualified to speak on fiscal policy, it is not his business to tell the Treasury Department how to run their operations. It is their business.

On the other hand, he feels independent and he has the duty to make his own independent decisions separate from the conclusions of the rest of the economic policymakers.

Mr. WALLICH. On the problem of the mix, if I may begin with that, I am very much in agreement with you, Senator. The present mix seems to be of the wrong kind. It is enforced now by the balance of payments. It is likely to continue to be enforced partly by the elements you cite, easy budget policies and partly, also, because monetary policy has to be increasingly oriented toward the balance of payments.

In Europe this has been so for a number of years. For us it has become so increasingly. But it is not impossible to achieve a growth-oriented mix, because during the 1920's we did it. We paid off debt with a tight fiscal policy and monetary policy therefore was relatively easier than it would have been, had we not repaid debt.

Now to coordination. There are national legislations where the Secretary of the Treasury and Secretary of the Economy are admitted to the sessions of the central bank, the German Bundesbank, for example. They may come or send delegates. They may even cause a vote to be suspended for 2 weeks, but if within those 2 weeks the central bank does not change its mind the central banks vote stands.

This seems to be a procedure that is welcomed in Germany. The German central bank is very independent. We have in the past had the Secretary of the Treasury on the Board—until either 1933 or 1935—as well as the Comptroller of the Currency. They were taken off, apparently because it was felt at that time that the Secretary was too overpowering an influence. Whether mere attendance at open-market meetings would be a very overpowering influence, I do not know. I do know that there is a great deal of informal contact both at the top and at staff levels.

Senator PROXMIRE. You see, what I am getting at is the fact that the newest member, Dr. Maisel—who was just appointed to the Board and is an eminent economist, in my judgment—said he was shocked at the lack of coordination. He said he was not informed. He said important executive staff memoranda never came to his attention. Meetings bringing him into association with executive economic policy men were never formalized. His vote is just as important as Mr. Martin's vote. This is true of six members of the Board. They have no formal regular way of knowing first-hand the official views of the Treasury, Bureau of the Budget, and the Council of Economic Advisers; the very helpful and valuable opinions, what the plans are, what the President's budget is going to be. They don't have that.

It seems to me as a result of these hearings, we ought to consider seriously legislation that would, as Senator Javits said, require a greater degree of information, understanding, coordination, influence. If perhaps we don't take the additional step of ending the legal position, so-called independence.

Mr. WALLICH. Certainly I would say, Senator Proxmire, that the routing of information, memorandums, and so forth, ought to be good; in fact, I assumed that it was. I am surprised to hear that memorandums get stuck. Going one step further toward more formal coordination, a number of proposals have been made. One of them was by the Commission on Money and Credit. It offers a very elaborate setup but it does not really arrive at anything solid. There are really two routes. One is to make the arrangement statutory so that there would be a voting committee. In that case the Federal Reserve can be

outvoted and the Federal Reserve Act must be changed to say that if the Federal Reserve is outvoted by a group consisting of Secretary of the Treasury, Secretaries of Commerce, Labor, Agriculture, and all agencies interested in economics—which is really almost all except the Post Office—they must do what the majority says.

That is then a central bank that is wholly subordinated to the executive.

If coordination occurs at a meeting which is informal such as the meetings that occasionally occur now, then there is no way of making the Federal Reserve take a particular action. It depends on the willingness and ability of the Chairman of the Fed to stand up to the very great authority of the President, which ultimately is exerted in these meetings.

I think these meetings have been a good thing. Whether more can be done to formalize them, or to bring in more departments, I don't know. It certainly would not alter the situation very fundamentally.

Senator PROXMIRE. I have one more brief question. You say:

> In 1965, the Fed again found itself trying to maintain a level of interest rates and free reserves that was lower than market balance would have permitted. To do this, it had to feed in reserves, with the result that money and credit expansion accelerated.

This statement was contradicted yesterday by Governors Mitchell and Maisel. They said since June reserves had actually declined. I got the statistics this morning. In June, $21,840 million. They stayed stable in November. They were $21,827 million; they weren't up. Therefore, it is hard for me to follow the subsequent reasoning, which is very important. There was no bank reserve increase that required the Fed to increase the discount rate. The facts were the reverse. The Fed had frozen the reserves, tightened the credit picture.

Does this not mean that the Federal Reserve had a different purpose in mind? The purpose that struck me, and I am sure thousands of others, is that it smashed the President's power to persuade the banks to maintain the prime rate. The banks obviously wanted the Reserve to lift the discount rate. So the particular result was that the President could no longer be effective with the banking system in keeping the prime rate down.

Mr. WALLICH. I think the movement of reserves as the sole indicator is wholly misleading. The question is the relationship between the volume of reserves and the deposits, demand deposits and time deposits, which they sustain. Money may shift from city banks with 16½ percent reserve requirements to country banks with 12 percent requirements.

The same reserves then support a very much larger money supply. Money also shifts from demand deposits to time deposits if we adopt that definition of the money supply. The same reserves support a vastly greater volume of time deposits than demand deposits. So, merely to look at the volume of reserves is of no indicatory value without knowing the other facts. This has been spelled out very well by a study by two economists whom I respect greatly, Allan Meltzer and Karl Brunner who have tried to elaborate these relationships quantitatively. They believe that they can say accurately that a given change in reserves under such and such conditions produces such and such a change in money supply.

They likewise say that a change in discount rate, specifying all accompanying circumstances, produces such and such a change in money supply.

Senator PROXMIRE. My time is up but let me say that you said in your statement and I quote you, "had to feed in reserves." The statistics indicate they did not feed in reserves in the last 4 or 5 months. On the contrary, they maintained reserves at a level which in an expanding economy has a contracting power.

Mr. WALLICH. I am aware of this. But they feed them in relative to the need that a constant money supply or slowly rising money supply would have required. The money supply actually accelerated during the last half year. That is the important thing.

Chairman PATMAN. Mr. Curtis?

Representative CURTIS. Thank you, Mr. Chairman. I was very pleased to see that we are beginning to zero in on some of the basic issues here. One is the term "independence" which of course needs a great deal of attention because there seem to be some differences of opinion.

Dr. Galbraith, as I understand him, interprets independence one way. Dr. Wallich and others, including the Chairman of the Board, have their own definitions. So do members of this committee. So I think we clearly have established that we need another label if we are going to get anywhere.

The second question is coordination. This, too, has become a concept that we ought to identify clearly. We have separated some confusion already. Coordination among the Board members themselves is one thing and coordination with the executive is another.

Now I must comment, Dr. Galbraith, that your statement is almost in direct conflict with all the testimony—just about all the testimony—that we received from the Board yesterday as to whether or not they are operating in ignorance—or did operate in ignorance—as far as this point regarding coordination and independence is concerned.

It is unfortunate that this testimony was not available to you before you wrote your statement because I would have appreciated having your answer in reference to what was said then. Let me point out one of the things that was established, apparently by Secretary Anderson. Chairman Martin called it a Quadriad—regular meetings involving four people; the Chairman of the Federal Reserve Board, the Secretary of the Treasury, Director of the Bureau of the Budget, and the Chairman of the Council of Economic Advisers.

I think it is important for this committee, in fact, all of us, to think in terms of whether this needs to be more formalized. But even now, to not have the other three members of the Quadriad here before this committee, so that we can really examine into these questions of independence and coordination, is very unfortunate.

The Secretary of the Treasury made speeches on this within the past 2 days criticizing the Board's decision. The Chairman of the Council of Economic Advisers has done the same. We have not heard from the Bureau of the Budget. They are not available here for us to examine into this question.

I hope these questions and these very important points——

Representative REUSS. Will the gentleman yield for a correction briefly?

Representative CURTIS. Yes.

Representative REUSS. I think the gentleman from Missouri said that the testimony yesterday failed to disclose any lack of coordination on the part of the Governors of the Federal Reserve Board.

As I recall the testimony of Governor Maisel, he testified that he did not receive an important staff paper.

Chairman PATMAN. The gentleman refused to yield further.

Representative CURTIS. This is not a correction; this is an argument. Let me clear this thing up. I didn't say that. I said there was a great deal of evidence presented. As a matter of fact, when we come to review the evidence I think it will reveal that Governor Maisel retracted some parts of his broad statement with regard to how much information he was receiving, because Governor Mitchell who happened to join him as a minority himself felt that this exchange of information did exist and that the staff of the Federal Reserve Board had done a great job. But this is the very area we are examining. I think it is very pertinent to know to what extent this problem does exist. I agree with Senator Javits. I don't go as far as he does. I have not seen the evidence yet to say that there needs to be a change.

I first want to find out the extent to which this coordination does exist because there well may be areas that need attention. The Board itself indicated that it is constantly looking into how this could be improved.

Now to you, Dr. Galbraith. Your main theme as I see it in the first part—as you read history—is that the independence of the Board is an anachronistic power which has remained simply because it has not been used. But let me ask you: Don't you think that 1951 and all that led up to the Federal Reserve-Treasury accord was the fact that the Federal Reserve did finally use its power of independence? This was hardly anachronistic.

Mr. GALBRAITH. Let me go back, Mr. Curtis, to an earlier point if I may. I did not see the testimony which was given yesterday apart from the rather abbreviated comments in the papers but I did have a chance to read Governor Maisel's testimony of the day before.

I would say that my view of this matter is not drastically different from Governor Maisel.

Representative CURTIS. May I interrupt just a minute? This was his original testimony but he was cross-examined and other people developed it. You can say all sorts of things in the original statement but some of it does not stand up. This is true of any of us.

Mr. GALBRAITH. Let me say further, that this is the point I made in my own testimony, and I would be happy to be cross examined on it and I would be surprised if I would wish to retract it. But Mr. Martin has attended regularly the meetings on economic policy emerging from the Budget Bureau, from the Treasury, from the Council of Economic Advisers, or from other responsible agencies. These meetings have been going on for years.

The other members of his Board, except as I say, an occasional deputy, have not been participating in those meetings.

Representative CURTIS. That became a subject of considerable colloquy, development, and interrogation. The explanatory information was that there was a great deal of reporting back by the Chairman and coordination. But go ahead.

Mr. GALBRAITH. That is right. I said they got their information secondhand and thirdhand.

I am saying that if a board or body that then gets its information secondhand or thirdhand and reserves the right then to overthrow—to depart from the agreed policy, then this is a very bad way to conduct an economic policy.

Representative CURTIS. Yes, but I want to develop this colloquy——

Mr. GALBRAITH. And this problem can be solved very simply by giving the ultimate authority to the President of the United States, where it belongs.

Representative CURTIS. This is the thing I want to zero in on. You take a point and then you proceed as if all information is secondhand. Here is what I would like to point out. There is only a limited area of information that goes, as I understand the testimony, from the quadriad to the other members. The other members have direct information from the overwhelming mass of material that is developed by the staff of the Federal Reserve System and do have available directly to them the staffs of the people in the executive branch of the government.

So, you have just very nimbly proceeded as if all information was secondhand. There is a very limited area which relates to that which is new in the quadriad meetings. Maybe your criticism concerns how it can be improved—that criticism was directed to Mr. Martin who commented on it. Possibly this is true. But this is not the picture you have painted of the other Board members having only secondhand and thirdhand information.

I would say they have the firsthand information on the great bulk of data that is necessary to make these decisions.

Mr. GALBRAITH. You are an experienced debater, Mr. Curtis. I would object slightly to your dismissal of inconvenient fact on just being "nimble." The point I am making is that the ultimate policy on these matters—the ultimate responsibility—lies with the Secretary of the Treasury, Council of Economic Advisers, Bureau of the Budget, and, also, with the Federal Reserve. If the system of economic management which we have then allows six members of the Federal Reserve who have not attended these meetings, have not participated in this discussion, to exercise arbitrary independent power to overthrow the decisions reached by the previous group, this is a very poor form of coordination. It is indefensible.

Representative CURTIS. That is an interesting theory and I think you are certainly correct in directing attention to the issue. We need a great deal more evidence to examine it. Certainly, I will say the picture you have presented seems a considerable contrast to the testimony that we received with two of the members of the Board present and agreeing with a great deal of this structure as set up.

Governor Maisel on "independence" said:

> 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.

Again it can come to his definition of independence. I think we have to get in behind that word to see what we are talking about. Your definition of coordination it would seem to me would be to have the Executive have the final power of decision rather than having the

final power of decision in monetary matters rest in the Federal Reserve Board as it presently exists.

Mr. GALBRAITH. Could I respond?

Representative CURTIS. Surely.

Mr. GALBRAITH. It seems to me this is a fair statement. The question here ultimately is whether one trusts authority in the President of the United States or not.

Representative CURTIS. Oh, no.

Mr. GALBRAITH. One of the unfortunate facts of our time is that a great deal of power resides in the Office of the President of the United States. Undoubtedly, many of us would prefer a system of government—a system of life where it was necessary for Government to have such awesome power. But is there then something special, something peculiar, something uniquely precious about the power over banking or banking policy?

No. There is nothing in this power that is more dangerous to entrust in the President of the United States than power over atomic weapons or power over civil rights or other explosive and delicate issues which the country faces.

Representative CURTIS. You have accurately stated the point. The reason we have a division of power is not that we don't trust people. I think you are an experienced debater, as you say I am, in your choice of rhetoric. I see my time has expired. I will come back.

Chairman PATMAN. Mr. Reuss?

Representative REUSS. Mr. Galbraith, you have suggested, as Congressman Curtis has just alluded to, that Congress should pass a resolution affirming the ultimate authority of the President to direct the Fed on matters of monetary policy. You have gone on to say that this battle should be undertaken—and I will quote you—"only if the fire of popular concern is strong enough in the Congress to win it," which I agree is a good threshold criterion for undertaking battles.

As a practical matter, however, the President would have to indicate that he favored the readjustment in our political science inherent in your proposed resolution before Congress could really be expected to pass it; would he not?

Mr. GALBRAITH. I suspect that is true. I think, Congressman Reuss, also an as experienced legislator, that you picked on the rather tactical point. I find it easier to instruct Congressmen than I do the President of the United States. This was meant to be a reminder to Members of Congress that they had a duty in this matter.

I would, however, agree and certainly hope that the Executive would take leadership on this.

Representative REUSS. On the same subject, Dr. Wallich—still talking about political science, which is half of our session here this morning—let us suppose that next month the President feels that a tax increase is necessary to combat inflationary tendencies in the economy. Let us suppose that Secretary of the Treasury Fowler does not so feel. In your judgment, under our system of government should the President have the right to order the Secretary of the Treasury to prepare such a tax bill?

Mr. WALLICH. Definitely, and I believe he has it. If the Secretary should refuse he can replace him.

Now I would go one step further. I would like to see the President have the power, within limits and subject to safeguards, to alter tax rates within a given range.

Representative REUSS. I know your views on that and I agree with them.

Let me go on with my next question. Under our system of government should the President have the power in December to ask the Federal Reserve, which in the model I am putting to you seems to be ready to vote 4 to 3 for raising the discount rate to 4½ percent from 4 percent in December, to withhold its action until January? Or should the Federal Reserve have the right to thumb its nose at the President and put that into effect despite the President's request?

Mr. WALLICH. If no more is involved than to request a postponement and if action then can proceed freely, one might very well come out to say that, somewhat analogous to the German system, the President should be entitled to some postponement of the action.

If this postponement has the practical effect of making it very difficult or impossible to consummate the action then, of course, much more is involved. So long as the President doesn't have the power over fiscal policy, I see little reason for concentrating in his hands the policy over monetary policy.

Parallelism to fiscal policy would be to divide monetary power between the Congress and the President. The President would propose a change in the discount rate and the Congress would vote on it.

Representative REUSS. Let me break a lance with you on that point, because I really think you led yourself astray a bit on this. You say in your paper, and you just repeated, that the lack of Presidential authority over the Fed is not really very alarming, because the President does not have any authority over fiscal matters; the Congress may refuse to go along on tax or spending matters. Quite true, but the real question I put to you is what is the focus of authority within the noncongressional, nonjudicial branch of Government, call it the executive, or executive plus the Fed, or what you will?

It is a fact, is it not, that even if you adopted the Galbraith resolution putting the ultimate power in monetary matters in the Presidency, that the Congress under its constitutional power to coin money and regulate the value thereof could always overturn both the President and the Fed just as effectively as it can overturn the President and the Secretary of the Treasury on tax matters?

Thus, doesn't this—because the President is without authority anyway—distinctly tend to drop out of the area?

Mr. WALLICH. I would say that for the Congress to overturn a discount rate action on the grounds that it can regulate money and credit, which in the days this was written meant the size and weight of coins and not the purchasing power of the dollar, nevertheless, is a very different thing.

Representative REUSS. Do you doubt the constitutional power of Congress to direct the Federal Reserve to take a given discount or open market or bank reserve requirement policy? Because even Governor Martin does not doubt that power.

Mr. WALLICH. The Congress could pass a law requiring this and it would abrogate the Federal Reserve Act in that respect.

Representative REUSS. Hence, doesn't the distinction drop out? There is no difference between the powers of Congress to make fiscal policy and the powers of Congress to make monetary policy?

Mr. WALLICH. I am not a political scientist but I see the Congress legislating each year on taxes and I have not seen it legislate on discount rate.

Representative REUSS. I am talking about the constitutional power.

Mr. WALLICH. The constitutional power in the ultimate sense may be the same but the political practice I think is very different.

I think, perhaps, some pragmatic light could be shed on these problems. Suppose we visualize a situation which doesn't exist. If the Federal Reserve happened to be very much more liberal than the existing administration and favored an easier monetary policy than the administration, I have a strong suspicion, if I may say so, that in that case fronts would be reversed on the issue of independence of the Fed.

It is really, in other words, a pragmatic matter. People who feel that monetary stability is underrepresented favor independence so long as the Fed leans that way, and vice versa.

Representative REUSS. Speaking for myself and my sincerity in the matter, I have always said that I am prepared to stick by the consequences of what the President does either way, whether I like it or not, and let Congress, if it wants to, then overrule the President. But enough on this. Let me get to another interesting subject which you, Mr. Wallich, raised in your paper—the question of certificates of deposit. You indicated at several points that you regarded this new and very volatile instrument as being deeply involved in the action on December 3. I agree with you. You weren't here at the prior 2 days of hearings, but I expressed my concern to the Federal Reserve, with such force as I could muster, at the do-nothing attitude of the Fed in the last 3 or 4 years about this new and highly volatile instrument.

I suggested specifically that one of the things the Fed should have done and should now do is to make the certificate of deposit a little less irresistibly attractive to the 30 large banks which issue 70 percent of them by raising the reserve requirement, which it could do, to 50 percent more than its present level, from 4 percent to 6 percent, without any congressional action at all.

Had this been done it might have measurably, in my judgment, eased the problems confronting the Board of Governors on December 3.

I welcome your comments on the whole problem.

Mr. WALLICH. On your positive suggestion of raising reserves against time deposits, while I have not thought it through, prima facie this seems like a good way of at least improving this awkward situation. The whole buildup of certificates of deposits is very puzzling. Basically, it is an improvement in the market. It deprives the banks of the peculiar advantage that they have had of having a ceiling placed on their costs. This has sheltered them against having to compete with each other for funds and very likely has increased their profits.

Now with the ceiling at 5½ percent they no longer have that advantage. I would expect their profits to go down, as they have done from time to time when that ceiling was raised by notches.

Whether or not this introduces instability into the banking system, I am unable to tell. I would argue that even if it does, any improvement in the market should be accepted, if at all possible, and perhaps guarded against by other safeguards. One view which I don't share, but it is an interesting proposal, is to insure deposits 100 percent and then allow the banks to take much bigger risks than they are taking now to improve competition and the allocation of credit.

But I do want to draw your attention, Congressman Reuss, to the development of promissory notes which are legal ways for banks to borrow without any reserve requirements at all.

A bank that issues a promissory note simply borrows like a corporation and gets the full amount for expenditure.

Where these promissory notes rank in the hierarchy of liabilities, presumably below the deposits and presumably below the FDIC, if the bank should fail and the FDIC should be a claimant upon the residual assets of the bank, I don't know. Maybe the credit quality of the promissory notes is not good enough to permit their substantial expansion.

This, I think, deserves to be looked at.

Representative REUSS. My time is up. I am grateful to you for calling my attention to this. It is one thing to have 25 to 1 volatile instruments like these CD's floating around, but to have an infinity to one instrument like these promissory notes, makes one wonder what the Federal Reserve Board is doing.

Thank you very much.

Chairman PATMAN. Mr. Widnall?

Representative WIDNALL. Thank you, Mr. Chairman. Mr. Wallich and Mr. Galbraith we are certainly grateful for your appearance here this morning. I have listened to and read your statements with interest.

Mr. Galbraith, I am a little bit concerned by your statement when you say, "At the time when this is so much of concern for minorities perhaps there should be a special concern for the rich."

I think that is a too all-encompassing statement. There is a concern for organized pressure of the minorities and there is no concern for the little individual, the little farmer, the small businessman, and others who are being run over by Government mostly in this country today. That is one of the saddest things taking place. If they want to earn a living and they go on social security they are limited with what they can do with the welfare payment they get out of social security. It certainly is not an insurance payment in any sense of the word. I am sure if you retired as a college professor you would hate to be limited to the money you could make through outside working. In the same way a lot of people in this country want to be constructive, they want the ability to contribute and contribute in a major way. They are being limited by Government today. They are willing to do this.

The ones who are being taken care of are the organized pressure minorities of all kinds while millions of people are not having their day in court. I am talking about condemnation, about urban re-

newal, and what it does to the small businessman, the small property owner.

I am deeply concerned that Congress is not paying enough attention, and the administration is not paying enough attention, to these. These are factors that are building up a condition in this country that I think will contribute to an inflation; and I detect this fear in many, many talks with people who are not bankers—people in big business and in small business.

The greatest concern they have outside of Vietnam is the fear of inflation and the forces building up in their own businesses that they feel they cannot contain much longer without major price increases. Don't you find any of that feeling in the land today?

Mr. GALBRAITH. Mr. Widnall, I am very glad to have you on my side. It is possible that my irony here was a trifle extravagant. I was ridiculing—or attempting to ridicule—a policy by which in 1 year we reduce taxes with primary effect on those in the upper surtax brackets and in the next year raising interest rates primarily on the people you are talking about. This seems to me to be the wrong policy. As I say, I am very glad to have your agreement on the error in that policy.

Representative WIDNALL. And also increase social security rates so that the person who is below 65 probably won't have a net gain on his tax reduction by the time he comes to the end of the year and he will wake up with that and fully realize we will have more demand in order to take care of the increase.

Mr. GALBRAITH. I think that would be hard to argue that that is unpopular. I agree with you raising the ceiling on earnings outside of social security for people who are past 60, I think this is long overdue.

Representative WIDNALL. I don't think I have any further questions.

Chairman PATMAN. I am willing to forego asking further questions, myself, if it is the will of the committee that we conclude this session. We would like to have permission, gentlemen, to submit to you written questions before you look over your transcript for approval with the understanding that you will give us answers to the questions when you look over your transcript. Will that be satisfactory?

Mr. GALBRAITH. Yes.

Mr. WALLICH. Yes.

Chairman PATMAN. We have a committee meeting in the early afternoon of the whole committee—an executive session. If it is agreeable to all we shall conclude this session now.

Representative CURTIS. Mr. Chairman, I would like to have maybe just a few minutes to zero in on the one economic factor that I was engaged in previously in interrogating these witnesses. I would hate to lose the opportunity to ask a question along the line that relates to the economic aspect of this problem.

Chairman PATMAN. Would you like to continue for say, 5 minutes, something like that?

Representative CURTIS. I would.

Chairman PATMAN. Without objection, you may do so.

Representative CURTIS. Thank you, Mr. Chairman. I wanted to have an opportunity to pose this to the witnesses because this involves a point about which I would like to leave the record open for further

expansion. This is zeroing in on the rate of increase of productivity as a guidepost in evaluating these monetary policies. Granted this is a difficult statistic to arrive at with any exactness. I put in the record yesterday an article appearing in Fortune magazine by their economists where they had computed that the rate of productivity increase had declined from 3.5-percent average to a 2-percent average. Now, Governor Maisel had a different rate of 3.8, I think, and their figures showed that this declined to a 3 percent. (See p. 236 for article mentioned.)

There is an agreement on the decline. I have asked our staff to try to reconcile those differences. But the key question that I have in mind when I ask you this is, do you regard this as a very important guidepost in the exercise of monetary restraint in the Federal Reserve System? To give you my view, it seems to me it is one of the most important, if not the most important, guidepost. I will ask Dr. Wallich and then I will turn it over to Dr. Galbraith and if you want to expand on it further we will leave the record open. (See p. 238 for memorandum relating to above.)

Mr. WALLICH. Congressman Curtis, as for the drop in productivity I think this is a major indication that we have reached the latter stages of an expansion. We are now encountering less utilizable labor supply and productivity gains become smaller. This has been characteristic of all cycles. I think that technically it is possible to go on to reduce unemployment to 3 percent, even to 2 percent, but at the expense of substantial wage increases and loss in productivity gains. At this point monetary policy certainly should come in.

This also reflects the fact that the guideposts for wages and prices have set much too high a level for permissible wage increases. In the long run we have not had 3.2-percent productivity gains.

It is too bad that monetary policy is always called upon to be the goalkeeper as it were and to try to stay at the last moment the consequence of mistakes that have previously been made. But the least monetary policy can do when such signals go up is to put on the brakes immediately.

One normally steps on the brakes before the accident has happened. Monetary policy has to look at least 6 months into the future and ask itself what is going to happen 6 months from now. I think they have acted, if anything, later than they should.

Representative CURTIS. Thank you very much. Dr. Galbraith?

Mr. GALBRAITH. There are two or three points that I think need to be made here. First, I think it is of some importance, Congressman Curtis, to look at the anatomy of these productivity changes. We have come almost automatically to think in recent years of productivity gains being in industry—manufacturing enterprises; in fact, the productivity gains are in agriculture.

In agriculture it has been far in excess of those in industry.

Representative CURTIS. In quoting the Fortune magazine they used this figure I gave you as nonagricultural.

Mr. GALBRAITH. This was nonagricultural?

Representative CURTIS. That is right.

Mr. GALBRAITH. There is always the possibility—I make the same point—there is always the possibility that one reaches the end of the cycle of some major technical improvement. As in the case of agri-

culture, one reaches the end of the major cycle in the use of mechanical power and fertilizer. So you level off. The process of coming abreast of the existing technology. So that one can't take productivity figures as being related to economic factors. They may be related to technical factors. This is a caution one must always observe in the use of these figures.

More generally, it seems to me that the importance of the productivity figures is another indication of the unwisdom of placing excessive, or even very much, reliance on monetary policy. The point where, I was delighted to see, as on quite a number of other things, Professor Wallich and I are in agreement.

One of the reasons that monetary policy is unwise—the principal reason that it is unwise—is that its results are so uncertain.

The high degree of unpredictability of action flowing out of the interest rate is in my judgment the prime reason for primary reliance on fiscal policy and, as I say, on the structure of price and wage restraints. But one should always bear in mind that monetary policy works on investment. One should also always bear in mind that there is no form of new technology, no form of increased productivity, that is possible without investment. Therefore, when one is cutting back on investments one is cutting back on technology, cutting back on the rate of future increase in productivity. This, to an extraordinary extent, gets dropped out of discussion of the interest rate.

The same people come before this committee—and have in the past—praising the productivity gains in the American economy and go on to praise a policy of monetary restraint designed to cut back on those productivity gains. I have gone considerably beyond the import of your question, Congressman Curtis. Let me stop at that point.

Representative CURTIS. Thank you very much. This is what I wanted to develop to some degree. Did you have a further comment, Dr. Wallich?

Mr. WALLICH. No, thank you.

Senator PROXMIRE. When Chairman Martin appeared here he admitted that the principal effect, in his judgment, of this increase in the discount rate is to cut back on investment in plant and equipment by business. I specifically asked him if that was the principal effect.

He agreed that it will be the principal effect. Now I would like to ask both you gentlemen if it is not true that when you cut this back you not only, as you just said, reduce the efficiency and productivity in the future with this new equipment but you also reduce the capacity of American industry in the future to meet demand and therefore prevent future inflation. In addition to this isn't it also true you have the effect of restraining school building which of course inhibits education, another element in increasing efficiency in the productivity of our labor force. So that if what Chairman Martin said is correct it seems to me this is bad. Wouldn't it be wise, if you want to restrain credit expansion, to consider the possibility of selective credit controls, of limiting the time that a man is given to pay for his car or his appliance, as we have done before.

This would have the effect of not increasing the cost of credit, the effect of not increasing cost of servicing the national debt. Then it certainly would not restrain business expansion?

Mr. GALBRAITH. I won't reply at length, Senator Proxmire, because basically I agree with you.

Certainly the Federal Reserve should be pressed as to why something of the order of regulation W is not appropriate. The answer, of course, is as everyone knows: it runs into the most formidable objection from the people, from the finance companies. But it is still a point that should be raised, nonetheless. The other point on which I would very strongly agree with you: the fiscal policy—tax policy—operates on spending, on consumer expenditures. That is its ultimate incidence. Therefore, it has no direct effect on investment for the future. No direct effect on productivity gains. It may have some indirect effect as it influences the rate of private savings. That is an indirect and partial effect. Whereas credit expansion, as you have correctly said, operates directly on investment; and you must always bear in mind, as I stressed to Congressman Curtis, one can have no technological advance without investment.

Senator PROXMIRE. Dr. Wallich?

Mr. WALLICH. I agree very much, Senator Proxmire. I, too, would like to see fiscal policy used more actively against inflation, not only because it works on consumption but also because it is the more proper instrument domestically if monetary policy is to be specialized in manipulating the balance of payments.

But when fiscal action isn't taken, then it is better to take monetary action than to let things go. I would add one caution. While I would favor accelerating growth for many reasons, it is not true under all conditions that our generation, which is poor relative to that of our children if they live, ought to tighten its belts so that they who will be richer than we will inherit even more. If anything, the growing wealth of the society suggests one should borrow from future generations.

Senator PROXMIRE. Thank you.

Chairman PATMAN. Senator Javits wanted to ask a question.

Senator JAVITS. I would like to ask you this, Professor Galbraith. It is a fact that regulation W is no longer within the power of the Federal Reserve Board. The law has been repealed on that. We have to give them new authority to impose a regulation W; that is, to impose the kind of credit controls that you have just referred to.

Mr. GALBRAITH. I stand corrected on that. You are undoubtedly right.

Senator PROXMIRE. That then was the point of my question.

Senator JAVITS. I realize that, Senator. We could do it. It was not an instrument available to the Federal Reserve Board.

Mr. GALBRAITH. You are right. I was thinking of this as being available. I was wrong.

Senator JAVITS. I would like to ask you both this question. Taking all of these considerations which you have described and the state of the law as it is, I gather that you, Professor Galbraith—please correct me, I am not trying to put words in your mouth, I am just trying to phrase a question—I gather, you, Professor Galbraith, believe that whatever inflationary effect there was in leaving the rediscount rate as it was, was warranted by the gains that we would get out of it, whereas Professor Wallich feels exactly opposite: that we would have a net loss in the present state of the law, in the present situation if we al-

lowed the discount rate to stay as it is in terms of the inflationary threat. Could you each answer that so that we have it very clearly in the record?

Mr. GALBRAITH. I would have left the rediscount rate where it was and I think I would have kept it there. I do not now see any reason for increasing it. I do not agree with my good friend, Professor Wallich, about the balance-of-payments effects of this. I think that the Secretary of the Treasury is right in saying that these increases are not within the range that have real effect on the balance of payments, not even an appreciable cosmetic effect as to where balances are held.

This in my view is not relevant to the discussion.

Now, when the budget data are in if we need to have a restraint there is no doubt in my mind what we should do—we should raise taxes. We should reverse what was a wise policy 2 years ago in one direction, it becomes now a wise policy in the next Congress in the other direction. We should not get into our mind that if we are going to use taxes as an instrument for the maintenance of high and stable employment that this is a one-way measure.

We are much too smart to believe that. I would particularly resist the notion of using the interest rate as a substitute for this much more precise, much more equitable, and much more valuable tool of economic management.

Mr. WALLICH. On the question of tolerating possibly a little more inflation I would argue against that, not because I would be willing to tolerate more unemployment but because I think that inflation is not a permanent way of curing unemployment. As soon as people understand it and discount it and allow for it in their wage demands and interest demands, 2-percent inflation, 4 percent, 6 percent, will all be the same as far as the employment effect is concerned.

As far as balance-of-payments effects of the measure are concerned, I, too, believe that they are not going to be overpowering. At least the discount rate increase gives evidence of good faith and that we mean business. It shows that we are not doing business completely as usual, which is a useful demonstration even in Hanoi.

Finally, I might add on the balance of payments, that the Europeans do seem to be concerned that our discount rate increase may cause some flowback of funds. They seem to think there may be an effect. And, as to raising taxes, I share my friend, Professor Galbraith's view, if the military buildup gets any larger we will have to raise taxes. I don't know whether today's news on the budget really implies that kind of buildup yet.

How this is to be done—Professor Galbraith suggested that an equal tax cut is one that gives equal posttax increases in disposable income to everybody.

Now, if we apply the same principle on the way up, we will have to increase taxes in the lower income brackets by very much higher percentages than for people in the upper brackets. For a man who has a 10-percent tax and 90-percent income after taxes, we will have to increase taxes by almost a hundred percent in order to achieve the same effect as increasing the tax on somebody who has a 50-percent retained income from 50 to 55 percent.

I am not sure that that would be really equitable.

Senator JAVITS. As I understand it, just to clarify your answer, you do not rule out the use of tax increases regardless of its dynamics. We will deal with that. You don't rule out a tax increase because of the increase in the rediscount rate but you say in the absence of anything else at this period of time this was a wise and useful thing to do in pursuance of the restraint you feel was needed on the danger of inflation.

Mr. WALLICH. Yes, sir.

Mr. GALBRAITH. Mr. Chairman, may I congratulate Professor Wallich on a very good debating point. But I did not say that tax reduction should be by equal amounts. I was merely illustrating the way in which equal percentage rates of reduction accrue in different amounts to different income brackets. I also would remind him that I suggested an increase in the corporation tax and related that to the very great increase in the last 5 years then in corporate profits after taxes.

Chairman PATMAN. Thank you, sir. I would like to insert in the record an editorial from the New York Times, December 7, 1965, on a coordinating economic policy and a letter to the editor in the New York Times, December 15, 1965, by a former member of the Council of Economic Advisers, Prof. James Tobin, in which he comments on this editorial.[1]

Without objection, it is so ordered.

(The documents referred to follow:)

[From the New York Times, Dec. 7, 1965]

COORDINATING ECONOMIC POLICY

Long before Sunday's surprise action by the Federal Reserve Board it was an open secret that Chairman William McChesney Martin, Jr., and President Johnson disagreed about the threat of inflation. They had managed to reconcile their differences, however, achieving a remarkable meshing of fiscal and monetary policies that made a major contribution to the duration and balance of the expansion.

It is disquieting to learn that the process of consultation and coordination between the administration's economic policy makers and the money managers at the Federal Reserve is far from the smoothly functioning operation it seemed to be. Mr. Johnson himself revealed that full information was not entirely available to all the parties most concerned, in observing that the Fed should have waited until January, "when the nature and impact of the administration's budgetary and Vietnam decisions are known."

With less than a month to go before the new budget for fiscal 1967 is released, the administration already must have a pretty clear idea of its proposed spending for the domestic economy. It also must know by now how much more it will need in the near future for the war in Vietnam. The administration, after all, has boasted that the expansion was not a lucky accident but the result of careful and constant planning on its part. Yet it does not seem to have provided the Federal Reserve with the broad details of what it has in store.

The money managers, acting on the basis of current economic developments, obviously felt that they could not wait for the administration to disclose its plans. They did hold up their decision until the administration made public its new, tougher, but still voluntary, targets for stemming the outflow of capital abroad. But it is apparent that they were given no information by President Johnson or the Secretary of the Treasury or the Council of Economic Advisers to suggest any change in existing administration policy. If any such change had been indicated, it is inconceivable that they would have gone ahead.

Synchronization of fiscal and monetary policies has brought the economy within sight of the goal of full employment without inflation. At this juncture there is nothing to be gained by deploring the breakup of coordination. Instead,

[1] For further documentation on this subject, see column by Clayton Fritchey in Newsday Specials, Dec. 21, 1965, in appendix to these hearings.

both sides must endeavor to restore a coordinated approach as speedily as possible. It is up to the administration to demonstrate that it is willing to improve its coordinating machinery by being as candid and as flexible in formulating policies to maintain stability, now that the economy is close to full employment, as it was when full employment was a distant and elusive objective.

[From the New York Times, Dec. 15, 1965]

FED RISE CRITICIZED

(James Tobin, Sterling professor of economics at Yale University, served on President Kennedy's Council of Economic Advisors 1961–62)

To the Editor:

Your December 7 editorial rightly deplores the failure of policy coordination exhibited by the unilateral decision of the Federal Reserve to raise its discount rate to 4.5 percent. To blame the rest of the Federal Government rather than the Federal Reserve, however, is through-the-looking-glass logic roughly equivalent to holding everyone except De Gaulle responsible for lack of coordination in NATO or the Common Market.

The facts are that the Federal Reserve participates widely in the policymaking processes of the executive branch and that the President regularly receives the counsel of the Reserve Board Chairman along with that of other high officials in the economic "quadriad." The reverse is much less true, because of the paranoiac mania for Federal Reserve independence.

The Federal Open Market Committee, the real high court of monetary policy in this country, does not even let the Secretary of the Treasury and the Chairman of the Council of Economic Advisers inside the door to explain the administration's economic and fiscal outlook and strategy.

FEW INFLATION SIGNS

As to the merits of the Federal Reserve action, the Times has given a conditioned reflex approval without any serious assessment of economic prospects for the coming year. In any historical or international perspective, the signs of inflation are remarkably few.

Headlines are full of inflation because journalistic nature abhors a problem vacuum—something must be wrong with the economy. It is certainly not obvious that in 1966 total demand would, without monetary brakes, outrun the growing productive capacity of the economy. The stimulus of new defense expenditures, of unannounced but apparently modest size, will be partially offset by increases in social security taxes and by the normal growth in other tax collections.

The steady expansion, which is now bearing such welcome fruit is reduced unemployment, not to mention higher corporate profits, owes its long life to a sequence of fiscal stimuli—each opposed by those who see inflation around every corner. Does the Times, does the majority of the Federal Reserve Board, really think that 4.2 percent unemployment is dangerously low?

The latest increase in the discount rate is of much greater significance than previous twists of the monetary screw since 1961. Until now the main effects have been to raise short-term market interest rates. Now the discount rate has been set so high that the whole structure of rates, including those on long-term bonds, bank loans, mortgages, will have to rise—to levels that may well be too high for the long-term investment requirements of the economy.

The United States was well on the way to converting a cyclical recovery into steady balanced growth at full employment. This would be a great achievement. Let us hope the Federal Reserve has not placed it beyond our reach.

Representative REUSS. Mr. Chairman, Senator Javits' question has changed my mind a bit. I was not going to ask anything more. Could I have one brief question?

Chairman PATMAN. Yes.

Representative REUSS. In the light of the question of Senator Javits and of your answer to it, Mr. Galbraith, if the demand picture should show it necessary that you would urge a tax increase so as to combat inflation, if that were done would you hope that the Federal Reserve

Board would coincidentally with that reexamine its action and hopefully by a switch of one vote, vote to rescind its December 3 monetary discount rate increase?

Mr. GALBRAITH. I would certainly hope so. This is a considerably optimistic note on which to end the hearing this morning. But, yes, I would urge reconsideration. This is consistent with my whole belief that the sound as well as safe and predictable policy calls for the use of fiscal rather than monetary measure.

Representative REUSS. Thank you, Mr. Chairman.

Senator JAVITS. Mr. Chairman, may I insert, under unanimous consent, a column in the morning New York Times entitled "Economic Molehill," by M. J. Rossant, bearing directly on this question of the critical importance, the fulcrum effect of this particular action by the Federal Reserve?

Chairman PATMAN. Without objection, it is so ordered.

(The document referred to follows:)

[From the New York Times, Dec. 15, 1965]

AN ECONOMIC MOLEHILL?—ANALYSTS STICKING TO THEIR OPTIMISTIC PREDICTIONS FOR 1966 DESPITE RATE RISE

(By M. J. Rossant)

While the Johnson administration has made a mountain out of the Federal Reserve's rise in interest rates, most economic forecasters seem to view it as pretty much a molehill. They are sticking to their previous predictions that 1966 will be another good year for business.

They also seem to think that the increase in activity next year will be accompanied by more rapid—and inflationary—price changes despite the fact that the decision of the money managers was aimed at avoiding inflation.

Economists for the Johnson administration tend to agree with this majority view. They are much more troubled by the manner and timing of the Federal Reserve's action than by its possible consequences.

JANEWAY A DISSENTER

There are some dissenters. Eliot Janeway, who heads his own economic consulting concern, contends that the rise in interest rates combined with present tax rates will lead "to a drastic fall in the rate of new corporate investment in 1966." He expects that the present expansion in plant capacity and in profits will be followed by a shrinkage that will mark the end of the boom.

But Mr. Janeway is in a small minority. Most economists explain that the Federal Reserve's action has made relatively little difference to their forecasts because it was not a harbinger of higher rates and tighter credit but merely a confirmation of what was already taking part in the money and capital markets.

Economists who regard the furor raised by the Federal Reserve's surprise action as something of a tempest in a teapot do not belittle the effectiveness of a strong monetary policy. But they doubt that the money managers are taking a tough stand.

John Brigante, economist for the General Tire & Rubber Co., pointed out that many economists thought that the rise in interest rates, "far from being uncalled for, actually came several months later than it should have.". And, in contrast to Mr. Janeway, he asserted that "the sheer momentum of capital goods spending will give the economy more than enough vigor" to assure a healthy rise in total output of goods and services next year.

COMMENT BY SPRINKEL

According to Beryl W. Sprinkel, an economist for Chicago's Harris Trust and Savings Bank, the Federal Reserve's move does not "preclude sufficient monetary expansion to maintain the upward momentum of the economy." He thinks that less monetary expansion is desirable, but he does not want to see a monetary contraction that could crimp the expansion.

James J. O'Leary, director of economic research for the Life Insurance Association of America, expects "that the economy will continue to expand at a vigorous pace throughout 1966." But he predicted that "the monetary authorities will move somewhat further in the direction of restraint" in order to keep inflationary price and wage rises from getting out of hand.

In sticking to their guns, most forecasters are counting on the administration to continue its heavy spending, both for the war in Vietnam and for the civilian sector. The are inclined to think that once the White House ends the elaborate guessing game now going on, its new budget will be a stimulant to business that may well offset the braking impact of monetary restraint.

Assumption on Spending

The lack of concrete information about the budget does not worry the forecasters. They assume that spending will go beyond the estimates, as they did this year. The administration's unexpected stepup in spending has helped to make the forecaster, both private and Government, look good this year, and they are taking another big increase for granted for next year.

Thus, Irving Schweiger of the University of Chicago, predicts that defense spending will go up about $8 billion in 1966 without any reduction in nondefense outlays. As a result, he predicts that the expansion will proceed at about the same rate as in 1965.

Walter D. Fackler, another University of Chicago economist, sees a different mix, with defense spending going up about $5 billion and with civilian spending also rising, so that the end result is about the same.

Forecasters Not Perturbed

Clearly, most forecasters are not perturbed that the Federal Reserve has decided against continuing to coordinate its monetary policy with the administration's fiscal policies. On the contrary, they are saying that the economy should benefit from restraint on the part of the Federal Reserve and expansion on the part of the administration.

Their optimism about the outlook could be upset if the money managers pressed harder on the credit brakes or if the administration proved to be less expansive than expected. And it could also be changed by a squeeze on business profits or a deterioration in business confidence.

Chairman Patman. Without objection I will also include in the record at this point a telegram and correspondence relating to this hearing.

(The documents referred to follow:)

Los Angeles, Calif., *December 8, 1965.*

Hon. Wright Patman,
U.S. Congressman,
Chairman, House Banking Committee,
House Office Building, Washington, D.C.:

News reports indicate your intentions to inquire from each member of the Federal Reserve Board as to reason for their decision to raise Federal Reserve discount rate. Your concern over the effect of Federal Reserve Board's action is wholly justified and we hope that the Congress will follow this flagrant disregard of the little people's interest and will cause legislation to be introduced establishing responsibility of managing our Nation's currency in a manner subject to approval of the Congres or the President. The recent raise in discount rate will not be felt by those who can well afford to pay more for goods, and more for money, but will fall upon the shoulders of little people whose economic pinch is most seriously felt in the midst of prosperity. While our economy is in good working order there are millions of people in low-income-group brackets who can ill afford to pay cash for goods and must rely on credit to make ends meet. Since credit will be mostly out of their range it seems that the Federal Reserve Board's move was to further depress the plight of the poor and enhance the privilege of the rich.

Joseph T. DeSilva,
Executive Secretary of the 22,000 Member Retail Clerks Union, Local No. 770.

NATIONAL HOUSING CONFERENCE, INC.,
Washington, D.C., December 14, 1965.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. House of Representatives, Washington, D.C.

MY DEAR CHAIRMAN PATMAN: It is my pleasure, at the direction of the board of directors of the National Housing Conference, to send you a resolution adopted yesterday by the board in regular meeting assembled.

It would be appreciated if this action of the NHC board would be included as a part of the record of the hearings you are currently conducting.

With personal good wishes and may your Yuletime be a happy one, I am

Yours cordially,

NATHANIEL S. KEITH, *President.*

Resolved, That the board of directors of the National Housing Conference in regular quarterly meeting assembled, shares the concern expressed by President Johnson on the impact of the Federal Reserve Board's action in increasing the discount rate, particularly on the housing economy.

This further impetus to rising interest rates cannot fail to have an adverse effect on housing production and financing. It will mean increased costs to the consumer and a tighter mortgage market, and could result in a serious slowdown in homebuilding in the coming year.

This is no time to allow housing production to drag. Congress has given the President a far-reaching set of programs to bring our production of good housing closer to our rising needs and to speed up the improvement and redemption of our urban areas. It has established a consolidated agency to effectuate this mission by creating the Department of Housing and Urban Development.

We must not now erase these hopes by diverting and denying adequate financing to the housing market and the people who need housing. Already, as interest rates have risen, the annual homebuilding rate by October had declined to the lowest point since January 1963. We must reverse this trend, not accelerate it.

We urge the President and the Congress to take such actions as may be necessary to assure an ample flow of mortgage financing at reasonable rates into housing production. We recommend that the President make full use of the new and expanded programs for housing for the low- and moderate-income group, as contemplated in the 1965 legislation, and to implement these programs administratively as quickly and fully as possible. We recommend also that the Congress, as it did in 1958, give the President standby authorization for the purchase of mortgages on the private market at the present interest rates through the Federal National Mortgage Association to counter any decline in housing production as the spring building season gets underway. Any setback in the housing economy at this time would have serious and costly consequences for the Nation for years to come.

NATIONAL ASSOCIATION OF HOME BUILDERS,
Washington, D.C., December 13, 1965.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
House of Representatives,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Association of Home Builders, meeting in Chicago, Ill., December 5 to 8, 1965, for its 22d annual convention, considered the December 5, 1965, action by the Federal Reserve Board increasing the rediscount and time deposit rate.

Deeply disturbed over the effect that this action could have on the Nation's economy, particularly on the homebuilding industry, the board of directors of the NAHB adopted a resolution concerned with the action of the Federal Reserve Board as a part of the 1966 policy statement for NAHB. A copy of that portion of our policy statement is enclosed for your use.

We feel that the inquiry by the Joint Economic Committee into the action by the Federal Reserve Board is an excellent idea, and trust that whatever legislative proposals are required will be forthcoming shortly.

Very truly yours,

LARRY BLACKMON, *President.*

POLICY RESOLUTION ON MORTGAGE FINANCE

The extraordinary economic growth of the past 5 years was possible only against a background of stable prices and a harmonious monetary policy. The action of the Federal Reserve Board, which permits the rediscount rate to rise to 4½ percent and the rate paid by the commercial banks on certificates of deposit and other time deposits maturing in 30 days or more to jump from 4 to 5½ percent, means the homebuilding industry now must retrogress to the recurrent mortgage money shortages which marred the 1950's.

Home buyers learned then—and apparently now must painfully relearn—that "tight money" drastically curtails mortgage financing, but does not effectively prevent inflation in speculative endeavors. That portion of the current Board action which allows commercial banks to outbid depositaries of long-term savings for the capital normally flowing into mortgages will particularly assure that result. It is estimated this will draw billions of dollars of deposits from savings institutions. Once again, mortgage loans and loans to small business will be more costly and more difficult to obtain while commercial banks use the people's savings freely to offer credit for less essential uses which can and do pay higher interest rates.

We are deeply concerned with this latest example of what an uncoordinated approach to the whole problem of the fiscal and monetary systems can do to us. It is long past time for our Nation to devise an approach to these problems that is both anti-inflationary and promotes economic growth on a coordinated basis. We pledge our aid in the development of such a program.

Undoubtedly the Congress will consider all the circumstances leading to the Board's action. Meanwhile the Board should determine whether, in fact, its action can effect its stated purpose without grave damage to small business, to homebuilding, and to mortgage financing.

Chairman PATMAN. Without objection we will stand in recess until tomorrow morning at 10 o'clock in this room.

Thank you very much for your appearance, gentlemen.

(Whereupon, at 12:25 p.m. the committee recessed, to reconvene at 10 a.m., Thursday, December 16, 1965.)

RECENT FEDERAL RESERVE ACTION AND ECONOMIC POLICY COORDINATION

THURSDAY, DECEMBER 16, 1965

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

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

Present: Representatives Patman and Reuss; 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.

Today the committee will hear two prominent economists: Dr. Martin R. Gainsbrugh, who is a senior vice president of the National Industrial Conference Board and well known to this committee; likewise, Prof. Seymour E. Harris, professor of economics at the University of California, and professor emeritus of Harvard University, will testify.

Professor Harris has done much to enlighten us in the past and I am particularly pleased to see him here today. He has made a long trip all the way from California to oblige us. I want him to know that the committee appreciates this.

Before the testimony starts there are some additional items for the record. Without objection let the record include the staff analysis which has been prepared in conjunction with these hearings. In addition, of course, any data that members of this committee wish to place in the record with excerpts and statements as we have heretofore agreed upon will be received. I have been requested to put in the record the recent New Orleans speech of Secretary Fowler. Without objection this is done.

(The documents referred to follow:)

JOINT ECONOMIC COMMITTEE

BACKGROUND INFORMATION FOR FEDERAL RESERVE HEARINGS [1]

1. *Bank Profits.*—The attached table (table A) shows the relation between bank profits and the discount rate changes. The second column shows the rate of return; that is, the ratio of net profit to capital. Allowing for a timelag of about 1 year, profit increases followed the rate jumps of 1953, 1956, 1957, 1959, and 1963. Conversely, profits declined, allowing for a lag, pursuant to the rate drops in 1954, 1958, and 1961. The probability of a further rise in net profits attendant on the rise to 4½ percent in the discount rate is indicated by

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[1] Prepared by staff, Joint Economic Committee.

the sudden jump taken by bank stocks as reported in the Wall Street Journal and New York Times.

2. *Inflationary forces.*—The three major indicators are unit labor costs, plant capacity, and price movements. The following tables show movements in each of these series. Unit labor costs (and these are the figures used by the Fed) show them to be 100.6 as of October, based on the 1957–59 average of 100 (see table B). Over the whole year the increase was negligible and in itself would not justify any inflation fears. Our plant capacity utilization has risen from 87 percent last year to 90 percent (see table C).

TABLE A.—*Bank earnings and discount rates (for all Federal Reserve banks)*

Year	Net profit [1] and capital	Discount rate	Year	Net profit [1] and capital	Discount rate
1952	8.07	1¾	1959	7.73	3–4
1953	7.93	2	1960	10.03	4–3
1954	9.50	1½	1961	9.37	3
1956	7.82	3	1962	8.83	3
1957	8.30	3–3½	1963	8.86	3½
1958	9.60	2½–3	1964	9.40	3½–4

[1] It appears that increases in the discount rate raise bank profits. Allowing for a timelag of about a year, we see profit increases following the rate jumps of 1953, 1956, 1957, 1959, and 1963. Conversely, profits declined subsequent to rate drops in 1954, 1958, and 1961.

Table B.—*Unit labor cost (manufacturing)*

1964—October (auto strike)	101.2
November	99.5
December	98.9
1965—January	98.9
February	99.5
March	99.1
April	99.8
May	99.8
June	99.6
July	98.8
August	99.8
September	100.8
October	100.6

NOTE.—1957–59 average equals 100.

Table C.—*Plant capacity*

	Percent
1964—1st quarter	87
2d quarter	88
3d quarter	88
4th quarter	88
1965—1st quarter	90
2d quarter	90
3d quarter	90

NOTE.—The last preceding quarter with a rate as high as 90 was the 1st quarter of 1956. The last quarter with a higher rate than 90 was the 4th quarter of 1955, when the rate was 92 percent.

Overseas capital flows increased after the discount increase of November 23, 1964 (see table D). The discount rates and interest rates generally are higher than they have been since 1930. The accompanying chart shows the relative movement of these rates.

Money supply figures are also attached (table E). These show cash and demand deposits. In general, the money supply over the last year has grown at a rate of approximately 4 percent. Gross national product rose about 6 percent.

TABLE D.—*International capital transactions of the United States, short-term claims on foreigners reported by banks in the United States, by type*

[Amounts outstanding; in millions of dollars]

End of period	Total	Payable in dollars	
		Total	Other than loans, collections and acceptances [1]
1960	3,614	3,135	1,233
1961	4,726	4,177	1,837
1961 [2]	4,820	4,234	1,874
1962	5,163	4,606	1,967
1963	5,975	5,344	384
1964—September	6,806	6,132	428
October	6,912	6,242	446
November	6,964	6,303	432
December	7,469	6,810	552
December [3]	7,950	7,323	800
1965—January	7,762	7,130	779
February	7,881	7,220	765
March	7,929	7,327	706
April	7,794	7,243	668
May	7,768	7,191	673
June	7,748	7,180	599
July	7,560	7,025	564
August	7,531	7,020	542
September	7,490	6,995	507

[1] Until 1963 includes acceptances made for account of foreigners.
[2] These figures reflect the inclusion of data for banks initially included as of Dec. 31, 1961.
[3] Differs from December data in line above because of the exclusion as of Dec. 31, 1964, of $58,000,000 of short-term U. S. Government claims previously included; and because of the addition of $539,000,000 of short-term claims arising from the inclusion of claims previously held but 1st reported as of Dec. 31, 1964, and revision of preliminary data.

Source: Federal Reserve Bulletin, November 1965, p. 1639.

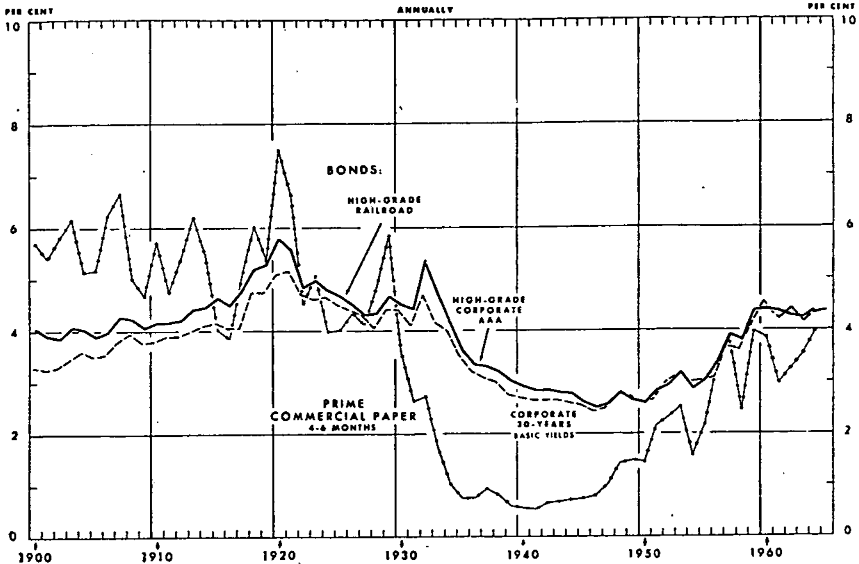
TABLE E.—*Money supply and related data*

[In billions of dollars]

Period	Seasonally adjusted			
	Money supply			Time deposits adjusted [1]
	Total	Currency component	Demand deposit component	
1957—December	135.9	28.3	107.6	57.4
1958—December	141.1	28.6	112.6	65.4
1959—December	141.9	28.9	113.1	67.4
1960—December	141.1	28.9	112.1	72.9
1961—December	145.5	29.6	116.0	82.7
1962—December	147.5	30.6	116.9	97.8
1963—December	153.1	32.5	120.6	112.3
1964—December	159.7	34.2	125.4	126.6
1964—September	158.2	33.9	124.3	122.1
October	158.8	34.0	124.8	123.5
November	159.1	34.2	124.8	125.1
December	159.7	34.2	125.4	126.6
1965—January	160.0	34.5	125.5	128.8
February	159.7	34.7	125.1	131.0
March	160.3	34.7	125.6	132.1
April	161.1	34.7	126.4	133.5
May	160.0	34.9	125.1	134.6
June	161.8	35.0	126.8	135.9
July	162.5	35.2	127.3	137.6
August	162.7	35.4	127.3	140.1
September	164.3	35.6	128.7	141.6
October	165.6	35.9	129.7	143.6

[1] At all commercial banks.

Source: Federal Reserve Bulletin, November 1965, p. 1562.



REMARKS BY HON. HENRY H. FOWLER, SECRETARY OF THE TREASURY, BEFORE THE PRESS CLUB OF NEW ORLEANS, HOTEL ROOSEVELT, NEW ORLEANS, LA., SUNDAY, NOVEMBER 28, 1965

For the South, as for the Nation, the closing decades of the 20th century hold forth the promise of progress and prosperity in all spheres of human endeavor of a kind and scale to surpass all we have seen and all we might surmise. To realize this promise we must look back on what we have learned and look ahead to the adaptation of these lessons to new situations.

Now, to look back.

For the last 57 months, nearly 5 years, the Nation has experienced an economic resurgence without parallel—an expansion remarkable not only for its length, but for its strength, its soundness, and its stability.

Certainly, the expansion we now enjoy was far from a foregone conclusion 5 years ago. Then the Nation was gripped by the fourth postwar recession—somberly aware that each of the three prior recessions had been followed by shorter and weaker recoveries, and that the previous recession had produced the largest peacetime budget deficit in our history. Unemployment was intolerably high. Business investment in new plant and equipment which for some years had been unable to clear a barrier to the path of steady increase was far less than we needed to generate more vigorous economic growth and a stronger competitive position in world markets—including our own home market which was becoming increasingly open to import competition. At the same time, a series of balance-of-payments deficits—averaging almost $4 billion a year for 3 years, had made the dollar vulnerable and threatened the international monetary system based upon it.

We faced dire possibilities: economic stagnation at home; interruption of the unprecedented postwar growth of free world trade and economic development; and the weakening of the financial base of U.S. political, diplomatic, and military power. These prospects clearly called for a revaluation of policy and a new program of action.

Since that time, there has been constant revaluation of policy and a steadily evolving program of action.

As a result, the 57-month-old expansion in our national economy has restored the dollar and the productive and competitive strength behind it to its previous

position of preeminence. The expansion has been broadly based, and its benefits have been broadly shared. They include:

A 35-percent rise in our total national output;

A 32-percent rise in consumer spending:

A 51-percent rise in business investment in plant and equipment;

A 39-percent rise in manufacturing production;

An 84-percent rise in corporate profits after taxes;

A 32-percent rise in personal income.

Our resurgent economic performance since early 1961, increasing our gross national product from a rate of $504 billion in the first quarter of 1961 to $677½ billion in the third quarter of this year has been marked by a rate of economic growth exceeding more than 5 percent a year, in constant prices, as compared to 2.5 percent in the 4 preceding years. This increase—this extra slice of the cake—exceeds the entire gross national product of France and Belgium. In fact, the increase alone in our national output over the past 57 months surpasses the total annual output of any other nation of the free world and continues to widen the already enormous gap between the productive capacity of the Soviet Union and our own.

During that expansion, as well, the unemployment rate has fallen from 6.9 percent in early 1961 to 4.3 percent last month—the lowest figure in nearly 8 years.

What is most impressive about this decline in the unemployment rate is that it has occurred at a time when our labor force has been growing at a phenomenal rate—as the young people born in the early postwar years have entered our work force in enormous numbers.

In the past year, from October 1964 to October 1965, the expansion has created 2.6 million new nonfarm jobs. In other words, in one 12-month span the U.S. economy has provided additional nonfarm jobs equal to the total employed in our eighth largest State—the State of New Jersey—or in the entire country of Denmark.

Impressive testimony, also, to the power of this expansion is the fact that—despite the impact of automation—employment in manufacturing rose last month to a record high of 18.2 million on a seasonally adjusted basis—slightly above the previous peak reached in November 1943 at the height of World War II factory production.

This region—this State—have shared fully in these abundant benefits of expansion.

Between 1961 and 1964, for example, in the States of the sixth Federal Reserve district which include Louisiana, Alabama, Florida, Georgia, Mississippi, and Tennessee:

The total number of nonfarm workers has grown by 8.3 percent, compared with 5.2 percent for the Nation as a whole;

Average weekly earnings of production workers in manufacturing have grown by 12.7 percent, compared with 11.5 percent for the Nation as a whole;

Total personal income has grown by 23 percent, compared with 18 percent for the Nation as a whole;

Per capita personal income has grown by 16 percent, compared with 13 percent for the Nation as a whole.

This awesome economic advance—in which so many have shared so amply—did not simply happen. It has been demonstrated that the business cycle does not move by the calendar but by our private and public policies. This economic advance is the direct result of public policies deliberately fashioned and coordinated to reinvigorate the private enterprise system as the prime mover in the achievement of our national economic goals on both the domestic and international fronts.

What are some of those policies?

In the presence of my good friends, Senator Russell Long and Congressman Hale Boggs, it is easy to give primacy to tax policy. As the majority whips of the Senate and House, and as leading members of the Senate Finance Committee and the House Ways and Means Committee, these two gentlemen from Louisiana played outstanding roles in the formation and adoption of a series of tax measures since 1962 that most analysts consider the key to the prosperity and dynamic growth that has marked the last 4 years. Senator Long will be remembered in history for, among other reasons, being the man whose superb leadership on the floor and in committee carried the Revenue Act of 1964 through the Senate. And Congressman Boggs has been a tower of strength in pushing for these constructive tax policies in the House.

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The investment tax credit of 1962 and its improvement in 1964, the liberalization of depreciation in 1962 and 1965, the corporate tax cut and individual tax rate reductions from top to bottom of the scale, the excise tax reductions enacted this year—these measures, at next year's levels of income, will add up to a net total of over $20 billion worth of annual tax reduction. And yet, during that same 5-year period—fiscal 1961 to 1966—Federal income tax revenues will have increased more than $18 billion because of the increased scale of corporate profits and personal income created by the rapid growth of the economy. It might be noted in passing that this revenue increase is substantially greater than the increase for the previous 5 years, when there was no tax reduction.

These measures provide dramatic new incentives and opportunities for the private individual and business to assume the dynamic constructive role that characterizes our American system. They have materially eased the burden of oppressive wartime tax rates that were imposed partly to restrain private investment and consumption and allowed to persist long after that need had passed. They have raised the profitability of a typical investment in new equipment by more than one-third. They have provided a massive increase in private demand.

To these tax reduction and incentive measures for expanding the rate of growth and role of the private sector, there was joined a vigorous program of control over increases in Federal Government expenditures—a program that reached new heights of intensity and effectiveness under the leadership of President Johnson. By combining severe restriction on increasing expenditures in 1964 and 1965 with revenues that increased beyond expectation, he pulled the projected budget deficit of $11.9 billion in fiscal 1964 down to $8.2 billion and in fiscal 1965 to $3.5 billion, despite the impact of the tax reductions previously cited.

These fiscal policies were coordinated effectively with monetary programs of the Federal Reserve Board which combined a reasonably expansionary credit policy and a relative stability of long-term interest rates to facilitate domestic growth with several increases in short-term interest rates to diminish outflows of short-term capital disadvantageous to achieving an equilibrium in our international balance of payments.

I would venture to say that, at no time in our history has our National Government pursued with such vigor or such success public policies designed to promote private economic growth, than over the last 4½ years.

The mix of public policies employed in this period of economic expansion has been designed to attack problems of inadequate growth and excessive unemployment in a manner planned to avoid inflation and to restore equilibrium to our balance of payments. Let me cite a few examples:

A dangerous reliance upon increasing aggregate demand as the sole answer to unemployment, with its attendant risks of inflation, was avoided by initiating early in the recovery an attack on structural unemployment through a manpower retraining program in the Department of Labor. This has been intensified and supplemented by various parts of the program of the Office of Economic Opportunity.

A first and early priority was given to securing incentives for investment in both expanded and more efficient productive and distributive capacity designed to encourage business (*a*) to avoid bottlenecks and inflationary strains, (*b*) to compete more effectively at home and abroad, and (*c*) to hold down increasing unit costs that might otherwise result from wage and other cost increases.

Early in 1962 the Council of Economic Advisers issued wage-price guideposts to help both business and labor arrive at noninflationary wage and price decisions.

But the key to our unexampled economic achievements has not been this mix of public policies alone—although it has created the climate and offered the encouragement and inducement.

The decisive element has been the response to that policy mix of the private sector of the economy—business, finance, and labor.

It is largely the character of that response that has kept our expansion relatively free from the excesses and imbalances that too often in the past have undermined our periods of prosperity.

Businessmen, for example, have greatly enlarged their productive facilities to keep pace with their expanding market potential, thus avoiding bottlenecks in production and inflationary strains on capacity. But at the same time, they have refrained from building far beyond foreseeable needs—and thus inviting the inevitable contraction.

Similarly, while inventories have been rising steadily in absolute terms, businessmen have by and large maintained them at conservative levels in relation to the growing volume of sales—thus forestalling another potential pitfall in the way of continuing economic advance.

A vast growth in the internally generated funds of business has helped assure ample financing for this growth in investment. But, in addition, the financial community has demonstrated its ingenuity in drawing upon our enormous potential for saving for funds to meet the financing needs of our businesses, our home buyers, and our State and local governments.

Even more crucial—both in terms of sustaining our domestic prosperity and improving our international competitive position—has been our excellent record of balance between wages and productivity gains.

We can all point to blemishes on that record—they have been widely publicized, and rightly so. But the key fact is that, for manufacturing as a whole, wage increases since 1960 have remained within the bounds of productivity growth—and, today, factory unit labor costs in manufacturing are actually a bit lower than they were when this expansion began.

We have refused, therefore, to fall prey to that sometimes alluring but always illusory process by which we force wages up beyond the capacity of the economy to absorb them, only to see the dollar gains in workers' income washed away by higher prices, with the attendant dangers of pressures on profit margins and of an inflationary and speculative psychology that would distort and impede an orderly growth in real output.

We see the ample fruits of this balance and this restraint in the relative stability of our industrial prices which, at the wholesale level, are only about 1½ percent higher than they were 6 years ago.

We see them also in the demonstrated ability of our expansion to adjust to potentially severe disturbances without serious damage or distortion.

For our expansion has not only survived, but surmounted, the sharpest break in stock prices in many years in 1962, as well as the smaller, but still sizable, declines earlier this year; the Berlin crisis in 1961 and the Cuban missile crisis in 1962; and large variations in our budgetary deficit, which rose to a peak of $8.2 billion in fiscal 1964 before it fell sharply to $3.5 billion only a year later.

These were tests that might easily have tripped up a less viable and durable expansion—but tests that we have met and mastered, avoiding recession on the one hand and inflation on the other, as business, labor, and Government have worked together in a climate of mutual cooperation and confidence.

And now to look ahead:

Since July 28 of this year, this winning combination of public policies and private cooperation has been subjected to its greatest test since early 1961. For on that day, after securing all the information available to him and hearing the advice of spokesmen for every admissible point of view, after exhausting every honorable means to bring the situation in Vietnam and southeast Asia to the negotiating table, and after searching his own mind and heart for countless hours, President Johnson told the world why he had been forced to make the decision to send tens of thousands of our young men into battle in Vietnam to fulfill our commitment to stand against aggression.

He said: "I have been in public life for more than three decades. In each of those 35 years, I have seen good men and wise men work to bring the blessings of our land to all our people. * * *

"It is what I have wanted all my life. And I do not want to see all those hopes—the dreams of so many people for so many years—drowned in the wasteful ravages of war.

"I will do all that I can so that never happens.

"But I also know, as long as there are men who hate and destroy we must have the courage to resist or see it all—all that we have built and all that we hope to build—dreams, freedom and all—all swept away on the flood of conquest.

"So this too shall not happen, we will stand in Vietnam."

Since that day, and that statement, every American, whether in public or in private life, has carried an added burden of responsibility. This is particularly true in the economic and financial sphere. Let me tell you why:

In amassing the gains from our expansion we have narrowed the gap between demand and supply so that today it is at the lowest point in our 57-month expansion. Private demand is increasing at a healthy rate and defense expenditures are rising because of accelerating action in Vietnam at a time when the availability of manpower, particularly skilled manpower, and unused efficient productive capacity, are at their lowest levels since early 1961.

We now have some new preliminary estimates of the administrative budget for fiscal 1966. It is expected that expenditures will fall within the range of $105 to $107 billion—some $5 to $7 billion more than originally estimated. The increase reflects not only Vietnam, but higher expenditures as a result of interest payments, increased crop output, higher pension payments, and other uncontrollable items. Controllable expenditures will actually be below original estimates, testifying to the discipline that President Johnson has enforced on the Federal budget.

While budget expenditures are rising, the expected deficit is rising by a smaller amount. The deficit is now estimated at $7 to $8 billion—up just $1.5 to $3 billion from the last official figure. Thus, while the budget will be more of a stimulative force in fiscal 1966, the additional stimulus will be appreciably less than many have expected. I believe that the new estimates do not imply any major inflationary threat stemming from the increased expenditures and the higher deficit, although the situation obviously calls for careful watching.

I want to stress that these figures for fiscal 1966 are preliminary and that work is still going on to refine them. As you know, work on the budget for fiscal 1967 is still far from complete and consequently, we have no very good fix on expenditures, revenues, or deficit for the coming fiscal year.

In the price sector, some disturbing signs have appeared. This year, there is a greater tendency for price increases to outweigh declines than in any year since 1958. Industrial wholesale prices have risen by 1.3 percent in 12 months after 6 years of comparative flatness. Consumer prices are 1.7 percent above a year ago, as compared with yearly increases averaging about 1.3 percent since 1958.

The situation calls for confidence in our private sector's capacity to match available supplies of men, materials, and productive margins with increasing demand, so that excessive pressures of demand on supply do not give rise to inflation. And it calls for action to do so. At the same time, we must recognize, both in the public and the private sector, that the margin for error is much smaller and the need for responsible restraint—particularly restraint on wage and price increases—is much greater; certainly until the conflict in Vietnam moves from the battlefield to the negotiating table and we no longer face its unpredictable consequences.

Some of the elements of responsible restraint in the period ahead for both Government and private industry seem clearly discernible:

Fiscal dividends from our economic growth in the form of tax cuts are, at least for the present, a casualty of the increasing requirements for the defense of freedom in Vietnam. These requirements have first claim on our anticipated revenue growth.

Responsible restraint in the period ahead also calls for a fiscal 1967 budget that will enable us to meet both our domestic objectives and our international commitments without fostering inflationary pressures. It calls for the kind of budget that President Johnson has given us in the past and is going to give us next year—a budget that reflects both the most stringent kind of fiscal discipline and the most effective response to essential national needs.

A policy of responsible restraint also requires an all-out effort by Federal and local government and private business to intensify the attack on structural unemployment and the upgrading of manpower resources by accelerating job training and retraining and improving the organization of the labor market. Despite gratifying improvement, overall unemployment is still significantly above the levels that represent a realistic noninflationary target for our economy. Moreover, there are some categories—particularly nonwhites and teenagers—where rates of unemployment are clearly excessive by any standard.

Responsible restraint also calls for joint action by Government and business to utilize and absorb in an orderly manner that will not disrupt normal markets the surpluses of material in Government stockpiles which are determined to be no longer needed for mobilization requirements, particularly when shortages or intense pressures of demand on supply may be reasonably anticipated.

The need for responsible restraint in making private price and wage decisions consistent with the wage-price guideposts of the Council of Economic Advisers is particularly acute against the background of smaller margins of unutilized labor and production capacity and the special responsibility the situation in Vietnam places on every American. It is not in the private interest and it is contrary to the national interest to gamble with the future for the sake of immediate—and, very possibly, temporary—gain.

There is one other area which requires comment—money, credit, and interest rates. There are those who have advocated, without any detailed knowledge of the budget for fiscal 1966 and the new budget for fiscal 1967, a sharp change in monetary policy to restrict further the expansion in money and credit. It seems to me that monetary policy so far has played a vital and constructive role in the coordinated mix of fiscal and monetary policy that has brought us to our present posture of economic strength. Credit has been ample, but not excessive, and has fueled a balanced economic expansion. It is premature and unwise to call for further restrictive monetary action now, in order to curtail the expansion of money and credit and raise interest rates more than the market has already raised them.

There may be room for honest differences of opinion among well-informed and unprejudiced persons on this issue. However, it is my strong belief that any orderly adjustment of a properly coordinated mix of fiscal and monetary policies to deal with the period ahead calls for that policy mix to be determined only with full knowledge of the President's new budget.

Of course, I recognize, as all realists must, that new facts and new developments may at any time call for a reexamination of the policy mix that has served us so well—and that there may well be circumstances when the use of monetary policy to combat inflation would be wholly appropriate. However, today's circumstances call for a policy of watchful waiting until the 1967 fiscal year outlook is clarified in mid-January with the presentation of the President's new budget.

It must never be forgotten that today's balanced expansion, free from inflation, reflects a combination and coordination of sound fiscal and monetary policies, intelligent business planning, and responsible restraint by business and labor in making wage and price decision.

Our task at home now is to prove that we can nourish and preserve that balanced expansion, free from inflation, in the darkening shadows of intensifying battle in Vietnam as well as we did in the months prior to July 28.

Senator MILLER. Do I understand cartoons may be placed in the record? If so, I will submit one from U.S. News & World Report.

Chairman PATMAN. By specific permission. If you have one we will be glad to pass on it.

(Cartoon later submitted by Senator Miller appears below.)

—Basset in "Washington Daily News"

"Hey, I Didn't Turn in Any Alarm!"

Dr. HARRIS. You may proceed.

STATEMENT OF DR. SEYMOUR E. HARRIS, CHAIRMAN, DEPARTMENT OF ECONOMICS, UNIVERSITY OF CALIFORNIA, SAN DIEGO, AND LITTAUER PROFESSOR OF POLITICAL ECONOMY, EMERITUS, HARVARD UNIVERSITY

Mr. HARRIS. Yes, sir, Mr. Chairman. Thank you.

At present there are some inflationary signs. But these do justify the use of the scalpel, not the sledgehammer. There is also evidence of deflationary factors at work.

Some precaution may be necessary; but not the use of a weapon that may deny the American people $40 billion of additional income expected in 1966 in the absence of restrictive monetary policies. With output rising about four times as much as prices in the years 1961–64 and four times as much in the third quarter of 1965, it is a foolhardy policy to introduce a dear money policy, especially in the light of serious rises of interest rates in the preceding year.

At most, economies in Government, inclusive of some stretching out of welfare programs and if necessary even a small increase in taxes and the use of anti-inflationary weapons already available, might be justified.

The Kennedy-Johnson administration has avoided a general attack such as the use of higher money rates. Experimentation with higher rates has not solved our balance-of-payments problem as Mr. Martin suggests would result from higher rates. The result of such policies would be a deterioration of economic conditions and less interest in investing capital at home rather than abroad.

Recourse to wage and price guidelines, sale of Federal stocks, control of capital exports, stimulus to investment and rising productivity—these direct attacks have served Presidents Kennedy and Johnson well.

Federal Reserve independence is an insane idea. Even in less troubled times, it is folly to allow the Federal Reserve to run in one direction and the Executive in another. President Johnson is—and President Kennedy was—a strong President, and whatever lipservice they may have paid to the independence theory, neither believed in it in practice. Even Mr. Martin, if we are to judge from his policies generally, does not believe in it.

Who wants higher rates here? Primarily European bankers because they are unwilling or unable to control their inflation; and American bankers who want higher prices for their product, and more profits. But the banking system and the Fed should serve the public, not the banks.

Congressman Patman reminds us that President Wilson, when confronted with a demand that bankers join in the control of the monetary machinery, made the classic remark: "Which one of you gentlemen would have me select presidents of railroads to be on the Interstate Commerce Commission to fix passenger rates and freight rates?"

THE OCCASION

The Federal Reserve Board increased its rediscount rate from 4 to 4½ percent on December 6.

THE ISSUE OF INDEPENDENCE

President Johnson quite rightly does not seem pleased with the "independent" and defiant action of the Fed.

I have never had much sympathy with the theory of independence. Particularly in these troubled times the Government certainly should not move in one direction and the monetary authority in another. The latter has every right to push its views before Government decides on a policy. But once the decision is made monetary policy must be an instrument of Government policy, not a barrier to its achievement.

In the famous accord of the early 1950's to which Senator Douglas contributed so much, the issue was that monetary policy should not be determined primarily or exclusively by an assumed need of supporting the price of Government bonds. I am sure that this accord did not sanction divergent policies between the executive and the Fed.

In fact, despite Mr. Martin's frequent avowal of the independence theory, he in fact does not operate independently most of the time. Under Eisenhower, he and the President proclaimed an independent status for the Fed; but actually Martin gave the President what he wanted; namely a restrictive monetary policy that reflected the administration's excessive fear of inflation.

Under Kennedy and Johnson, the Fed, in its monetary policy, accommodated itself to the requirements of a rising GNP, in turn responding to an unprecedented and potent fiscal policy.

Indeed, both Presidents Kennedy and Johnson have affirmed the independence of the Fed. I doubt that this is more than paying lip-service to the slogan that the Fed is independent. Two strong Presidents are not likely to go for the independent theory in practice. On several occasions I talked to President Kennedy on this issue, and it was clear to me that independence meant little in practice to him. The policy of the Fed in the 1960's confirms this fact. The President did not hestitate to tell the Fed what he wanted; and what he wanted he got.

INFLATIONARY PRESSURES

I agree that there are some indications of increased inflationary pressures. The escalation of the Vietnam war, the unlikelihood that the 3- to 3½-percent annual rise in productivity can be maintained, the increasing number of bottlenecks, the large rise of money and quick substitutes for money and bank loans, the reduced level of unemployment and hence pressure on wages, the expected rise of Federal deficits, are among the factors that raise the specter of inflation.

The need of exercising caution is clear. Many are urging dear money. But it must be clear that there has already been a substantial rise of money rates. If the advice of some outstanding bankers and economists for restrictive monetary policy had been taken as early as 1962, we never would have achieved anything like a $700 billion economy.

Mr. Chairman, perhaps you saw the letter from Professor Tobin in the New York Times which is an awfully good letter. I might suggest if I may that it be put in the record.

Chairman PATMAN. It was put in the record. (See p. 342.)

Mr. HARRIS. I would like to read two paragraphs from it.

The facts are the Federal Reserve participates widely in the policymaking process of the executive branch and the President regularly receives the counsel of the Federal Reserve Board Chairman along with that of higher officials in the economic quadriad. The reverse is much less true.

Because of the paranoic mania for the Federal Reserve independence, the Federal Open Marget Committee, the real hard core on policy in this country, does not even let the Secretary of the Treasury or the Council of Economic Advisers inside the door to explain the administration's fiscal outlook or strategy.

Mr. Chairman, it is also true that Mr. Maisel said he was all for independence but I think if you will read his statement and what he means by "independence" I would be perfectly willing to accept that kind of independence from the Federal Reserve because what this statement really says is that above all you have to have integration between the executive and the Federal Reserve.

If that is what you mean by "independence," I am all for it but I do not understand that is Mr. Martin's view of independence.

What is the appropriate policy in Washington? Is it to introduce really dear money and abort a recovery of 58 months and almost $200 billion? The policymaker has to choose between allowing a slight hardening of rates and even possibly a small increase in taxes and a stretching out of welfare expenditures and continuing the recovery, or using a monetary sledgehammer and depriving the people of $40 billion additional income in 1966.

IS THIS THE TIME?

A restriction of monetary supplies at a time when the percentage increase of GPN is four times that of the rise of the price level, as it was in the third quarter of 1965, does not seem like the most propitious time to introduce dear money. Surely a $40 billion rise of GNP (annual rate) should not be snuffed out because prices are rising even at 2 percent a year.

The verdict is almost unanimous that we are to have a very good year in 1966; but these projections are based on the assumption that monetary policy will be accommodating; not destructive of progress. (Two of the leading forecasters anticipate a rise of GNP of $42 billion (Lintner) and $40 billion (Suits).)

I might add that more recent projections have been a little higher.

WHO WANTS HIGHER LONG-TERM RATES?

The strongest supporters of higher long-term rates are bankers, European and American. The former blame us for their inflation and they would have us deflate our economy through higher long-term rates because they are unable or unwilling to introduce the measures which would effectively treat their inflation. They want us to do their job.

Incidentally, from the viewpoint of the responsibilities to the Nation, they should have some responsibilities to influence the balance

of payments because the creditor countries have a certain amount of responsibility in this area.

As for the American bankers, they are simply interested in raising the price of the product they sell. Their profits are high and rising; but they want market forces, with an assist from the Fed, to raise their profits even more. Somehow they do not seem to realize that a high money rate will reduce the national product and hence even at higher prices cut into banker's profits.

In suggesting the Federal Reserve Board in the Federal Reserve organization, President Wilson above all sought to protect the interests of the public; not those of the bankers. He was quite sarcastic when he inquired in discussing the nature of the Board, whether it would be appropriate to have a railroad executive determine railroad rate. Yes Mr. Martin speaks for his clients, the bankers. He apparently has acknowledged that the pressure of the New York bankers was becoming irresistible and therefore, higher rates had to be introduced. Evans and Novak (Los Angeles Times, Dec. 9, 1965) in an able article wrote:

> * * * The Martin affair again raises the question of whether this vital economic henhouse should be guarded by the banking forces of New York—or by the public's elected officers.

I should also like to say parenthetically I am sure something should be said about doing something about certificate deposits but it should be pointed out that this particular measure on the whole favored the commercial banks against loan institutions and also against the savings banks. One might ask the question of why corporations should be allowed something like 5 or 5½ percent on their capital when the Federal Reserve has done nothing to increase the return on savings deposits which is now set at a ceiling of 4 percent even though the people with savings deposits are a much lower income group than the owners of the corporations that give you these corporation deposits. Incidentally, it is also interesting that the bankers all approved the increase in the rate on the amount of money which they will be able to lend but they are not so sure that they want to pay a higher price for the corporate deposits.

CHAIRMAN MARTIN ON HIGHER RATES

The Chairman has been an early advocate of high money rates. Early in 1963 he announced that then he would not finance the deficit, that is provide the money to finance the resultant higher GNP, which would result from the tax cut. Mr. Martin, it was charged, was vetoing the tax cut. Under pressure he modified his position.

In an address of December 9, 1963,[2] Chairman Martin said:

> At a meeting 12 months ago—on December 18, 1962, to be exact—the Committee came to the conclusion that it would be dangerously inappropriate to continue further the extensive degree of credit ease that had been long prevalent—since at the least the beginning of the 1960's. Accordingly, it redirected its policy toward lessening that degree of ease and toward accomodating moderate further increases in bank credit and money supply, while aiming at money market conditions, that would minimize capital outflows internationally.

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[2] Monthly Report, Federal Reserve Bank, New York, January 1964.

This tightening of credit, please note, came with GNP at $567 billion and unemployment at more than 5½ percent. The rise of GNP to about $690 billion by the last quarter of 1965 and an expected $710 billion in 1966 suggests the unwisdom of these restraints late in 1962.

Actually, Mr. Martin's policies were not as highly restrictive as under Eisenhower. He frequently pronounced on the excessive supplies of money, and unwillingness to create more bank reserves. But the fact is that Federal Reserve credit even from 1962 to 1964 expanded at a substantial rate and member bank reserves adequately. There was a difference between what Mr. Martin said and what he did. The pressures of that public spirited and able watchdog, Congressman Patman, the two Presidents and the Council of Economic Advisers, and the Treasury certainly contributed to monetary expansion.

Of this we may be sure. Had policy followed the proposals of the finance men and the announcements of Mr. Martin—undoubtedly to please his clients the finance men—we never would have experienced a rise of GNP of almost $200 billion since 1960. Fortunately, the executive paid little attention to those seeking higher rates.

DEFLATIONARY FORCES

Earlier I listed some inflationary pressures in the economy. But it would be a mistake to assume that the net inflationary forces are clear and sufficiently strong to justify a restriction in the supply of money.

(Chairman Martin may indeed announce that the rise in rates is not a measure to restrict credit. But a higher price for a commodity affects demand for it. Surely, a strong supporter of free markets like Chairman Martin cannot deny the relationship of supply and demand.)

Against the inflationary forces itemized, there are also some deflationary forces.

1. The substantial rise of interest rates already consummated is one such force. Thus, in the year ending September 1965, there were serious rises in interest rates, and rises that were brought about partly by Fed control of free reserves:

	Percent rise
Prime commercial paper, 4 months	13
U.S. 3-month Treasury bills	11
U.S. 3–5 year securities	5
U.S. long-term bonds	2
Corporation bonds	3
State and local bonds	3½

Increases of those proportions for long-term securities are really very serious.

2. The very large increase of payroll taxes scheduled for 1966.
3. Restraints imposed by the deficit in the balance of payments and the reduced stimulative effect associated with a decline in the excess of exports.
4. Excessive inventories that have to be reduced, and notably in iron and steel.
5. A tendency for growth of capacity to exceed capital output (Fortune, December 1965).

On the net impact of inflationary and deflationary forces, it is well to remember that prior to the acceleration of the Vietnam war, a view widely held was that in order to sustain the growth into 1966, it would

be necessary to raise expenditures or (and) reduce taxes. The effect of Vietnam seems to have been to provide the additional stimulus needed, rather than to bring a net inflationary situation.

How effective is a rise of interest rates? For example, in solving the dollar problem?

Martin claims that higher rates will help solve the balance-of-payments problem; but the Executive since 1961 has fought higher interest rates as a solution to the dollar problem. Even such conservative (but very able) authorities like Secretary Roosa fought increases in the long-term rate of interest from 1961 to 1964. Some concessions were made on short-term rates; but an examination of short-term capital movements does not for a moment suggest that the higher short-term rates were very effective.

From 1961 to 1964 we had a tremendous outflow of short-term capital. Only in 1965 was this reversed and it was reversed because of the voluntary capital control program, not because of any change in the rate of interest.

And what of higher long-term rates? The assumption is that these higher rates invite capital to come in and less capital to go out. But when the return abroad may well be 25 percent on direct investments abroad compared to one-half as much at home, the rise of long-term rates will not be very effective. What is more, capital will not be attracted here by a policy that deflates the economy and reduces output.

HOW TO COMBAT INFLATIONARY PRESSURES?

Dear money is not the only way to treat inflation. In fact the Kennedy-Johnson administrations have shunted the old-fashioned classical approach so strongly pushed by finance men.

In the international field major recourse has been had to other weapons: Tied loans, rising productivity, control of capital movements, guidelines for determining wages and prices, sale of Government stocks, and stimulation of additional output of capital.

Above all, the Kennedy-Johnson administrations have preferred these direct attacks to an overall measure like higher long-term rates. Relying on guidelines is painful. One large contract may tie the White House up for a week. I am not so sure the guidelines will work in the long run because coverage tends to extend to a point where overall wage and price control become necessary. Purchasing power shunted from iron and steel, copper, and aluminum finds its way to other industries and pushes wages and prices up.

But the Kennedy-Johnson administrations have preferred this painful and difficult approach to the two alternatives: first, inflation; second, higher interest rates and a reduction of purchasing power. Confronted with similar situations, President Eisenhower allowed wages to rise and then to exclude inflation, restricted the supply of money. The result was of course increased unemployment and, over several years, the unusual "achievements" of price rises of 3 percent a year and also wage increases of 5–6 percent a year.

The foregoing represents my statement which necessarily had to be prepared with some haste. I have had several additional days to think about the problem.

One cannot be certain that the rise of one-half of 1 percent in the Reserve bank will have serious effects on the economy. But it was a most unwise move, nevertheless, because the increase was heralded as a danger signal calling for great restraint. And it would have been much easier to continue as in the past and allowing a slight further hardening of rates as demand exceeded supply. Then there would not have ensued great doubts in a period of continued economic advance.

Over the years 1961–65 the Fed always had the alternative of not making available the amount of cash which might contribute to substantial inflation. The fact is that the Federal Reserve credit rose from $27 to $39 billion from the end of 1960 to September 1965. This rise of credit financed $4 billion of gold outflow, $7 billion of additional money in circulation and $1½ billion of additional member bank reserves. ($1 billion of the last was financed by additional reserves of currency and coin.)

Obviously the Fed could have dealt with any inflationary danger less dramatically by financing additional member bank reserves at somewhat less generous levels instead of the dramatic use of higher money rates.

The real issue is, is the rise of December a prelude to a more serious increase of interest rates and the end of the recovery? In view of the pressures on Mr. Martin, his numerous early pronouncements, and the seeking of the shelter of the "independence" theory, I am afraid that the Fed will continue to move excessively in this direction.

Chairman Patman, I mentioned I would like to have my Los Angeles Times letter put in the record, if you don't mind.

Chairman PATMAN. Yes, sir; without objection, it is so ordered.

(The document referred to follows:)

DECEMBER 2, 1965.

To the Letters Editor of the Los Angeles Times:

In your issue of November 30, you urged a dear money policy. I agree that there are some indications of increased inflationary pressures. The escalation of the Vietnam war, the unlikelihood that the 3–3½ annual rise in productivity can be maintained, the increasing number of bottlenecks, the large rise of money and quick substitutes for money and bank loans, the reduced level of unemployment and hence pressure on wages, the expected rise of Federal deficits are among the factors that raise the specter of inflation.

The need of exercising caution is clear. Many are urging dear money. But it must be clear that there has already been a substantial rise of money rates. If the advice of some outstanding bankers and economists for restrictive monetary policy had been taken as early as 1962, we never would have achieved anything like a $700 billion economy.

What is the appropriate policy in Washington? Is it to introduce really dear money and abort a recovery of 58 months and almost $200 billion? The policymaker has to choose between allowing a slight hardening of rates and even possibly a small increase in taxes and a stretching out of welfare expenditures and continuing the recovery or using a monetary sledge hammer and depriving the people of $40 billion additional increase in 1966.

It is difficult to introduce a dear money policy at a time when gross national product is rising by about $40 billion (annual rate) and when the increase in gross national product percentagewise is four times that of prices, as it was in the third quarter of 1965. Surely the $40 billion of gross national product is a greater gain than the loss to be associated with a 1½ percent price inflation.

There is indeed a point when the rise of prices becomes more costly than the gains from a higher gross national product. At 10 percent gain of gross national product and 1 percent rise of price, the case for growth is strong; and at 1 percent gain of gross national product and 10-percent inflation, the case is

strong for anti-inflationary policies. I would intuitively choose a growth policy so long as the percentage rise substantially exceeds the inflation. We need much growth to raise our standards of living and to remain strong.

SEYMOUR E. HARRIS,
Chairman, Department of Economics, University of California, San Diego, and Littauer Professor of Political Economy, Emeritus, Harvard University.

Chairman PATMAN. Dr. Gainsbrugh?

TESTIMONY OF MARTIN R. GAINSBRUGH, SENIOR VICE PRESIDENT, NATIONAL INDUSTRIAL CONFERENCE BOARD

Mr. GAINSBRUGH. First, I would like to compliment my colleague this morning for staying within his time limit. That is not always true of our profession. Next, I would like to add that I have no cartoons to submit.

In accepting the invitation to appear before this distinguished committee—and it is an honor—we at the conference board did so in the hope of shedding more light upon the economic conditions which have given rise to the recent revision in monetary policy by the Federal Reserve System, and to which this revision is likely to give rise in turn.

I shall spend virtually all my time on the present economic outlook, because this is a field to which the National Industrial Conference Board devotes so much of its resources, rather than to banking per se.

My presentation is divided into two parts. The first part, I believe, will be of interest to all of you. Recognizing the intensity of interest in the outlook for private investment in 1966, we undertook, just a week ago, a telegraphic survey of the thousand largest manufacturing corporations in this country. We asked them about the effect of the change in monetary policy on their capital investment plans for the present quarter, for the quarter ahead, and for the calendar year 1966.

The results of this survey will be the first part of my presentation. The second part contains a brief commentary on the outlook for 1966 in the light of this survey and related analyses. In that connection, I would like also to refer on occasion to the views of our own conference board economic forum, a group which has met each year for the past 20 years to discuss the outlook for the year ahead.

They met 2 weeks ago at their annual session. But I polled that group just 2 days ago to see what changes were necessary in their views for 1966 on the basis of the change in monetary policy of the Federal Reserve System. I will report on these latest opinions. Among the members of that economic forum are the economists for Du Pont, for United States Steel Corp., for Sears, Roebuck, for Armstrong Cork, for American Airlines—you can see the depth there of industry participation. Other members are outstanding academicians such as Paul McCracken, Jules Backman, and Solomon Fabricant; and bankers such as Roy Reierson and Armand Erpf from the investment fraternity.

EFFECT OF RECENT CHANGES IN MONETARY POLICY UPON CURRENT AND PROSPECTIVE BUSINESS OUTLOOK

I. THE OUTLOOK FOR CAPITAL INVESTMENT

Trends in capital spending

Let us turn first to the outlook for capital investment in the light of change in monetary policy. Capital spending by American industry has been and continues to be a major support for the Nation's economy. Between 1964 and 1965 capital spending increased by 15 percent, continuing a broad expansionary trend which has seen outlays for new plants and equipment rise from $34.4 billion at the beginning of this expansion to a prospective level of $51.8 billion in the current year—and perhaps as much as 15 percent in the calendar year 1966, even after change in monetary policy.

At the end of the last month the conference board reported the findings of its survey of capital appropriations—which has been financed since its inception by Newsweek magazine—for the third quarter of 1965. This series was first developed back in 1955 and is now recognized as having the longest leadtime of any sensitive indicator in our system of economic intelligence. The survey showed that the thousand largest manufacturing companies authorized the spending of $5.8 billion for plant and equipment in the coming quarters.

This is a sixth above the rate in the same period a year ago. Even more important, the backlog of funds on authorization for future expenditure, moreover, has risen for 12 consecutive quarters to a new 13-year record of $18.2 billion. This backlog is four times the rate of current expenditures. Continuation of this trend into the final months of this year would assure that capital spending will rise nearly as much in 1966 as it did in 1965. The reason behind that assurance is appropriation precedes spending by some 10 to 13 months.

A few days ago the Department of Commerce and the SEC issued their joint report on business plans for new plant and equipment expenditures—this was one of the most salient statistics of the fourth quarter of 1965. It confirmed our earlier findings that capital outlays next year are likely to rise as rapidly, if not more rapidly, than they did in 1965.

The available data on capacity utilization suggest that factories are operating a bit below their preferred rates. Even so, an earlier board survey found that the vast majority of manufacturers must increase their productive facilities in order to satisfy customer demands both currently and in reasonable prospect for the year ahead. The continuing decline of inventory-sales ratios in the manufacturing and trade industries lends further confirmation to these indications by suggesting that manufacturers are making current production and productive capacity bear an increasing share of the burden of meeting sales requirements.

Thus, a continued increase in the stock of plant and equipment is evidently in line with the growing demands of the economy and with the changes in the manner in which industry is meeting those demands. Additions to productive capacity may, moreover, help materially to contain any incipient tendencies toward price markups which have begun to appear here and there in product markets. Nevertheless,

there is a legitimate concern lest continuing sharp increases in plant and equipment spending outrun gains in sales at some future time. They have not as yet. There is in this concern some justification for actions which may help to screen out the less soundly considered capital projects and leave in those which are more certain to find a ready and sustained market.

THE BOARD'S TELEGRAPHIC SURVEY

Last Thursday evening the board sent a telegram questionnaire to the thousand largest manufacturing companies with the purpose of ascertaining the influence which the change in Federal Reserve monetary policy initiated the preceding Sunday night might have upon the companies' capital investment programs. The full text of that very long night letter appears below. We worked hard on this telegram to prevent possible response bias. This is a difficult thing to do in a telegraphic questionnaire. The language used is as colorless as possible. The opening paragraph reads, "The conference board requests information on the influence on your company's capital appropriations for domestic investment of last Monday's change in Federal Reserve monetary policy, please wire answers for receipt not later than Monday a.m. December 13. Replies held confidential, information important. Thank you."

Notice that the telegram did not say "wire collect."

Copy of telegram questionnaire:

The conference board requests information on the influence on your company's capital appropriations for domestic investment of last Monday's change in Federal Reserve monetary policy. Please wire answers for receipt not later than Monday a.m. December 13. Replies held confidential. Information important. Thank you.

1–A. Has the Federal Reserve action influenced your company's capital authorizations in the current quarter?—Yes or no.

1–B. If yes, is this influence slight (under 5 percent) or substantial (5 percent or over)?

2–A. Will the Federal Reserve action influence your company's capital authorizations in the first quarter of 1966?—Yes or no.

2–B. If yes, will this influence be slight or substantial?

3–A. Will the Federal Reserve action cause a change in your company's planned expenditures for plant and equipment in calendar 1966?—Yes or no.

3–B. If yes, will this influence be slight or substantial?

4. As you judge current business conditions, do you regard the Federal Reserve action at this time as well advised?—Yes or no.

MARTIN R. GAINSBRUGH,
Senior Vice President, National Industrial Conference Board.

It is a testimonial to the degree of interest industry manifested in this decision that of the thousand requests we made, 644 responses were received at the time this tabulation was completed as of Tuesday noon and some more have come in since that time.

Chairman PATMAN. Have you provided a breakdown?

Mr. GAINSBRUGH. Yes; tables 1 and 2 show all of the answers. I would like to highlight some of the findings.

Chairman PATMAN. Please do. It is very interesting.

TABLE 1.—*Influence on manufacturing companies of change in Federal Reserve monetary policy of Dec. 5, 1965*

[Percentage distributions]

	Influence of Federal Reserve policy change on—		
	All manufacturing [1]	Durable goods industries [2]	Nondurable goods industries [3]
1. Capital authorizations, fourth quarter, 1965:			
Slight [4]	0.9	1.3	0.4
Substantial [5]			
No effect	98.9	98.4	99.6
Nonresponse	.2	.3	0
2. Capital authorizations, first quarter, 1966:			
Slight [4]	2.2	2.4	1.9
Substantial [5]			
No effect	97.4	96.8	98.1
Nonresponse	.4	.8	0
3. Planned capital expenditures, calendar 1966:			
Slight [4]	6.5	5.6	7.8
Substantial [5]			
No effect	92.4	92.5	92.2
Nonresponse	1.1	1.9	0

[1] Number of answers received, 644.
[2] Number of answers received, 374.
[3] Number of answers received, 270.
[4] Under 5 percent.
[5] 5 percent or over.

TABLE 2.—*Assessment by company managements of change in Federal Reserve monetary policy of Dec. 5, 1965*

[Percentage distributions]

Was the policy change well advised at this time?	All manufacturing [1]	Durable goods industries [2]	Nondurable goods industries [3]
Yes	79.0	78.9	79.3
No	8.1	8.8	7.0
Uncertain	12.9	12.3	13.7

[1] Number of answers received, 644.
[2] Number of answers received, 374.
[3] Number of answers received, 270.

Mr. GAINSBRUGH. Three questions, designed to indicate the impact of this policy change in successive periods of time, were asked. First, we inquired whether the Federal Reserve action would influence the companies' capital authorizations in the current quarter—that is the fourth quarter of 1965—and whether capital authorizations would be influenced slightly—less than 5 percent—or substantially—5 percent or more. We were told in 98.9 percent of all replies that the Federal policy change would have virtually no effect on capital authorizations in this quarter. Not a single company believed it would have a substantial effect and only nine-tenths of 1 percent believed that it would have a slight influence.

Next, we asked them to indicate the influence of this monetary change upon capital authorizations in the coming quarter—first quarter 1966. Here 2.2 percent indicated that this policy change would cause a slight readjustment. (We defined "slight" as being under 5 percent.) Still no company believed it would exert a substantial effect—of 5 percent or more—on authorizations in this period and over 97 percent believe it would have no effect whatsoever.

Our third question—perhaps the most important question of the three—inquired into the impact of the Federal Reserve action upon the companies' current plans for capital expenditures in the calendar year 1966. There has been considerable concern that the FTC–SEC

projections for 1966 may have been undercut by the change in monetary policy.

Here, again, no company expected expenditures next year to be revised downward by 5 percent or more, and over 92 percent expected no revision whatsoever. However—and this is why I am emphasizing the time progression—as the year runs on it would appear from the judgment of 6½ percent of the respondents that capital investment would bring about a slight—under 5 percent—downward revision in the light of the change in monetary policy.

These findings show that the change in interest rates will affect more and more companies as the coming year wears on, as would be expected. But, at the same time, no capital project currently planned seems likely to be cut back significantly. This suggests that the effect of the policy change will be to induce corporate managements to review their investment programs in order to postpone or to eliminate less profitable ventures.

This is a most desirable effect of the recent action by the Federal Reserve since it will help to reduce unnecessary demands for funds from the banking system and the securities markets at a time when the financial system is in a highly illiquid position.

Finally, and this is the last question in our telegram, we asked the enterprises, "As you judge current business conditions, do you regard the Federal Reserve action at this time as well advised?" Nearly 13 percent of the companies appeared uncertain about the significance of the policy change. At least they offered no response. Of the total, however, 79 percent were in agreement with the change although a number of them raised questions as to the exact timing involved. Only 8 percent of the companies indicated they felt this change was ill-advised at this time.

I would like to read the contents of three or four telegrams I received in the belief you will find them a testimonial of the extent to which our questions were given serious, searching consideration.

Chairman PATMAN. Certainly, you may read them.

Mr. GAINSBRUGH (reading):

Reserve action at this time seems well advised. By raising the cost of money it has placed a restraining force on domestic economic expansion while making our interest rates more in line with those in the international markets. If investments continued at the present pace they would equal another 15-percent increase and could result possibly in overexpansion for producing more goods than there are customers, requiring later heavy investment cutbacks that might undermine entirely the economy. However, it still allows businessmen the flexibility to respond to favorable investment opportunities while less sound projects would be abandoned because of the higher cost of financing.

That is one of the telegrams we received.

Senator PROXMIRE. Would you like to identify the one who sent the telegram?

Mr. GAINSBRUGH. We assured the senders of the telegrams of the confidential character of their response. We would like to respect that. I can identify it to the extent of noting that it is one of the thousand largest corporations, but not a very large one within this group.

Another reply read:

Last Monday's change in the Federal Reserve monetary policy will have no effect on our capital appropriations either now or in calendar year 1966. Most companies expect a much higher return before approprating money. The re-

cent change in the Federal Reserve is well within the margin of error of corporate estimates. I believe the action was well advised at the time because shortages in both certain fields and certain skilled labor would lead to substantial inflation.

I tried to select three answers which gave different points of view, and here is the last one. "Federal Reserve action will not influence this company's decisions on capital authorizations or expenditures. Reserve action is well advised but timing might have been deferred to January 1966."

And this point was made in several of the telegrams.

Moving on from this special survey that we attempted, I also polled the various members of The Conference Board Economic Forum and asked them two questions.

Excluding Government participants—because I did not think it was wise to raise this question with them—I found that no member of our forum cut back on his economic projections for 1966 because of the change in Federal Reserve policy which was made after his model for 1966 had been supplied to us. I did find that in quite a few instances the economists in building their model for 1966 had already assumed action by the Federal Reserve similar to that which was subsequently taken. The question of timing was again raised in one or two instances.

Let us move on from this telegraphic survey to the implications of this change in policy for the economic outlook for 1966.

Acceleration in defense spending is now widely accepted as a far more important factor in appraising the future course of the economy than when the first rough models for 1966 were drawn back in September or October. This, coupled with the sharp burst in capital outlays anticipated in the Commerce SEC series just released, has compelled intensive reexamination of yearend forecasts. Expanded as the dimensions of absolute defense outlays may be in 1966, they should also be viewed in relative terms, as percentages of total output, in considering the probable need for restrictive monetary fiscal or related measures. Some of us are of the school that believes no single economic statistic has much meaning. It is only when you relate that statistic to the whole, of which it is a part, that it starts to take on meaning.

In this connection we have prepared table 3, entitled "National Defense Expenditures and Military Personnel," all based on official data. It shows that expenditures for national defense have risen by about $3 billion this year. In the third quarter of 1965, such spending totaled $50.8 billion and this was, in turn, equivalent to 7.5 percent of our gross national product.

TABLE 3.—*National defense expenditures and military personnel, quarterly, 1950–65*

Year and quarter	Government expenditures for national defense		Military personnel on active duty, July 1 (thousands of persons)
	Billions of dollars	As percent of GNP	
1950—1st quarter	12.5	4.5	1,460
2d quarter	12.6	4.6	
3d quarter	14.2	4.8	
4th quarter	17.1	5.6	
1951—1st quarter	24.1	7.6	3,249
2d quarter	30.4	9.3	
3d quarter	37.7	11.3	
4th quarter	42.1	12.5	

See footnotes at end of table.

TABLE 3.—*National defense expenditures and military personnel, quarterly 1960–65*—Continued

Year and quarter	Government expenditures for national defense		Military personnel on active duty, July 1 (thousands of persons)
	Billions of dollars	As percent of GNP	
1952—1st quarter	42.5	12.5	[1] 3,685
2d quarter	45.7	13.5	
3d quarter	47.0	13.6	
4th quarter	48.5	13.6	
1953—1st quarter	49.2	13.5	3,555
2d quarter	49.5	13.5	
3d quarter	48.4	13.2	
4th quarter	47.6	13.2	
1954—1st quarter	44.4	12.3	3,302
2d quarter	42.0	11.7	
3d quarter	39.9	10.9	
4th quarter	38.5	10.3	
1955—1st quarter	38.7	10.0	2,935
2d quarter	38.2	9.7	
3d quarter	39.2	9.7	
4th quarter	38.1	9.3	
1956—1st quarter	38.4	9.4	2,806
2d quarter	40.4	9.7	
3d quarter	40.4	9.6	
4th quarter	42.1	9.8	
1957—1st quarter	43.4	9.9	2,796
2d quarter	44.1	10.0	
3d quarter	44.8	10.0	
4th quarter	44.6	10.1	
1958—1st quarter	44.7	10.3	2,601
2d quarter	45.7	10.4	
3d quarter	46.3	10.3	
4th quarter	46.9	10.1	
1959—1st quarter	46.5	9.8	2,504
2d quarter	46.1	9.5	
3d quarter	45.7	9.4	
4th quarter	45.9	9.4	
1960—1st quarter	45.0	8.9	2,476
2d quarter	44.4	8.8	
3d quarter	44.6	8.8	
4th quarter	45.8	9.1	
1961—1st quarter	46.9	9.3	2,484
2d quarter	47.7	9.3	
3d quarter	47.7	9.1	
4th quarter	48.9	9.1	
1962—1st quarter	51.1	9.3	2,808
2d quarter	53.0	9.5	
3d quarter	51.3	9.1	
4th quarter	50.9	8.9	
1963—1st quarter	51.5	8.9	2,700
2d quarter	50.5	8.7	
3d quarter	51.0	8.6	
4th quarter	50.3	8.3	
1964—1st quarter	49.8	8.1	2,700
2d quarter	51.7	8.3	
3d quarter	49.5	7.8	
4th quarter	48.8	7.6	
1965—1st quarter	48.9	7.4	[2] 2,700
2d quarter	49.4	7.4	
3d quarter	50.8	7.5	

[1] Korean peak Apr. 30, 1952. Labor force totaled 61,700,000 in same month.
[2] Figure for September 1965. The number in the total labor force was 78,000,000.

Sources: U.S. Department of Commerce; U.S. Department of Defense.

In contrast, at the start of the Korean war they equaled only 4.5 percent of the gross national product. At the peak of that effort in late 1952, nearly twice as much of the national output, 13.6 percent, was siphoned for this purpose than is currently spent.

The impact of defense activities on the economy is perhaps more clearly seen in terms of military personnel requirements and its drain upon the labor force. As also shown in table 2, military personnel on active duty currently number about 2.7 million. As in the case of defense outlays, the absolute dimensions of our defense forces prior to involvement in Vietnam are of a substantially higher order than prior to the Korean war. The military then—that is, in the second quarter of 1950—numbered 1,460,000. The peak came in April 1952

at 3.6 million. And yet, in relative terms, the Armed Forces today—when they total 2.7 million—are equivalent to only 3.5 percent of the total labor force compared to 6 percent at the Korean peak. Finally, the total number in the field in Vietnam is currently placed at 170,000 as against nearly 500,000 in the earlier instance.

Clearly the burden of the Vietnam war to date is far less taxing both in manpower and material. Equally important, we begin from a broader defense base than prevailed in 1950. We can divert manpower within the Armed Forces to a greater degree than we could back then. We can adjust spending within a matrix of total defense outlays that are far greater in absolute terms then in 1950.

Looking ahead, the prospective impact of Vietnam does not yet seem to imply a much heavier load in 1966 in relative terms on either capacity to produce or manpower. In most yearend models, expenditures for national defense are now assumed to rise by $5 billion to $6 billion as the year progresses. A popular current assumption—and this was written even before similar figures were reported yesterday in the New York Times—is that the maximum annual rate of defense outlays by yearend 1966 may reach $60 billion.

Even this would represent little more than 8 percent of national output. (If you would like the GNP for comparative purposes, the figure that is most widely used now, after the change in monetary policy, for GNP by yearend 1966, is between $730 and $735 billion. On this basis, a $60 billion national defense outlay would still be between 8 and 8½ percent of GNP.) In the prosperous mid-1950's we devoted somewhat more than this proportion to defense without serious inflationary consequences. In fact, at the cyclical peak of 1957, 10 percent of GNP went into defense without creating any undue strain on capacity or price.

True, some bottlenecks will be encountered; some have already developed. But defense priorities have in the main assured the required flow of critical materials into defense without impeding production of civilian commodities. As late as September 1965, the McGraw-Hill survey reported that the actual rate of operation for all manufacturing stood at 87.5 percent of capacity.[3] The comparable rate for December 1964, well before escalation in Vietnam emerged, was, in contrast, 88 percent, while the preferred rate of operation was 92 or 93 percent. It would appear, therefore, that unless the war in Vietnam escalates far more rapidly than is publicly stated we can have both guns and butter without encountering the shortages of industrial capacity and resulting price pressures that quickly compelled the various restrictions, regulations, and controls on price, materials, and credits early in the Korean war.[4]

In the footnote below I indicate how quickly these restraints were brought into being during the Korean war. But that is not the situation currently, nor is it in sight.

Pressures upon price in the past, however, have arisen from the wage-cost-price push as well as the demand pull of defense awards.

One of the main major strains the economy faces as it enters 1966 is the approach to full employment and the threat this constitutes to unit labor cost and national productivity.

A rough indication of the changes brewing on the productivity-wage

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[3] Arthur F. Burns subsequently placed the operating rate at above 90 in his Fairless Lecture at Pittsburgh, October 26.

[4] These included regulation W on the use of installment credit as early as September 1950; regulation V, September 1950; regulation X, October 1950; materials controls were introduced in September 1950; a wage-price freeze became effective Jan. 26, 1951.

front can be secured by comparing output and employment through September of this year—the latest figures we have for these data—with what happened to those measures in the prior 2 years. Gains in factory employment this year have almost matched the rise in factory output. The table below shows that the increase in the FRB index of output for the first 9 months was 3.1 percent and the corresponding increase in manufacturing employment was 2.6 percent. These gains in factory employment have almost matched the rise in factory output, thereby providing less offset to wage increases than in the past and these wage increases, in turn, have been greater than in the earlier years of expansion. In that connection, unless it has already been submitted for the record, you may be interested in the most recent release of the U.S. Department of Labor on major wage settlements for the first 9 months of 1965.

This announcement said that the average median change in wage rates thus far this year was 11 cents or 4.2 percent. Here I am quoting verbatim "The average increase of 11 cents or 4.2 percent was higher than the average adjustment negotiated in comparable periods in recent years. It was 3.1 percent in 1963, 3.2 percent in 1964."

Output and employment in manufacturing

Period	FRB index of output	Total employment	Production-worker employment
Percent increase over period:			
January to September 1965	3.1	2.6	2.6
January to September 1964	4.8	1.9	2.4
January to September 1963	4.9	.8	.7

Going back to my comments on output and employment, the relatively small gains in productivity this year is in sharp contrast with the very large increase that we have had in output in the earlier years of this expansion with a far smaller input of labor.

This Nation's informal wage-price guidelines may have worked well in the earlier years of expansion. One of the reasons they did is because they were accompanied by a persistent slack in the labor force. Five years ago, when this expansion first began, the unemployment rate stood at 6.9 percent. Now the unemployment rate has dipped to 4.2 percent. This is the same rate as prevailed at the cyclical peak in 1957. In fact, at the peak of the 1960 expansion the unemployment rate still held above 5 percent.

The unemployed today differ significantly in composition as well as in relative size. This, too, has to be kept in mind in appraising our future production potential.

At both previous peaks the bulk of the unemployed were adult males. Nearly a fifth of the jobless were males aged 25 to 44. The corresponding figure in October 1962 was 13.8 percent. (See table 4.) Today's unemployed are far more to be found among the young, the untrained, and women seeking part-time employment, all of whom are given equal weight in the official unemployment figure. Furthermore, at regional meetings of The Conference Board—and we hold more such meetings than any other business group—we hear steadily more of skilled and semiskilled labor shortages across the continent. Our series on help-wanted ads actually went into orbit in November—a fact which has not yet been made public but which we bring to you. The rise in November was the largest in the history of that series—from 168 to 180 with 1957–59=100.

TABLE 4.—*Age and sex composition of the unemployed as of October of 1960, 1964, and 1965 and at 2 past peaks of the business cycle*

Age and sex	Number of persons (in thousands)					Percent distribution				
	July 1957	May 1960	October 1960	October 1964	October 1965	July 1957	May 1960	October 1960	October 1964	October 1965
BOTH SEXES										
Total, 14 years and over	3,007	3,459	3,579	3,252	2,757	100.0	100.0	100.0	100.0	100.0
14 to 24 years	1,248	1,287	1,135	1,344	1,195	41.5	37.2	31.7	41.3	43.3
14 to 19 years	847	765	663	737	772	28.2	22.1	18.5	22.7	28.0
20 to 24 years	401	522	472	607	423	13.3	15.1	13.2	18.7	15.3
25 to 44 years	1,009	1,193	1,342	1,024	868	33.6	34.5	37.5	31.5	31.5
25 to 34 years	568	602	705	495	414	18.9	17.4	19.7	15.2	15.0
35 to 44 years	441	591	637	529	454	14.7	17.1	17.8	16.3	16.5
Total, 45 and over	750	979	1,100	882	695	24.9	28.3	30.7	27.1	25.2
45 to 54 years	377	547	616	437	353	12.5	15.8	17.2	13.4	12.8
55 to 64 years	265	326	380	329	267	8.8	9.4	10.6	10.1	9.7
65 years and over	108	106	104	116	75	3.6	3.1	2.9	3.6	2.7
MEN										
Total, 14 years and over	1,803	2,184	2,200	1,762	1,462	60.0	63.1	61.5	54.2	53.1
14 to 24 years	723	758	684	708	642	24.0	21.9	19.1	21.8	23.3
14 to 19 years	476	444	394	368	440	15.8	12.8	11.0	11.3	16.0
20 to 24 years	247	314	290	340	202	8.2	9.1	8.1	10.5	7.3
25 to 44 years	581	745	787	530	380	19.3	21.5	22.0	16.3	13.8
25 to 34 years	339	382	414	258	193	11.3	11.0	11.6	7.9	7.0
35 to 44 years	242	363	373	272	187	8.0	10.5	10.4	8.4	6.8
Total, 45 and over	499	680	727	524	442	16.6	19.7	20.3	16.1	16.0
45 to 54 years	247	352	384	225	190	8.2	10.2	10.7	6.9	6.9
55 to 64 years	174	250	264	233	191	5.8	7.2	7.4	7.2	6.9
65 years and over	78	78	79	66	61	2.6	2.3	2.2	2.0	2.2
WOMEN										
Total, 14 years and over	1,203	1,276	1,379	1,489	1,295	40.0	36.9	38.5	45.8	47.0
14 to 24 years	525	529	451	636	553	17.5	15.3	12.6	19.6	20.0
14 to 19 years	371	321	269	369	332	12.3	9.3	7.5	11.4	12.0
20 to 24 years	154	208	182	267	221	5.1	6.0	5.1	8.2	8.0

25 to 44 years	428	448	555	494	488	14.2	13.0	15.5	15.2	1..7
25 to 34 years	229	220	291	237	221	7.6	6.4	8.1	7.3	807
35 to 44 years	199	228	264	257	267	6.6	6.6	7.4	7.9	9.7
Total, 45 and over	251	299	373	258	253	8.3	8.6	10.4	11.0	9.2
45 to 54 years	130	195	232	212	163	4.3	5.6	6.5	6.5	5.9
55 to 64 years	91	76	116	96	76	3.0	2.2	3.2	3.0	2.8
65 years and over	30	28	25	50	14	1.0	.8	.7	1.5	.5
Addendum:										
Rate of unemployment, overall:										
Not seasonally adjusted (percent)	4.3	4.9	5.0	4.4	3.6					
Seasonally adjusted (percent)	4.2	5.2	6.1	5.2	4.3					

NOTE.—Data not seasonally adjusted.

Source: U.S. Bureau of Labor Statistics.

As our friends in Western Europe have discovered, wage-price guidlines, even of a more formal character than ours, lose effectiveness as labor scarcity develops. Most models for 1966 now incorporate the prospect of 4 percent unemployment. When these new recruits are added to payrolls, their addition may work adversely upon further gains in output per man-hour in 1966.

Escalation in Vietnam and a tighter labor market have begun in combination to erode the stability of producers price—wholesale prices—that has prevailed since 1958. The last table in my exhibit, table 5, demonstrates that industrial prices other than food and farm commodities have been climbing slowly but steadily since midyear. Initially we thought the rise in the general price level was primarily attributable to farm and foodstuff, and that as the second half of 1965 developed we would see some moderation. Instead, we now find the gains are coming in industrial commodities other than farm products and foods.

Table 5.—Wholesale price of industrial commodities [1]

[Index number: 1957–59=100]

Month	Index	Month	Index
1964—July	101.1	1965—April	102.1
August	101.1	May	102.3
September	101.1	June	102.5
October	101.5	July	102.5
November	101.6	August	102.7
December	101.8	September	102.7
1965—January	101.9	October	102.8
February	101.9	November	103.0
March	102.0		

[1] Commodities other than farm products and foods.

Source: Bureau of Labor Statistics.

Viewed against this context, an ounce of prevention may well be worth its price in terms of the mild restraint such anti-inflationary measures as those recently introduced may exercise. The Federal Reserve Board action to brake the unparalleled expansion in debt and money supply, according to the Conference Board's telegraphic survey will dampen down business investment modestly as the year progresses. But the upward course of outlays for new plant and equipment remains assured although a small fraction of new investment will now be postponed or withheld.

Similarly the recent decision to close down certain military bases here and abroad as well as the proposed tightened rein on Federal

The Conference Board

FOUR DECADES OF NATIONAL ACCOUNTS

Totals: Billions o. Dollars; Per Capita Data: Dollars; Quarterly Data, Seasonally Adjusted at Annual Rates

LONG-TERM GROWTH

	Item	1929 (A)	1939 (B)	1955 (C)	1963 (D)	1964 (E)
1	GROSS NATIONAL PRODUCT	103.1	90.5	398.0	589.2	628.7
2	END-PRODUCT DEMAND	101.4	90.1	392.0	583.5	623.9
3	Personal consumption expenditures	77.2	66.8	254.4	373.8	398.9
4	Durable goods	9.2	6.7	39.6	53.4	58.7
5	Nondurable goods	37.7	35.1	123.3	168.0	177.5
6	Services	30.3	25.0	91.4	152.3	162.6
7	Gross private domestic investment	16.2	9.3	67.4	86.9	92.9
8	Residential structures	4.0	2.9	23.3	26.9	27.6
9	Business investment	10.6	5.9	38.1	54.3	60.5
10	Structures	5.0	2.0	14.3	[illegible]	21.1
11	Producers' durable equipment	5.6	4.0	23.8	[illegible]	39.4
12	*Plant and equipment expenditures (1)*	*n.a.*	*5.5*	*28.7*	*39.2*	*44.9*
13	Change in business inventories	1.7	0.4	6.0	5.7	4.8
14	Net exports of goods and services	1.1	1.1	2.0	5.9	8.6
15	Exports	7.0	4.4	[illegible]	32.4	37.0
16	*Goods (1)*	*5.3*	*3.3*	*14.3*	*22.4*	*25.6*
17	Imports	5.9	3.4	17.8	26.4	28.5
18	*Goods (1)*	*4.5*	*2.4*	*11.4*	*17.1*	*18.6*
19	Government purchases of goods and services	8.5	13.3	74.2	122.6	128.4
20	Federal (less Government sales)	1.3	5.1	44.1	64.4	65.3
21	National defense	n.a.	1.2	38.6	50.8	49.9
22	State and local	7.2	8.2	5.5	13.6	15.4
23	PRODUCT COMPOSITION OF GNP:					
24	Goods Output	56.1	49.0	216.4	296.8	316.1
25	Services	35.6	34.0	132.6	226.9	244.0
26	Construction	11.4	7.5	[illegible]	65.5	68.6

	Item	1929 (A)	1939 (B)	1955 (C)	1963 (D)	1964 (E)
27	GROSS NATIONAL PRODUCT IN 1958 $ (2)	203.6	209.4	438.0	550.0	577.6
28	Implicit price index for GNP, 1958=100	50.6	43.2	90.9	107.1	108.9
A	Total Gross Capital Formation	a	a	a	a	a
B	Private	16.2	9.3	67.4	86.9	92.9
C	Public	a	a	a	a	a
29	PERSONAL INCOME	85.9	72.8	310.9	464.8	495.0
30	Disposable personal income (after tax)	83.3	70.3	275.3	403.8	435.8
31	Less: Personal outlays	79.1	67.7	259.5	383.4	409.5
32	Equals: Personal saving	4.2	2.6	15.8	20.5	26.3
33	NATIONAL INCOME	86.8	72.5	331.0	481.1	514.4
34	Compensation of employees	51.1	48.1	224.5	341.0	365.3
35	Proprietors' income (3)	15.1	11.8	41.7	50.8	51.1
36	Rental income of persons	5.4	[illegible]	13.9	17.6	18.2
37	Corporate profits (before tax) and after i.v.a.	10.5	[illegible]	46.9	58.1	64.5
38	Corporate profits before tax	10.0	7.0	48.6	58.6	64.8
39	Corporate profits after tax	8.6	5.6	27.0	32.6	37.2
40	Dividends	5.8	3.8	10.5	15.8	17.2
41	Retained earnings	2.8	1.8	16.5	16.8	19.9
42	Net interest	4.7	3.5	4.1	13.6	15.2
43	Per Capita, Constant (1958) Dollars					
44	Gross national product	1,671	1,598	2,650	2,904	3,006
45	Personal income	1,274	1,232	2,027	2,313	2,404
46	Disposable personal income	1,235	1,191	1,795	2,009	2,116
47	Personal outlays	1,173	1,146	1,692	1,908	1,988
48	Population, in thousands (4)	121,875	131,028	165,276	189,41[illegible]	192,119

RECOVERY PROFILE: NATIONAL OUTPUT AND EXPENDITURES

	Item	Business Cycle Turning Points*								Dollar Change Since			
		T-3rd Q. 1954 (F)	P-3rd Q. 1957 (G)	T-2nd Q. 1958 (H)	P-2nd Q. 1960 (I)	T-1st Q. 1961 (J)	3rd Q. 1964 (K)	2nd Q. 1965 (L)	3rd Q. 1965 (M)	1955 (1955 Avg.-3rd Q. 1965) (N)	1960 (1960 Avg.-3rd Q. 1965) (O)	Year Ago (3rd Q. 1964-3rd Q. 1965) (P)	
1	GROSS NATIONAL PRODUCT	364.7	446.[illegible]	438.3	504.7	503.6	634.8	665.9	677.5	279.5 *(70%)*	173.7 *(34%)*	42.7 *(7%)*	1
2	END-PRODUCT DEMAND	366.9	443.1	443.4	500.8	507.1	631.0	659.2	671.4	279.4 *(71%)*	171.2 *(34%)*	40.4 *(6%)*	2
3	Personal consumption expenditures	237.3	283.8	287.4	326.3	328.4	404.6	424.4	43[illegible].2	177.8 *(70%)*	107.0 *(33%)*	27.6 *(7%)*	3
4	Durable goods	32.5	40.6	36.8	46.1	41.9	60.5	63.7	65.0	25.4	19.7	4.5	4
5	Nondurable goods	118.4	137.7	139.3	152.0	154.1	179.8	187.[illegible]	191.1	67.8	39.8	11.3	5
6	Services	86.3	105.6	11[illegible].3	128.1	132.4	164.3	173.1	176.1	84.7	47.4	11.8	6
7	Gross private domestic investment	51.9	70.4	55.[illegible]	76.0	64.3	92.[illegible]	101.1	102.0	34.6 *(51%)*	27.2 *(36%)*	9.4 *(10%)*	7
8	Residential structures	[illegible]0.3	[illegible]0.0	19.5	23.1	21.7	27.2	28.0	27.6	4.3	4.8	0.4	8
9	Business investment	33.8	47[illegible].2	41.2	49.0	46.0	61.6	66.4	68.3	29.6	19.3	6.7	9
10	Structures	13.1	18.[illegible]	[illegible]	17.9	18.4	21.1	22.7	23.2	8.3	4.5	2.1	10
11	Producers' durable equipment	20.7	29.1	16.7	31.2	27.6	40.5	43.7	45.1	21.3	14.8	4.6	11
12	*Plant and equipment expenditures (1)*	*[illegible]*	*[illegible].8*	*24.5*	*36.3*	*33.9*	*45.7*	*50.4*	*51.2*	*22.5*	*15.5*	*5.5*	12
13	Change in business inventories	26.9	3[illegible]	30.3	3.9	−3.5	3.8	6.7	6.1	0.1	2.5	2.3	13
14	Net exports of goods and services	−2.2	3.[illegible]2	−5.1	3.5	6.6	8.8	7.5	8.1	6.1	4.0	−0.7	14
15	Exports	1.9	5.5	2.4	27.4	28.5	37.3	39.8	40.0	20.2	12.8	2.7	15
16	*Goods (1)*	17.6	26.2	23.0	*19.7*	*20.3*	*25.9*	*27.4*	*27.6*	*13.3*	*8.1*	*1.7*	16
17	Imports	*12.7*	*19.2*	*16.3*	23.8	22.0	28.5	32.3	31.8	14.0	8.6	3.3	17
18	*Goods (1)*	15.8	20.7	20.6	*15.6*	*13.9*	*18.8*	*21.9*	*20.7*	*9.3*	*5.7*	*1.9*	18
19	Government purchases of goods and services	*10.1*	*13.1*	*12.6*	98.8	104.3	128.7	132.9	135.2	61.0 *(82%)*	35.6 *(36%)*	6.5 *(5%)*	19
20	Federal	73.[illegible]7	86.6	92.8	53.0	55.4	64.9	65.9	67.1	23.0	13.6	2.2	20
21	National defense	4[illegible].7	49.7	52.9	44.4	46.9	49.5	49.4	50.8	12.2	5.9	1.3	21
22	State and local	39.9	44.8	45.7	45.9	49.0	63.8	67.0	68.1	38.0	22.0	4.3	22
		28.0	36.9	39.9									

civilian expenditures will help offset the mounting deficit arising from the war in Vietnam. Even so, the aggregate of total spending for goods and services by all units of Government is expected to rise more in 1966 than in 1965. A rise in private investment, in Government spending, and in consumer spending, all of these are still in store for us in 1966, even after the change in Federal Reserve policy.

As early as September, producers were already being asked to absorb higher unit labor costs as being in the national interest, particularly under the emergency conditions arising from Vietnam. The release of certain items from the national stockpile to restrain or prevent price increases was similarly justified.

Private investment and lending abroad, too, has been voluntarily curtailed in recognition of the special circumstances surrounding the international scene. Those who have accepted these constraints will look for a corresponding recognition of the emergency in the Government's own expenditure policy or its welfare program. They will expect fiscal as well as monetary policy to work in tandem with their own voluntary contributions toward the restraint of inflation, even in its incipient stage.

In summary, the prospective drain of escalation in Vietnam in *relative terms* would not seem to place an undue strain upon either the Nation's capacity to produce or its labor force. The huge additions to industrial capacity this year and those that are now coming on stream, particularly in defense and defense related industries, may prove more than sufficient to meet prospective aggregate demand. Viewed against this background, the more likely threat to price stability is the pressure arising from the wage-cost-price push rather than excessive demand pull. Conservative business economists as well as the majority of leading business executives do not regard the recent action of the Federal Reserve Board and similar constraints exercised by Government as a hazard or barrier to continuance of this expansion throughout 1966.

Instead they indorse such measures as a more restrained credit policy and a hold on nonmilitary outlays designed to offset the expanded Federal deficit arising from the Vietnam emergency. The initi[illegible] modest approaches toward controlling incipient inflation do *not* [illegible] much in terms of domestic production, investment or employment. Instead, they are viewed as serving not only to limit price pressures but also as desirable steps toward extending the lifespan of the present aging expansion well into the closing half of the 1960's.

Chairman Patman. Thank you, sir. The tables you have supplied will be included in the record.

(The tables referred to follow:)

- 1 -

CURRENT CHANGES IN INDUSTRIAL PRODUCTION

Seasonally Adjusted Index Numbers, 1957-59=100

Industry	1964 Oct.	1965 May	June	July	Aug.	Sept.	Oct.(p)	% Change Since 1955 ('55 Avg.-Oct. '65)	1960 ('60 Avg.-Oct. '65)	Year Ago (Oct. '64-Oct. '65)
INDUSTRY										
1 TOTAL INDEX	131.6	141.6	142.7	144.2	144.4	143.0	143.6	48.7	32.1	9.1
2 MANUFACTURES	132.0	143.1	144.1	145.7	146.0	144.6	145.0	49.0	33.1	9.8
3 Durable manufactures	129.9	146.4	148.1	150.0	150.3	147.8	148.4	45.6	36.8	14.2
4 Primary metals	133.6	140.2	143.0	148.7	145.0	129.9	122.0	3.0	20.4	-8.7
5 Fabricated metals	130.7	146.0	146.4	148.0	147.6	146.4	149.0	51.6	38.5	14.0
6 Nonelectrical machinery	145.4	157.0	159.4	161.7	162.4	161.8	164.0	66.3	50.7	12.8
7 Electrical machinery	144.9	156.8	158.4	159.2	160.1	161.6	164.0	75.0	44.4	13.2
8 Transportation equipment	105.3	147.3	149.5	149.8	151.5	149.4	151.0	48.0	39.6	43.4
9 Instruments	137.6	147.0	149.8	152.1	152.6	155.7	157.0	77.0	34.8	14.1
10 Clay, glass, and lumber	121.0	125.5	124.7	126.3	127.5	127.2	127.0	26.1	20.2	5.0
11 Furniture and fixtures	147.4	156.5	156.8	155.8	156.3	156.8	159.0	67.2	37.7	7.9
12 Nondurable manufactures	134.6	138.8	139.0	140.4	140.5	140.6	140.7	53.6	28.5	4.5
13 Textiles, apparel, and leather	128.9	135.0	134.5	134.7	134.3	134.8	135.0	41.4	25.6	4.7
14 Paper and printing	128.8	134.2	134.0	135.9	136.4	134.8	134.0	44.9	22.9	4.0
15 Chemicals, petroleum, and rubber	156.2	161.2	161.6	164.1	165.0	165.9	167.0	92.4	46.6	6.9
16 Food, beverages, tobacco	120.5	121.5	122.3	122.9	122.4	122.4	123.0	32.1	15.4	2.1
17 MINING	112.0	114.0	115.3	116.0	117.2	113.4	116.0	16.9	14.2	3.6
18 UTILITIES	154.9	160.4	162.5	161.6	161.9	163.0	164.0	104.5	41.9	5.9
MARKET										
19 FINAL PRODUCTS	130.5	140.2	140.7	141.7	142.3	142.6	144.1	53.5	31.1	10.4
20 Consumer goods	129.5	138.6	138.7	139.3	139.7	139.7	140.3	50.4	26.4	8.3
21 Automotive products	105.9	168.1	168.1	167.8	169.8	166.2	168.0	42.0	36.4	58.6
22 Home goods and apparel	134.8	141.4	141.5	140.9	140.6	141.4	n.a.	n.a.	n.a.	n.a.
23 Consumer staples	130.7	132.2	132.7	134.1	134.1	134.4	135.0	53.2	23.2	3.3
24 Equipment incl. defense	132.5	143.7	144.9	147.0	148.0	148.9	152.2	60.2	41.4	14.9
25 Business equipment	140.6	153.5	154.6	156.4	157.3	158.7	161.0	75.2	46.1	14.5
26 MATERIALS	132.6	142.6	144.5	146.4	145.9	143.0	143.2	44.6	33.1	8.0
27 Durables	128.6	143.4	146.1	148.4	147.0	142.3	142.0	35.6	33.2	10.4
28 Nondurables	136.7	141.8	143.4	145.0	144.8	143.6	145.0	55.9	33.4	6.1

(p) Prel[illegible]ary
n.a.-Not [illegible]able

Sources: Federal Reserve Board; The Conference Board

Line	Item												Line
23	PRODUCT COMPOSITION OF GNP:												23
24	Goods output	194.9	238.2	224.6	262.2	251.5	319.8	337.2	344.3	127.9 (59%)	84.7 (33%)	24.5 (8%)	24
25	Services	125.0	155.8	162.5	186.0	194.5	246.4	257.8	262.0	129.4 (98%)	74.7 (40%)	15.6 (6%)	25
26	Construction	44.9	52.3	51.3	56.5	57.6	68.6	70.9	71.1	22.1 (45%)	14.3 (25%)	2.5 (4%)	26
27	GROSS NATIONAL PRODUCT IN 1958 $ (2)	407.2	455.2	439.5	489.8	482.7	582.6	601.4	609.7	171.7 (39%)	121.9 (25%)	27.1 (5%)	27
28	Implicit price index for GNP, 1958=100	89.5	98.0	99.7	103.0	104.3	109.0	110.7	111.1	– (22%)	– (8%)	– (2%)	28
29	PERSONAL INCOME	289.8	354.7	356.0	401.3	406.6	499.1	524.9	535.9	225.0 (72%)	134.9 (34%)	36.8 (7%)	29
30	Disposable personal income (after tax)	257.3	311.6	314.5	350.4	354.8	440.3	458.9	471.3	196.0 (71%)	122.3 (35%)	31.0 (7%)	30
31	Less: Personal outlays	242.0	290.2	293.8	334.0	336.4	415.3	436.0	444.1	184.6	111.1	28.8	31
32	Equals: Personal saving	15.3	21.5	20.7	16.5	18.4	25.0	23.0	27.2	11.4 (72%)	10.2 (60%)	2.2 (9%)	32
33	NATIONAL INCOME	302.9	369.5	359.3	417.1	412.2	519.5	550.3	558.4	227.4 (69%)	143.9 (35%)	38.9 (7%)	33
34	Compensation of employees	207.1	258.1	253.1	295.0	294.8	369.0	388.7	395.2	170.7	101.0	26.2	34
35	Proprietors' income (3)	40.1	44.7	46.3	46.6	47.4	51.4	54.6	54.6	12.9	8.4	3.2	35
36	Rental income of persons	13.8	15.0	15.4	15.8	15.9	18.3	18.6	18.6	4.7	2.8	0.3	36
37	Corporate profits before tax and after i.v.a.	38.2	45.9	37.8	51.6	45.0	65.5	72.0	73.3	26.4	23.4	7.8	37
38	Corporate profits before tax	38.9	47.2	37.5	51.8	45.0	65.3	73.7	74.4	25.8	24.7	9.1	38
39	Corporate profits after tax	20.9	26.0	20.2	27.8	24.4	37.5	44.4	44.8	17.8	18.1	7.3	39
40	Dividends	9.2	12.0	11.7	13.5	13.5	17.4	18.2	18.6	8.1	5.2	1.2	40
41	Retained earnings	11.7	13.9	8.6	14.3	10.9	20.1	26.1	26.2	9.7	13.0	6.1	41
42	Net interest	3.8	5.7	6.6	8.0	9.2	15.4	16.4	16.7	12.6	8.3	1.3	42
43	**Per Capita, Constant (1958) Dollars**												43
44	Gross national product	2,501	2,653	2,530	2,716	2,642	3,027	3,095	3,128	478	428	101	44
45	Personal income	1,926	2,107	2,049	2,166	2,144	2,419	2,483	2,523	496	366	104	45
46	Disposable personal income	1,711	1,851	1,811	1,892	1,871	2,134	2,173	2,218	423	335	84	46
47	Personal outlays	1,609	1,724	1,691	1,803	1,774	2,013	2,062	2,090	398	299	77	47
48	Population, in thousands (4)	162,816	171,608	173,703	180,340	182,676	192,478	194,298	194,910	29,634	14,226	2,432	48

(1) Not directly comparable with GNP concepts (2) Line 1 divided by line 28 (3) Includes noncorporate inventory valuation adjustment (4) Annual data, July 1; quarterly data, middle of period

● Quarterly reference dates of peaks (P) and troughs (T) in the business cycle a – Not yet available on revised basis

Sources: U. S. Department of Commerce; The Conference Board

11/22/65

CURRENT TRENDS IN EMPLOYMENT

Millions of Persons

		Item	1964 Oct.	1965 May	June	July	Aug.	Sept.	Oct.	Change, In Number, Since 1955 ('55 Avg.-Oct. '65)	1960 ('60 Avg.-Oct. '65)	Year Ago (Oct. '64-Oct. '65)
H	1	TOTAL LABOR FORCE	77.1	78.4	80.7	81.2	80.2	78.0	78.7	-	-	-
O	2	Civilian labor force	74.4	75.7	78.0	78.5	77.5	75.3	76.0	-	-	-
U	3	Unemployment	3.3	3.3	4.3	3.6	3.3	2.9	2.8	-	-	-
S	4	Employment	71.1	72.4	73.7	74.9	74.2	72.4	73.2	-	-	-
E		SEASONALLY ADJUSTED										
H S	5	Civilian labor force	74.3	75.4	75.7	76.2	75.8	75.5	75.8	10.0	5.2	1.5
O U	6	Unemployment	3.9	3.5	3.6	3.4	3.4	3.3	3.3	0.4	-0.6	-0.6
L R	7	15 weeks and over	0.9	0.7	0.8	0.7	0.7	0.7	0.7	0	-0.3	-0.2
D V	8	Employment	70.4	71.9	72.1	72.8	72.4	72.2	72.5	9.6	5.8	2.1
E	9	Agriculture	4.7	5.0	4.7	4.7	4.6	4.4	4.6	-2.1	-1.1	-0.1
Y	10	Nonagricultural industries	65.7	67.0	67.5	68.1	67.8	67.8	67.9	11.7	6.9	2.2
	11	WAGE AND SALARY WORKERS										
	12	Total nonagricultural	58.4	60.1	60.4	60.6	60.7	60.8	61.0	10.3	6.8	2.6
P	13	***Private Nonagricultural***	***48.8***	***50.2***	***50.5***	***50.7***	***50.7***	***50.8***	***50.9***	***7.1***	***5.0***	***2.1***
A	14	Manufacturing	17.2	17.9	18.0	18.2	18.2	18.2	18.2	1.3	1.4	1.0
Y	15	Durable goods	9.7	10.3	10.4	10.5	10.5	10.6	10.6	1.1	1.1	0.9
R	16	Nondurable goods	7.5	7.6	7.6	7.6	7.6	7.6	7.6	0.3	0.3	0.1
O	17	Nonmanufacturing	41.2	42.2	42.3	42.4	42.5	42.6	42.8	9.0	5.4	1.6
L	18	Mining	0.6	0.6	0.6	0.6	0.6	0.6	0.6	-0.2	-0.1	0
L	19	Contract construction	3.1	3.2	3.2	3.2	3.2	3.2	3.2	0.4	0.3	0.1
	20	Transportation, public utilities	4.0	4.1	4.1	4.1	4.1	4.1	4.1	0	0.1	0.1
R	21	Service industries	33.5	34.3	34.4	34.6	34.6	34.7	34.9	8.8	5.1	1.4
E	22	Trade	12.3	12.6	12.7	12.7	12.7	12.7	12.8	2.3	1.4	0.5
C	23	Retail	9.0	9.3	9.3	9.3	9.4	9.4	9.4	1.7	1.0	0.4
O	24	Wholesale	3.2	3.3	3.4	3.4	3.4	3.4	3.4	0.6	0.4	0.2
R	25	Finance, insurance, real estate	3.0	3.0	3.0	3.0	3.0	3.0	3.0	0.7	0.3	0
D	26	Other service and misc.	8.6	8.8	8.8	8.9	8.9	9.0	9.0	2.7	1.6	0.4
S	27	Government	9.6	9.9	9.9	9.9	10.0	10.0	10.1	3.2	1.7	0.5
	28	Federal	2.3	2.3	2.4	2.4	2.4	2.4	2.4	0.2	0.1	0.1
	29	State and local	7.3	7.5	7.6	7.6	7.6	7.6	7.7	3.0	1.6	0.4
	30	UNEMPLOYED										
	31	14-19 years	0.9	1.0	1.0	1.0	0.9	0.9	1.0	n.a.	0.2	0.1
	32	20 years and over: Men	1.8	1.5	1.5	1.4	1.4	1.4	1.3	n.a.	-0.8	-0.5
	33	Women	1.2	1.0	1.1	1.0	1.1	1.0	1.0	n.a.	-0.1	-0.2
	34	Married men●	0.8	0.8	0.7	0.8	0.8	0.6	0.6	n.a.	-0.7	-0.2
	35	Experienced wage-salary workers●	2.7	2.5	3.0	2.6	2.6	2.3	2.2	n.a.	-1.3	-0.4
	36	White persons●	2.6	2.8	3.5	2.7	2.6	2.3	2.2	n.a.	-0.9	-0.4
	37	Nonwhite persons●	0.7	0.6	0.8	0.9	0.7	0.6	0.6	n.a.	-0.2	-0.1
	38	UNEMPLOYMENT RATE, SEAS. ADJ.										
	39	All civilian workers	5.2%	4.6%	4.7%	4.5%	4.5%	4.4%	4.3%	-	-	-
		NUMBER OF HOURS										
	40	AVG. HOURS, MFG., SEAS. ADJ.	40.5	41.1	41.0	40.9	40.9	40.8	41.0	0.3	1.3	0.5

Note: Household survey data are obtained by personal interview with members of a sample of households. Payroll employment data, obtained by mail questionnaire, are based on payroll records of business units. In addition to other differences between them, proprietors, the self-employed, domestic servants and unpaid family workers are excluded from the payroll data but not from the household survey.

● Not adjusted for seasonal fluctuations   n.a.-Comparable 1955 data not available

Sources: Bureau of the Census; Bureau of Labor Statistics   11/5/65

Chairman PATMAN. You gentlemen are to be congratulated for these fine statements of your respective viewpoints.

Chairman PATMAN. Senator Sparkman?

Senator SPARKMAN. I won't be able to stay long because I am due at a meeting at 11 o'clock and it is that time now. I want to add my word, Mr. Chairman, about both these papers. I think they are very able, very fine presentations, containing very able arguments. There is one question I hope will be discussed, Mr. Chairman, and I want to pose it before I leave. I was quite impressed by this survey of the thousand largest companies. But many of us have been fearful of the effect of this on small business, and on the little fellow, and the home purchaser, people such as these.

I hope that will be discussed. I will read very carefully the transcript of this when it comes out. I hope you may have the views of both of these esteemed gentlemen.

Chairman PATMAN. Thank you, sir.

Senator SPARKMAN. Thank you, and I apologize for having to leave.

Chairman PATMAN. Dr. Gainsbrugh, I would like to know something about your organization. Of course it is a highly respected organization. I have known about it for years. How many members do you have?

Mr. GAINSBRUGH. We have about 4,000.

Chairman PATMAN. How many of those are large businesses and how many are small?

Mr. GAINSBRUGH. I would say the majority are large but increasingly we are adding smaller ones.

Chairman PATMAN. Now this poll was sent out and you said you would keep the respondents confidential, which is all right. However, it would be very interesting to us to know who these concerns are because ofttimes concerns are interconnected with banks through interlocking relationships. Sometimes the banking interests might be of overwhelming interest in comparison to the business part. In that way the answer could be accordingly biased. Would you not think so?

Mr. GAINSBRUGH. This is a point well taken. The lists of the largest companies, of course, are public information. There is the Fortune magazine "Five Hundred Largest"; there is, also, the SEC–FTC series. But may I tell you why the "thousand largest" in this particular instance?

We have for more than 10 years been interested in the pattern of future private investment, particularly in plant and equipment, in the belief that this is the most volatile, the most explosive component of national demand. The more we, as a nation, knew about private investment the better job we could do in moderating the business cycle. We picked the thousand largest primarily because they account for so heavy a proportion of total private investment. Once we knew what was happening to this group we were in a pretty good position to speculate productively about the course of total private investment. They account for perhaps 75 percent of total investment in new plant and equipment and perhaps a somewhat lower percentage—perhaps two-thirds—of total manufacturing employment.

Chairman PATMAN. You have pretty well identified the thousand largest.

Mr. GAINSBRUGH. A very significant proportion of the private investment universe.

Chairman PATMAN. Now, I want to request you to make a poll of small business over the Nation and in that poll you tell them that you will keep their identities confidential. These little fellows can't afford to talk too publicly because if they are identified their credit would be cut off quickly. We get all kinds of complaints from small business people and they say, "Don't use our name, we can't afford to have our name used."

Many small businesses write me and say they are not getting credit furnished properly. They need it and the banks are not really treating them fairly. This is what they say, "The banks make us keep compensating balances, unduly large, and they charge us excessively for services that are being rendered us. And we can't get along this way." But be sure, these small businesses say, "to not use our name. The interest rates are often high, particularly when we have to have a compensating balance of a large amount."

Now, someone complained to the Federal Trade Commission about that but the banks are exempt from the Federal Trade Commission and they could not get anywhere there. I think the National Industrial Conference Board could render an outstanding service if you would take a poll—I mean send a questionnaire to the little people all over the Nation and find out, No. 1, if they are getting adequate credit; 2, if not, why not; and, 3, whether or not they have to have compensating balances in order to get a loan. And, also, the loan itself—whether or not it is reasonable or extortionate. Of course, there are other important questions which should be asked these small businesses.

Would you undertake a service like that, Mr. Gainsbrugh?

Mr. GAINSBRUGH. I stopped just a minute to wonder what this would do to the conference board's budget. But casting that aside——

Chairman PATMAN. I would not think you would be too worried about that because you have people in there who should not be worried about a little budget like that, I am sure.

Mr. GAINSBRUGH. We have to meet a payroll too, Congressman Patman.

Chairman PATMAN. I know; but if it could be provided would you do it?

Mr. GAINSBRUGH. I believe we would do so.

Chairman PATMAN. Some committee—in fact, this committee—might be interested in it. If you would furnish us the names and draw up a questionnaire that would elicit proper information on a fair basis, other committees of Congress, agencies of Congress—maybe even the Federal Reserve—might do so.

Of course, they have plenty of money. They spend all the money they want to on anything they want to. I am sure this would be a good expenditure.

Mr. GAINSBRUGH. I think this would be of interest to you. There are some sampling problems involved in moving into the smaller sector that are not necessarily present when you can saturate, as we do, the thousand largest markets. But going beyond that, Mr. Chairman, the Commerce FTC–SEC in its surveys covers not only the large

ones but the small. The interesting thing over the life of this series is that our figures on the investment plans and intentions and expenditures of the thousand largest anticipate and mirror almost to the exact degree the changes that will subsequently appear in the series after you put in the small as well as the big. So there is something to be said for this as being representative of not just the thousand largest.

Chairman PATMAN. I know, but I think it would be more meaningful if we actually had the smaller ones represented.

Mr. GAINSBRUGH. The conference board, I believe, would welcome the proposal.

Chairman PATMAN. Dr. Harris, I appreciated your statement, too. As I said it was a wonderful statement. It has information that we all are interested in and will be given very careful consideration by this committee in its deliberations on the matter before us now. It will be very helpful to us.

I believe you mentioned that interest rates have been going up the last year or two. They have been going up, you know, with no noise being made about it; rather quietly, in fact, the Federal Reserve has tightened credit. You can see its effect in the yields on Government long-term bonds. Most of them currently are yielding more than 4½ percent. You know, the law says long-term treasury bonds cannot be sold at more than a 4¼-percent interest rate.

We are in violation of the law, in spirit at least. Of course, some of the first items to reflect an increase in interest rates are items like food; things that you buy every day. I think anybody in the United States of America can ascertain this morning that food prices have gone way up the past year—in a significant part because of high interest rates.

The Federal Reserve Board is the cause of these prices going up. Now then, the Federal Reserve Board has, over the opposition of the President, raised interest rates again. At the same time they tell us they are going to furnish adequate reserves to the banks.

What this means is that the Federal Reserve has provided—through raising the discount rate—the tool the banks need to raise their rates to their borrowers. Now, Mr. Martin tells us he is going to provide adequate reserves to the banks. So, what has he done but provide the banks with more reserves upon which they can make more loans at higher rates. Is that a fair appraisal, or analysis of it, Dr. Harris?

Mr. HARRIS. Yes, I think that certainly the low rates on the corporate deposits, for example—the point that Congressman Reuss made the other day according to the papers—is one manifestation of favoring one large interest and also the banks.

Of course, the real problem in the last half year has been that there has been no increase in reserves, really. The way they have offset the shortage is to increase long-term deposits which require small reserves.

Chairman PATMAN. There is one point that has not been brought out. These corporation deposits, CD's, oftentimes are referred to as "hot money"; it is almost like getting interest on currency.

Now something was done here about the certificates of deposit that I think greatly affected our short-term interest rate. When the banks were permitted, as they have been, to accumulate over $16 billion in certificates of deposits, all during the last 4 years, we have had fewer and fewer bidders for short-term Government securities, for an obvi-

ous reason. This money went out of that short-term Government securities market and went into the certificate of deposit market. That has caused short-term securities to go up, up, up. Now short-term Government securities yield almost as much as the long term. Don't you think that is detrimental to the Government of the United States—to have policies and rules that will pull out the principal buyers of short-term obligations and get them into something else more attractive? Therefore, the Government will have fewer bidders, and the rates will be higher?

Mr. HARRIS. Congressman Patman, that is a very important point. You are an oldtimer in this field as I am. Of course, I wrote my book on the Federal Reserve System back in 1933 so you and I are really veterans in this field. You will recall we had a similar problem in the great boom of the twenties. You remember the corporation loans on the account of others which was a way of avoiding banking control and resulted in a tremendous amount of money being thrown in the stock market.

Chairman PATMAN. What was that?

Mr. HARRIS. Loans on the account of others. You remember the 1933 and 1935 acts dealt with that problem—got rid of those loans on account of others. Now we have a somewhat similar situation in these corporation deposits, these certificates of deposit. I think this is something that the committee should pay a good deal of attention to. This is something which has not been looked over by the Government in any serious way. It has been developed slowly. There has been an increase of from $1 to $16 billion in recent years. There is no doubt that the certificates of deposit give the large banks a disproportionate part of the cash reserve. When they receive these deposits they get cash at the expense of other parts of the financial system. This is one area where I think the committee should take a good look to see what can be done about—perhaps not exactly controlling—correcting that situation.

I think the recent increase in certificates of deposit rates is an attempt to favor large banks against other large organizations.

Chairman PATMAN. Senator Miller?

Senator MILLER. First, Mr. Chairman, I would like to ask to have placed in the record four articles, one in the New York Times, December 9, entitled "Weaver Doubts Discount Rate Will Spur Rise in Home Prices."

Second, an article by Charles C. Cain, appearing in the Washington Star for December 10, entitled, "Auto Industry Discounts Rate Boost."

Third, the column appearing in the Washington Post of December 13, "Fed Struggle Had Precedent" by J. A. Livingston, in which he says among other things, "The Johnson administration was converting the Federal Reserve System into an engine of cheap credit even as the Truman administration made it an engine of inflation in the 1948–51 Federal Reserve-Treasury struggle."

Finally, an article appearing in the December 13 issue of the Washington Post by Harold B. Dorsey entitled "Background of the Fed's Rate Increase" in which he says among other things, "Under present circumstances it is highly unlikely in my judgment that the higher price now placed on credit will do anything worse than reduce an un-

sustainable growth trend, with inflationary threats, to a rate of growth that can be sustained without inflation."

Chairman PATMAN. Without objection it is so ordered.

(The documents referred to follow:)

[From the New York Times, Dec. 9, 1965]

WEAVER DOUBTS DISCOUNT RATE WILL SPUR RISE IN HOME PRICES

(By Glenn Fowler)

CHICAGO, December 8—A Federal official expressed doubt today that the price of homes would rise and the number of housing starts would dwindle as a result of the rise in the Federal Reserve Board's discount rate.

Robert C. Weaver, head of the Housing and Home Finance Agency, said at a news conference that the rate rise had "certainly complicated matters in the mortgage market."

But he said, "I seriously doubt whether this will worsen the mortgage situation as far as builders are concerned."

The discount rate, which has been raised from 4 to 4.5 percent, is the interest that the 12 Federal Reserve banks charge the many member banks on borrowings from the Federal Reserve. The Board's action has led to a rise in the cost of borrowing by business and of short-term borrowing.

Mr. Weaver noted that pressures in the money market had been tightening in the last several months. But he refused to predict, as some other housing specialists have forecast, that the Federal Reserve rate increase would result in greater difficulty for builders seeking to borrow funds for construction.

DOUBTS RISE WILL HOLD

Indeed, Mr. Weaver hinted that he felt even more sanguine about the discount rate rise than did most other administration officials. Although he did not say it in so many words, he strongly implied doubts that the higher interest rates would last long.

"If the cost of borrowing increases, the cost of houses will increase, and higher prices would have an adverse effect on housing starts," he said. "But at this point nothing has happened to change my opinion that there will be no more stringency in the mortgage market in the next 4 or 5 months."

Mortgage lenders and builders have speculated in the 3 days since the rate increase announcement that the rise would lead to higher interest ceilings for mortgages insured by the Federal Housing Administration.

Mr. Weaver said that, while "the FHA rate is always under discussion," there had been no decision to make any change in the present ceiling of 5¼ percent on single-family home mortgages.

PRICES TO BE DISCUSSED

Perhaps more important is the possibility of action by the Federal National Mortgage Association. The Association, known as Fannie Mae, is, like the Federal Reserve Board, an independent agency of the Federal Government. In buying and selling Government-backed home mortgages, it has the primary function of stabilizing the market in these securities.

Mr. Weaver, who is ex officio chairman of Fannie Mae, noted that a regular meeting of the Association's Board would be held later in the week. At that time, the prices paid by Fannie Mae for mortgages offered to it will be discussed, he said.

There has been speculation among lenders and builders that Fannie Mae will raise the prices it pays for loans offered in the secondary market, where banks and other lending institutions go to sell the mortgages they have made in order to obtain funds to extend new loans.

Mr. Weaver refused to discuss any possible change in the Fannie Mae support prices. If the agency were to raise the prices at which it is willing to buy loans, the action would operate to increase the amount of lendable money in the hands of banks and other mortgage lenders and would thus help keep interest rates down.

SPEAKS TO BUILDERS

Mr. Weaver was in Chicago today to speak to the National Association of Home Builders' 22d annual convention on the provisions of the National Housing Act of 1956. Another speaker was J. Stanley Baughman, president of Fannie Mae.

Mr. Baughman reported that recent offerings of mortgages to Fannie Mae had been exceedingly large.

"Regular over-the-counter offerings have run at a rate approximately eight times greater than that of the corresponding period last year," he said. "The number of mortgages offered to us was 51,100, as compared with 6,500 last year. Moreover, twice within recent weeks we have had the heaviest offerings in more than a decade."

The significance of these figures is that they show a desire of lenders to obtain more money so that they can make new mortgages—at rates, incidentally, that are no higher than before last weekend's Federal Reserve action.

Moreover, Mr. Baughman reported that interest rates on conventional mortgages—those not insured by the Federal Housing Administration or guaranteed by the Veterans Administration—had in recent months been unchanged from the levels of years ago. This indicates that upward pressures in the money market, though undeniably felt in mortgage lending, have failed to push interest rates higher.

FINDS CHANGE ALREADY HERE

The Federal Reserve Board's action on the discount rate was "merely the formal recognition of the market change which has already taken place over the last several months," John J. Grinch, a vice president of the Chase Manhattan Bank, declared here yesterday.

Mr. Grinch said that the Board's action did not, in itself, set the stage for still higher mortgage interest rates.

He addressed a luncheon meeting of the Real Estate Board of New York at the Hotel Commodore.

[From the Washington Evening Star, Dec. 10, 1965]

BUYERS SEEN UNDAUNTED—AUTO INDUSTRY DISCOUNTS RATE BOOST

(By Charles C. Cain)

DETROIT.—Two unwelcome bits of news clouded the auto industry's otherwise bright picture this week.

One was the Federal Reserve Board's action in raising its discount rate. This raised the question of how the increased interest rate will affect the car-buying habits of milions of people who buy on time.

The other was the announcement by American Motors that its auto-building lines would be halted for 13 workdays between Christmas and January 17.

EXCISE TAX TO DROP

On the monetary front, the first reaction from auto executives was that they expected few buyers would be scared out of the market by the fact they would have to pay more for the money they borrowed.

One official, who refused use of his name, put it this way:

"If the interest rate charged to the car buyer was raised from 4½ to 5 percent, it probably would amount to about $1 a month additional on payments which now average about $80 a month.

"That increase would not be big enough to influence many buyers, particularly when you recall that another 1 percent cut in the Federal auto excise tax is due January 1, 1966. That cut would amount to about $23 on the average purchases and would be more than the buyer put out in extra interest charges."

Other observers said there was intense competition among banks, finance companies, savings and loan associations and credit unions who wanted to serve prospective car buyers.

The auto industry also has its own credit subsidiaries. They include the General Motors Acceptance Corp., Chrysler Credit Corp., and Redisco, owned by American Motors.

COMPETITION CITED

Credit sales currently account for about 60 percent of new-car purchases. Practically all the moneylenders agreed that the competition was so severe that there would be no sudden jump in costs to the consumer. They felt business was so good they wanted to do nothing to scare prospective customers away.

On the American Motors production front, the decision to close down AMC's production units at Milwaukee and Kenosha, Wis., for a few days was attributed to the necessity of realineing field stocks to the current sales pace.

Nobody at American Motors made any effort to conceal their concern over the fact that AMC car sales fell off to an unofficially estimated 296,000 cars in the first 11 months of this year compared with 355,636 in the same period a year ago. The drop came at a time when corporate sales of General Motors, Chrysler and Ford cars were up.

The significant part in AMC's statement about the shutdown was its use of the word "realinement" of its product line.

NEW IMAGE SOUGHT

AMC President Roy Abernethy had said repeatedly his firm's main problem was its image lag—the fact that too many people still thought of American Motors as the builder of plain jane compacts.

Abernethy said in a recent interview that AMC would be in good shape in the car market as soon as the image lag is corrected, but he refused to give his personal guess on a timetable as to how long the change would take. He pointed instead to AMC's current line of 26 cars, including sporty convertibles and hardtops, and said future sales figures would tell the story.

Sales figures compiled at AMC indicated the firm was trapped, along with other automakers, as the demand for stripped down compacts and near compacts fell off this year.

"This applied not only to the American and Classic but the market which includes Valiant, Falcon, Comet, Lark, and Chevy II," an AMC official explained.

NOW IN BLACK

"When we get back into operation January 17, we will be building a higher percentage of Classics and Ambassadors, for it is in that top of the line that demand is running highest," he said, adding, "you see, we have only 2 assembly plants, not 23 like General Motors, and when we have to change our model makeup around, it involves a major operation."

Abernethy said last month that AMC, which lost about $13 million in the last quarter of fiscal 1965, is "in the black for the current quarter."

AMC never has broken down the relative financial picture of its automaking or Kelvinator divisions, but Abernethy said that Kelvinator sales for the first 2 months of the firm's fiscal year ran 18 percent ahead of a year ago and that most workers at the Grand Rapids, Mich., Kelvinator plant were on overtime to keep up with demand.

The general feeling among AMC's top brass was summed up by one company public relations man who said, "Don't shed any tears over us. We're doing OK and things will get better soon."

[From the Washington Post, Dec. 13, 1965]

BUSINESS OUTLOOK—FED STRUGGLE HAD PRECEDENT

(By J. A. Livingston)

Yes, Mr. President, there is a Santa Claus. But he wears a business suit. William McChesney Martin Jr., Chairman of the Federal Reserve Board, made you a Christmas gift beyond compare. He offered himself as a scapegoat.

If anything goes wrong economically in 1966, if we have a stock market slump, an industrial slowdown or a recession, Martin's your blame man.

And if all goes well, if total output of goods and services climbs, it's to your credit Mr. President. Martin has fixed it so it's hard for you to lose.

True, you tried to fend off Martin's rates. An increase in the rediscount rate from 4 to 4½ percent was incompatible with your idea of administered prosperity."

But Martin wouldn't take the hint. Why? Because he was in an impossible predicament. The Federal Reserve System was out of step in its own parade. It had fallen behind the money market.

Not since November 24, 1964, had the rediscount rate been advanced. Then, the Reserve Board acted to defend the dollar. The Bank of England had boosted its rate from 5 to 7 percent during the pound crisis. Too great a discrepancy in rates—between Wall Street and Lombard Street—would draw gold from the United States.

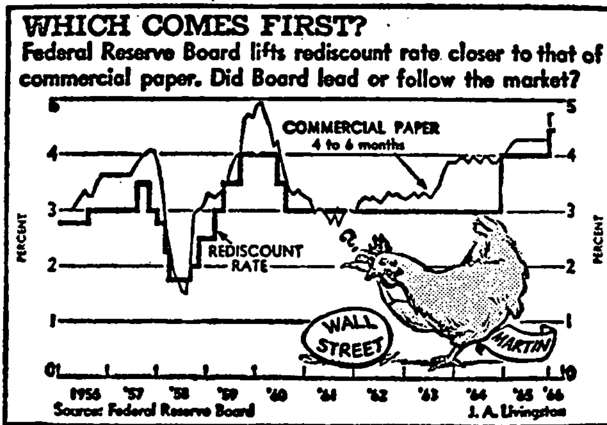
But President Johnson tried—like King Canute—to roll back the market consequences. Several large commercial banks decided that a higher rediscount rate required a higher interest charge to their best customers—usually the big-name corporations. This is the "prime rate."

They tried to go up from 4½ to 4¾ percent. In a few well-chosen words, the President changed their stance. Higher interest costs would impede the economic growth.

So, the rediscount rate and the prime rate stood still while interest rates on high-grade corporate bonds, Treasury issues, and commercial paper went up, as the following table shows:

Type	Percent—	
	After [1]	Before [2]
AAA corporate	4.44	4.60
AAA municipal	3.09	3.37
Long-term Treasury	4.15	4.37
3- to 5-year Treasury	4.11	4.52
3-month Treasury	3.78	4.12
4- to 6-month commercial paper	4.06	4.50
Prime bank rate	4.50	4.50
Rediscount rate	4.00	4.00

[1] After 1964 increase in rediscount rate from 3½ to 4 percent.
[2] Before 1965 increase in rediscount rate from 4 to 4½ percent.



No wonder bank loans have increased 12 percent in the last year. The banking system had become a bargain basement for credit. Low-interest rates encourage corporation treasurers to borrow at banks rather than pay interest rates in the capital markets.

The corporations were playing for time. The administration had given the impression that interest rates would not rise. At the same time, intermediate and long-term rates were rising.

Therefore, some corporation finance committees held off selling bonds. Maybe the credit conditions would ease, maybe interest rates would come down. They'd

raise long-term capital later. So, the banking system was overburdened. And banks scrambled for deposits, and even borrowed funds—to meet demand.

The Johnson administration was converting the Federal Reserve System into an "engine of cheap credit" even as the Truman administration made it an "engine of inflation" in the 1948–51 Federal Reserve-Treasury struggle.

Martin was a key figure in that settlement. Truman and John W. Snyder, then Secretary of the Treasury, wanted Government bonds to sell at 100 cents on the dollar. During the war and postwar period, the Reserve Board assured that. Its function was to finance the war. It made credit plentiful. The Treasury was able to sell long-term bonds at 2½ percent. But now the war was over.

First, Chairman Marriner S. Eccles and later Thomas B. McCabe indicated to Snyder that the Reserve Board could not sustain a 2½-percent Government interest rate. Any insurance company or bank, holding long-term governments, could dump them on the Federal Reserve at par.

By buying them, the Reserve System pumped out excess reserves—the lending power—to banks. It lost control of the money market—of interest rates. It was always expanding, inflating, never contracting.

When finally McCabe said he could no longer play Atlas to the money market, President Truman and Secretary Snyder designated Martin, then Assistant Secretary of the Treasury, to work out an "accord." He did. And when McCabe, shortly thereafter, resigned the Reserve Board chairmanship, Martin replaced him.

Before the accord, Federal Reserve Board policy was sectioned off from the real money market. Similarly, the "administered" 4 percent rediscount rate for many months (see chart) has been out of line with the money market.

This has been corrected. The Reserve Board has now caught up to its own parade. Instead of following the money market, it may now start influencing it.

[From the Washington Post, Dec. 13, 1965]

Investment View—Background of the Fed's Rate Increase

(By Harold B. Dorsey)

New York, December 12.—In appraising the difference between the Federal Reserve and the administration there is a strong tendency to overemphasize conflict and to jump to extreme conclusions which are not justified. This is one of the conclusions derived from this writer's conferences last week with top-level spokesmen for both sides.

Obviously, the increase in the discount rate by the Federal Reserve in December was in conflict with the administration's desire to have the decision deferred until January. There are logical arguments on both sides of this timing question.

Within the Federal Reserve management there has been a mounting opinion for several months that the discount rate should be raised. The Fed's thinking had to reflect the facts that business loans of the commercial banks have risen 20 percent in the past 12 months, that consumer loans were up by 14 percent, and real estate loans were rising at the annual rate of 11 percent. The rate of increase in these various types of debt is substantially in excess of the percentage increase in gross national product, a disparity that cannot prevail very long without causing serious trouble.

Meanwhile, the increase in the demand for credit in relation to supply has been boosting practically all other interest rates, in spite of an unusually sharp expansion of bank credit, with the exception of the two rates that were arbitrarily pegged; namely, the Federal Reserve discount rate and the commercial bank lending rate on prime loans. Thus these two latter rates became out of line with the practical facts of the situation, a condition that was beginning to make the pegged rates meaningless.

The timing decision of the Federal Reserve in respect to the discount rate was also influenced by the fact that the Federal Reserve would be restrained from raising the rate in January and February when the Treasury will be doing some additional financing.

Most economists will recognize the strength of these arguments for the Fed's action, although it is a fine point of judgment as to whether or not the decision might have been deferred another month under present circumstances.

From the administration's viewpoint, there was an understandable desire to coordinate monetary policies with budget problems, and with economic planning, which is now in the process of formulation for presentation to Congress and to the public around January 15.

Secretary of the Treasury Henry H. Fowler has emphasized on numerous occasions that the coordination of monetary policies with the administration's fiscal policies has been a winning combination in the past several years. For quite some time, he and other administration spokesmen have recognized that a tightening of monetary policies might be a useful tool if it became necessary to counteract inflationary pressures.

It is probably safe to assume that the administration's economic advisers have found it necessary to adjust their 9- to 12-month projections of total demand for goods and services in the last month or so. The latest available statistics indicate that the demands of the private sector are rising more sharply than expected. And the probabilities strongly indicate that the demands represented by defense expenditures will also rise more sharply than earlier anticipated.

The adjustment in projections required by these two recent developments leads to more serious consideration of the prospect that total demand will impinge on supply to a degree that threatens an even stronger upward pressure on costs, prices, and interest rates. In several recent speeches, Secretary Fowler has pointed to the narrowing gap between supply and demand to support the administration's pleas for voluntary restraint by labor and business in their attitude toward wages and prices.

The administration is not so naive as to expect that jawbone treatment alone will succeed in restraining wage and price increases. However, it would seem to be within the prerogatives of the Government to keep business and labor leaders aware of the damage to their own welfare that would result from excessive wage and price increases.

It may also be assumed that the administration must be taking into its calculations the share increases now indicated in the demand for credit. The upward revision in the size of the Government's deficit means that it will have to borrow more money. The recent acceleration in capital spending by business, coupled with the evidence of a flattening in the rising trend of corporate earnings, makes it clear that the corporate sector will have to increase its borrowing in the next 6 months.

Thus the pressure for higher interest rates has been building up for two primary reasons: (1) the probable need to discourage marginal spending financed by borrowed money, and (2) the simple fact that the demand for credit to finance expansion is exceeding the economy's generation of savings to supply that credit.

All of these conditions are well known to the President's economic advisers. They have publicly recognized their responsibilities to prevent the development of an inflationary boom-and-bust pattern. Consequently, it seems unrealistic to anticipate anything in the nature of a rollback of interest rates. Higher rates are now a fait accompli and probably would have been forced into that status within very few months in any case.

Under present circumstances it is highly unlikely, in my judgment, that the higher price now placed on credit will do anything worse than reduce an unsustainable growth trend, with inflationary threats, to a rate of growth that can be sustained without inflation.

Senator MILLER. Dr. Harris, I have an excerpt from a statement of then Senator John Kennedy on balance of payments, made in Philadelphia, Pa., on October 31, 1960, in which he said:

We must have a flexible balance and, above all, a coordinated monetary fiscal policy. We do not, let me make it clear, advocate any changes in the constitution of the Federal Reserve System. It is important to keep the day-to-day operations of the Federal Reserve removed from political pressures while reserving to the President the responsibility for coordination of economic policies.

Then on October 26, a year ago, President Johnson's statement on economic issues on the subject of monetary policy, and the stability of growth, says, among other things:

We have maintained the Federal Reserve's traditional independence within the Government. With continued moderation there can be the continued mone-

tary expansion essential to economic growth. But if inflation develops or an excessive outflow of funds occurs, the Federal Reserve System is in a position to do what is necessary.

Now, in your statement you expressed doubt that Presidents Kennedy and Johnson's affirmation of the independence of the Fed was more than "paying lipservice" to the slogan that there should be an independent Federal Reserve. Are you saying that these statements by these Presidents were just teasing the American public? Is that what you are saying?

Mr. HARRIS. There are a number of points I could make there. First, there is a great question of what you mean by "independent." As I suggested before, when Governor Maisel was talking about independence he was talking about independence in such a way that I would not object to it. Now as far as President Kennedy is concerned I might say I gave President Kennedy his first instructions in this area. I think President Kennedy was very much aware of the restrictionist policy in the 1950's and he was not going to have any of that.

But he was a smart politician, too, and he felt it was a mistake to come out and say that he was against this independence; so he did make statements about independence.

But what you have to consider is what his policies really were. If you take a good look at his policies in 1961 and 1963 you will find he very much got what he wanted out of the Federal Reserve. Of course he said, "Mr. Martin, you are independent." He also told Mr. Martin how much money he wanted. So, after all, Senator, I am sure you are a great politician, too, as President Kennedy was and when you are in politics you have to say things that sometimes you don't mean too seriously.

Senator MILLER. May I respectfully say this, Doctor; when I make my speeches I try to use the King's English in a way in which the people will know what I am talking about. I don't try to play around with the King's English and let people have the euphoria of thinking I am saying something that I really am not intending to say.

Mr. HARRIS. To put it another way, I will say that what President Kennedy was really saying was that independence is all right, but my theory of independence, not your theory of independence.

Senator MILLER. This is the point I am very pleased to have you bring out. I must say I agree with you. It seems to me that the American public had better start waking up to the fact that when they hear certain language used by some spokesmen, they had better consult not only the dictionary but they had better consult with somebody who knows what that person really means when he uses a word because independence, I think, to the average person, at least the average voter, probably means somebody who is going to stand on his own two feet and assert his own opinions regardless if he thinks that somebody else is wrong.

Maybe independence in some other person's mind is that he is going to have an independent opinion but when it comes to action, no, he wont be independent in his action. So, it appears to me—I am not criticizing you, I think you have brought out a very important point—that you can get into semantics on some of these most fundamental issues and the general public really does not know what is going on.

Mr. HARRIS. I think that is true. On the whole, if you take the 1950's I think that Mr. Martin was clearly adhering to the independence theory. Apparently he was doing what he thought was right. You must not forget he was also giving Mr. Eisenhower what he wanted. So that is hardly an independent position.

The same thing happened under Kennedy and Johnson. Generally what they wanted Mr. Martin gave. He talks about how friendly his relations have been with the Kennedy administration. They were friendly because he gave them what they wanted. He was not independent most of the time but he talks independence in order to satisfy his clients.

Senator MILLER. As I understand it he gave President Kennedy what he wanted in the form of an increase in interest rate in 1963.

Mr. HARRIS. I think Mr. Kennedy and I think the Treasury also wanted an increase in the rate, short-term rate anyway. My own point is, after looking the situation over pretty carefully, it may well be that that small increase in rate did to some extent reduce the exportation of capital. It is not altogether clear it did. In any case the problem of short-term capital movement continued right through 1964 at a very disturbing rate. It is only when the Government introduced the voluntary capital program, not the change in interest, when that position was corrected, at all.

Senator MILLER. At the very beginning of your statement you say the inflationary signs do justify the use of the scalpel but not the sledge hammer.

Mr. HARRIS. Yes, sir.

Senator MILLER. The testimony that we received from Mr. Martin, and I believe that the dissenting members of the board would agree was that this was at most a scalpel treatment. Are you suggesting that what was used was a sledge hammer?

Mr. HARRIS. I would say that it is closer to a sledge hammer than a scalpel; that is what I would say.

Senator MILLER. Pardon me?

Mr. HARRIS. I would say it is closer to a sledge hammer than a scalpel. It is something that would frighten people. As I say in my paper, Mr. Martin could have done it in a much easier manner without disturbing anybody. Now we have to take note of what the situation is and if instead of increasing the rate by half a percent if he had only allowed some slight hardening through the method he used for the preceding year or two I think he would have been much better off and we would have had much less disturbance and much less concern about what the situation would be like.

Senator MILLER. I can agree with you on that but at the same time that does not lead us to the conclusion that this was a sledge hammer approach.

Mr. HARRIS. It is nearer to a sledge hammer than it is to the scalpel.

Senator MILLER. I just want to remind you that yesterday Mr. Galbraith testified, "It would be silly to suggest that the recent increase in the interest rate will do irreparable damage."

It seems to me he is really saying in effect it would be silly to suggest that this is a sledge hammer approach.

Mr. HARRIS. I think you have to consider the increase in the rate alongside a number of other things. What Mr. Martin has been saying

right along amounts to generally excessive concern about inflation and despite Mr. Martin, you know the Democrats have made a good record on inflation in the last 4 years. This is quite a remarkable performance because the Democrats are generally associated with inflation. That is only because they happen to be in power when there is a war and that is when most of the inflation comes.

To have had the kind of recovery we have had in the last 4 or 5 years and a small amount of inflation is a remarkable achievement. I simply say with this kind of recovery and going up $40 billion a year it is a dangerous thing for anybody to come along and introduce a dramatic increase in interest from 4½ to 5 percent when you are not sure of the inflationary effects. I think this is a dangerous thing to do.

Senator MILLER. We will return to inflation at my next opportunity My time is up.

Thank you, sir.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Both of these papers have been stimulating and interesting.

Mr. Gainsbrugh, it is always helpful to have this kind of objective and comprehensive survey. It seems to me that we all see what we want to see. Your survey confirms the convictions I have had to which Senator Sparkman alluded, that this rate increase has an inequitable effect on American business.

Your finding in your survey is that big business is not affected at all really in the first quarter, a little bit, very, very little subsequently and so slightly as to not be significant.

Now this is logical in view of the fact that the flow of funds to big companies has increased greatly in recent times, their depreciation reserves, the tax cut, any number of other developments have given them far more money in many cases than they could invest.

They don't have to resort to the banks. As this indicates here, they have greatly increased their various investments. However, isn't it true in the competitive segment of the economy, not in the administered price section, but in the competitive section of the economy it is the small marginal firm, the firm that may be about to go out of business, the firm that is breaking even, that has a great influence really on price?

Isn't it true that this small marginal firm logically would be more likely to have to resort to bank credit, would be more likely to have to postpone its modernization of its plant, its investment in plant and equipment as interest rates go up and therefore that this might very well have the effect of increasing prices in a reasonably long period of time?

Mr. GAINSBRUGH. The questions are very searching.

Now, first I wish we had a reporting system that would embrace all of manufacturing rather than the group that we regularly poll. I have already indicated that so far as we can tell from the past, what we find for our thousand group holds for the balance of manufacturing. They sound much larger than they really are. When you get to look at the assets that are required to get into the thousand largest manufacturing group I think you will find that the cutoff point is possibly as low as $4 million.

Senator PROXMIRE. May I interrupt at that point?

The small business definition is firms that employ 500 or fewer?

Mr. GAINSBRUGH. Yes.

Senator PROXMIRE. Of the 4½ million firms in the Nation all but 200,000 fall into this category. So you have 1,000 of the biggest 200,000. In this sense it does seem to be the elite.

Mr. GAINSBRUGH. Our figures relate only to manufacturing, however. But you realize why it is that we concentratė upon this group. We do so primarily because we are interested in the most explosive sector of the economy, the investment sector.

If you go back and examine the history of the American economy since the end of Warld War II you will find that even at the trough of recession consumers have spent more than at the peak. Our society has grown virtually recessionproof so far as the average consumer is concerned. Secondly, you will find that consistently in every postwar recession total governmental spending—Federal, State, and local—has always been greater at the trough than at the peak. This is the result of countercyclical operation. Where, then, is the weak sector of demand? The weak sector of demand in the recession has been the tailing off of private investment. This is why the economic profession has concentrated on the investment sector.

Senator PROXMIRE. I don't question that. I think that is an excellent answer.

Mr. GAINSBRUGH. This then is the reason for our concentrating as we do upon the investment sector and for dealing with one part of the investment sector in the belief that if we know what is happening in that sector we have a good guide as to what will be happening to total investment. I wish there were a series of data for the smaller sectors of American industries corresponding to that for the large.

Senator PROXMIRE. I think what you have done is helpful. What I am saying is that when Governor Martin testified he said something that seems to be in direct contradiction. He said the main effect of this interest increase will be in restraining investment in plant and equipment. That was his conviction. I questioned him on that and that was his answer. You are saying as far as the 1,000 biggest firms are concerned there is no real constraint. It adds up to me that the real impact is on small business.

Mr. GAINSBRUGH. It will grow across the matrix of the private investment I think as the year runs its course. It may or may not be helpful to you in your thinking but I have asked several bank economists what they think the impact of this will be upon their lending patterns in 1966.

They believe the following changes may well occur. First, however, may I say that small business is largely financed by the banking system, as well as the medium and the larger. The American Banking Association has demonstrated repeatedly the extent to which its members help finance small business.

Senator PROXMIRE. They are financing small business much more than they are big business, far more in proportion.

Mr. GAINSBRUGH. That is correct.

Senator PROXMIRE. Because small business does not have the internal resource, does not have recourse to the equity market the way the larger ones do.

Mr. GAINSBRUGH. Insofar as their patterns of lending may be influenced by the Federal Reserve policy they believe they will grow more selective, that there will be a more careful selection policy relative to lending abroad, relative to mergers and consolidation, relative to oil and related "risk" investment; those types of investment that really ought to be financed in the equity market but have instead, under easier interest rates, been brought to the commercial bank.

The picture that they paint at least is that they will not cut back upon their traditional financing of smaller size business. These have been their traditional source of loan demand in the past. They propose to keep them their major source of investment now and in the future.

Senator PROXMIRE. There was a very interesting additional contradiction between your testimony and that of Governor Martin. Governor Martin testified that the main effect of this interest rate increase will be to dampen down demand, not to increase cost push on prices. You say the reverse.

I think what Governor Martin said is understandable because if Governor Martin's contention is right, if the effect is the dampening of demand, then it would tend to stabilize prices.

However, if your position is correct, we can make a strong case for what Governor Maisel told us that a Brookings computer, when you put all the variables into it, indicated the effect of this increase in the discount rate is going to be increased price.

I think perhaps because they emphasized the same thing you are here, the cost-push element. After all, interest is a cost of doing business. If you have to pay more for interest it increases cost. It increases especially when the small marginal firm—it is an important element—has to pay higher price.

Mr. GAINSBRUGH. May I first say that as much as I admire the Federal Reserve and Mr. Martin, I have not always accepted their economic analysis. As of mid-1965 I thought their analysis that we were on the verge of something resembling the great crash was unwarranted, and I said so.

Others did too, conservative business economists.

Senator PROXMIRE. You have been proved right, too.

Mr. GAINSBRUGH. Well, this helps a little. On the other questions, however—may I be refreshed as to the substance of the question?

Senator PROXMIRE. It was the conflict between your position and Martin's on cost-push versus demand effect of the rate increases.

Mr. GAINSBRUGH. I did indicate that demand might be cut back as the year progressed. This may very well be one of the consequences of the Federal Reserve policy.

Senator PROXMIRE. Let me state further that you said the demand was not an important element in pulling up price.

Mr. GAINSBRUGH. That is right.

Senator PROXMIRE. Your feeling was that the Vietnam situation with relation to the Gross National Product now was not as significant as had been Korea, since the economy is now vastly larger and our military commitment less. Therefore, you are arguing that the cost push, labor in particular, wage increases are going to be the main element.

Mr. GAINSBRUGH. I am not denying there will be some restraints exercised by the Fed upon demand. You can see in the case of our own survey that as the year progresses there will be a greater degree of selection in the investment process as a result of the rise in the discount rate.

But I do think that the primary problem we face in 1966 is not on the demand side. It is on the cost side. Therefore, I have my own reservations about the adequacy of monetary policy to deal with the wage-cost-price push.

Senator PROXMIRE. You feel fiscal policy may be more effective?

Mr. GAINSBRUGH. This may support what one witness previously said. Our own outlook on the course of prices in 1966, even after the Federal Reserve's change in monetary policy, is that price will drift upward more rapidly than in 1965.

This is what I meant by incipient inflation. The models that are being built for 1966 incorporate not only around a 1½- to 2-percent increase in the Consumer Price Index, which is a little bit more than the annual rate over the past decade, but they for the first time incorporate a rise in wholesale price of 1 to 2 percent.

This is not, to use a phrase in quotes, "galloping" inflation, but it is no longer a price creep. The offset to the consumer price increase in the service sector has been the dampening down of prices of industrial commodities throughout the past 4 or 5 years.

Now if we get both service sector price increases and industrial commodity price increases we are moving toward acceleration in price inflation. That is the type of inflation I have been trying to analyze here for you in my testimony.

Senator PROXMIRE. My time is up.

Chairman PATMAN. Mr. Reuss?

Mr. REUSS. I, too, want to thank both of you gentlemen, and through you, Dr. Gainsbrugh. I wish to thank the National Industrial Conference Board whose members, I believe, are just about every major U.S. corporation, both in manufacturing and in retailing——

Mr. GAINSBRUGH. And finance.

Mr. REUSS (continuing). For the public service you performed in spending whatever it cost to send those thousand telegrams and also for making it possible for us to hear your very excellent analysis today.

I am particularly struck by what you were just saying to my colleague, Senator Proxmire, and I think I will read back to you what you said on page 4, the second page 4 of your paper.

> In summary you say:
>
> The prospective drain of escalation in Vietnam in relative terms would not seem to place an undue strain upon either the nation's capacity to produce or its labor force.
>
> The huge addition to industrial capacity this year and that now coming on stream, particularly in defense and defense-related industries, may prove more than sufficient to meet respective aggregate demand.
>
> Viewed against this background the more likely threat to price stability is the pressure arising from the wage-cost-price push rather than excessive demand pull.

If I may say so, that—to me—is a profound analysis of the situation confronting us. I think you have made in your paper a very convincing case, and I believe that is a correct analysis.

I will now come to my question. If that analysis is correct, as I believe it to be; was not the Federal Reserve's action the other day

in placing monetary restraint, which operates on demand across the whole economy, a mistake. And if the major danger was wage-cost-price push, isn't what is needed in the economy a vigorous and prayerful application of the wage-price guidepost?

Before letting you answer, let me add this. You may disagree with that technique, but at least monetary restraint does just the wrong thing. Since the problem is not demand, since monetary restraint equals demand it is perverse, and since it is likely to raise cost, it simply accentuates the real problem of inflation confronting us which is not classic demand inflation but wage-cost-push inflation.

Would you comment?

Mr. GAINSBRUGH. Again your observations are very keen and pertinent.

In meeting wage-cost-price inflation I think we need about every tool we have in our anti-inflation kit rather than reliance upon any single tool. Federal Reserve policy insofar as it contributes toward dampening down demand will help in postponing or withholding types of investment that would in turn create additional demand for labor, that would in turn create more pressures via the wage-cost-price push.

Mr. REUSS. If, as you say, we are going to have sufficient factory capacity and materials to meet prospective adequate demand, won't restrictive monetary policies make contact with the wage-cost-push impetus only at the price of conking us on the head across the board, and causing much more unemployment and underuse of resources than either you or I would want?

Mr. GAINSBRUGH. Of course, I would hesitate to endorse any increase in unemployment arising from monetary policy as a factor that would contribute toward reducing the wage-cost-price push. I think as you look back retrospectively that this did contribute toward reducing the wage-cost-price push in the late 1950's and early 1960's. This at times is a rather high price to pay for the wage-cost-price push, but it is one that we have paid in the past.

Mr. REUSS. I think you have done a useful thing by recalling to all of us the activities of the Fed in the 1957–58 boom, in which they may have had some marginal impact on wage-cost pushes but only at the expense of plunging us into 7 percent unemployment. You have also pointed out their return to that buffoonery in 1960, when they tightened money and brought unemployment to 7 percent once again.

It looks to me as if they are tentatively launched on act 3.

Mr. GAINSBRUGH. I still come to the same problem that haunted me in trying to come to a summary of my presentation. So far as we know the record of history, it is difficult to determine how best to deal with the wage-cost-price push. The old traditional orthodox approaches were effective when they related to the demand pull. I recently participated in an international conference on monetary problems. Virtually every participant who came from Western Europe, where they have adopted the so-called incomes policy, told us they have found it hasn't worked. They looked at our price performance of the past 4 years with considerable envy, and wondered why it works so well here. But they warned us that one of the reasons the informal guideline approach had not worked over there, was that they had a tight labor market and we had a slack labor market.

They said that as you come closer and closer to a tight labor market, you may find yourself confronted with the same difficult problems of holding down price increases that we have abroad.

I thought in this connection of using everything we have at our command, of a voluntary character including lowering the guidelines temporarily. If that doesn't work with the passage of time, the answer may very well be more direct approaches, more direct restraints upon the wage-cost-price push in the belief that even this would be in the national interest.

Mr. REUSS. You make an interesting comparative point about the European experience. It is certainly true, as you have reported, that despite fairly advanced institutional income policies which go much farther than we dream of going here, they have had very considerable price inflation, much worse than ours, in the last 4 years.

I think you correctly spotted the reason for that. Despite much talk about fiscal probity from our European friends, actually they have spent a good deal, taxed very little, and thus have been running big deficits and have over full employment.

Thus, if you try to engraph upon full employment a wage guidepost policy, the problem will not be solved because it is essentially one of demand inflation. I think you have brought in an interesting comparison.

Let me ask Dr. Harris a question. As I remember reading my newspapers 3 or 4 years ago, there was much gossip at that time that President Kennedy wanted to appoint you to the Federal Reserve Board of Governors. All I know is what I read in the papers. But if that was true, and if you had been offered and accepted an appointment, do you think the course of monetary history in recent years would have been any different?

Dr. HARRIS. Thank you for asking that question, Congressman.

I think probably it might have been different. I don't know how much you know about the story. Some months before President Kennedy's tragic death, two openings in the Federal Reserve Board were imminent. The first opening developed when a member of the Board from Mississippi became ill and resigned.

The other post—which subsequently went to Governor Robertson—was going to be available about 3 months later. At that time the question arose as to who was to get the first of these two appointments. The President asked me if I was particularly interested in getting the first opportunity.

Since I preferred to have 3 more months in the academic world, I said I didn't have any strong preference for immediate appointment. The people who were pressing for Daane's appointment were anxious for him to have the first opening. I said, "Go ahead." It did not work out very well for me because President Kennedy was assassinated and before his death the Daane appointment had been made. When the other post became available, President Johnson didn't go along with President Kennedy's choice and I was turned down. If I had received the first appointment I would have been a member of the Board and President Johnson may very well have preferred Governor Robertson to Mr. Daane for the second opening, in which case he would have had a four-to-three vote against Martin's position rather than three to four with Mr. Martin.

That occurred to me the other day. I am not weeping about losing a Federal Reserve appointment because life is much more pleasant in California and my job much easier than being on the Federal Reserve Board, but I thought this was rather interesting.

If events had occurred according to plan we might have had a different vote on the Board and the crisis wouldn't have come up and we would not be sitting around here today.

Mr. REUSS. Thank you for a very interesting answer.

Chairman PATMAN. I have two or three papers to put in and a suggestion to make.

Dr. Gainsbrugh, did you say that you would follow through on polling these small businessmen along the lines I suggested?

Mr. GAINSBRUGH. I will take it back to the trustees of our Board with your recommendation and you will hear from us.

Chairman PATMAN. You will let us know what the score is?

Mr. GAINSBRUGH. Very promptly.

Chairman PATMAN. Could you include in that more than just the manufacturing industry? Could you include distribution?

Mr. GAINSBRUGH. I would like to have, as you would, as representative a cross section of American industry as we can get.

Chairman PATMAN. You will work to that end?

Mr. GAINSBRUGH. We will.

Chairman PATMAN. Thank you. That is very encouraging. I hope you can get it done. How big is your budget?

Mr. GAINSBRUGH. Three and one-half to four million dollars.

Chairman PATMAN. Considering all the big corporations in the United States that support your organization, this shouldn't be hard financially to get done. Your organization is tax exempt, isn't it?

Mr. GAINSBRUGH. I think it is correct that Board subscriptions are tax exempt.

Chairman PATMAN. It would not be too heavy, I hope.

Mr. GAINSBRUGH. Unfortunately our budget is already committed, you see. But this will receive very favorable consideration.

Chairman PATMAN. Thank you, sir.

I want to comment on a statement made by Mr. Martin about the coterminous term that he was interrogated about.

For some time now I have charged that the more than 90-year-old bankers lobby—the American Bankers Association—has been the most powerful and influential lobby in the United States. I have observed over time that there is not a Member of Congress that could not be called off the floor by a banker from his district. Bankers are influential people within their community. I do not, of course, impugn the integrity of either the bankers or the Members of Congress who listen to bankers because a Member of Congress is obligated to listen and represent all of the people of his district.

I have also charged that the American Bankers Association and its members—dominated by the larger banks of the country—have a great deal of influence over, and in fact in all too many instances control, the decisions and activities of our Federal Reserve System. This is so not only because of the way in which the members of the Board of the Federal Reserve district banks are chosen—whereby six of the nine members are elected by the banks in the Federal Reserve districts—but also because of the fact that the banks of and by themselves and

through such things as interlocking directorates represent one of the most powerful forces and, therefore, pressure groups in our economy.

This fact and observation was never more forcefully proved to me than when Mr. Martin appeared before this committee on Monday.

During my exchange with Mr. Martin concerning the matter of whether or not the term of the Chairman of the Board of Governors of the Federal Reserve System should be coterminous with that of the President, Mr. Martin had this to say. Mr. Martin said that he had discussed this matter a number of times with President Kennedy and that both Mr. Martin and the President agreed that it would be desirable to have the Chairman of the Board of Governors appointed by the President so that the President could select a man in keeping with the policies and programs of the President.

Mr. Martin said that "he [the President] suggested to me in our conversation that 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."

And now comes the most significant part of Mr. Martin's statement. Mr. Martin went on to say: "I [Mr. Martin] had told him [President Kennedy] that I [Mr. Martin] would undertake to take that up with the American Bankers Association to see if I [Mr. Martin] could not get their support for it."

I have never heard anyone, including Mr. Martin, be as plain and clear as he was in this statement. Nothing could be said which more clearly substantiates the case that the American Bankers Association dominates our Federal Reserve System and, in effect, controls and dictates monetary policy. Notice in this quote that Mr. Martin did not say that he would take this matter up with the Congress or with his fellow Board members, or with his staff. Mr. Martin said he would take it up with the American Bankers Association.

I invite the members of this committee to check this part of these hearings very closely for I am not quoting Mr. Martin out of context. (See p. 167, pt. 1.)

Chairman PATMAN. I have a table here showing the banks accommodated by the Federal Reserve over a period of years—1960, 1961, 1962, 1963, 1964, and 1965. I want to invite your attention to the fact that very few, comparatively few, banks who are members of the Federal Reserve System ever ask for any kind of accommodation whatsoever.

I would say the number each year was much less than 25 percent and are small in comparsion to the resources of the particular banks. Last year the accommodations were about 1,263 banks, in 1964. They received in credits—of course some of this is 15 days, probably less, some not much more—but the aggregate was $46,551,425,390. But this year, 1965, the amount increased the first 11 months to $67 billion-plus.

I will put the amounts in the record along with the other information. I have asked for the information broken down by months which we expect to have this afternoon to put in the record.

It indicates that credit has been so tight with the Federal Reserve—I mean that the reserve with the banks have been on a deficit basis rather than a surplus, and they have had to go to the Federal Reserve more often to get funds.

The objection by the banks to borrowing from the Fed is that the banks claim that it is expensive to them. Of course, I don't follow that because they borrowed money for about 4 percent from the Fed, which is high-powered dollars. For every dollar they have borrowed from the Fed and is in their reserve fund they can make loans and credits amounting to $10 to every one of those high-powered dollars.

So when they only pay 4 percent for that money, that is a high-powered dollar and they can lend 10 times that much, it occurs to me it is a rather small insignificant cost in comparison with the benefits.

(Tables referred to appear on p. 190 ff., proceedings of second day.)

Chairman PATMAN. We have an understanding that any member can put anything in the record that he believes is germane to these hearings and that answer any point from his viewpoint that has been raised in the hearings.

You gentlemen, if you want to extend your remarks when you look over your transcript, why it will be perfectly all right for you to do so.

Do we have anything else we ought to bring up?

Senator MILLER. I have some further questions.

Chairman PATMAN. Senator Miller.

Senator MILLER. Dr. Harris, in your statement you said the Federal Reserve's independence is an "insane idea."

Mr. HARRIS. I used that word carefully. I really meant it, too.

Senator MILLER. I am sure you did. You stated it very forcefully. Then you said President Johnson quite rightly does not seem pleased with the independence and "defiant" action of the Fed. Are you suggesting that this check-and-balance system we have is all wet and insane?

Mr. HARRIS. I don't mean to say that all checks and balance are out. I can see some reason for the Supreme Court.

Senator MILLER. What about Congress?

Mr. HARRIS. I think you all agree—I don't know whether you will—but I think it is generally assumed that Congress has lost some position vis-a-vis the executive in the last few years.

Senator MILLER. I would most thoroughly agree with that and I think that is terrible.

Mr. HARRIS. When you get in a bad situation you tend to concentrate authority and responsibility in a small number of people and perhaps more in one branch of the Government than in another.

Now what was your original question which I have forgotten?

Senator MILLER. I am just leading up to the question. If the Congress in its wisdom—now you may call it an insane idea—but if the Congress in its wisdom decided to have an independent Fed and if the independent Fed in its judgment thinks that the President is wrong, then why would you call it defiance for the Board to act according to its judgment? Why would you not praise them and say they were good boys?

Mr. HARRIS. Senator, I am not absolutely sure that the legislation says that they are independent. This idea of their being independent is something which has grown up over the years. What I would argue is that—of course we are really at war, but even in the great depression the same view would prevail—the independent has the right of the Federal Reserve to do what it pleases is a great luxury.

It is a luxury you may afford when everything is going beautifully but I think it is a very costly luxury at the present time. I think for the Federal Reserve to move in one direction and the Government to move in another seems to me to be an insane way of having any worthwhile economic policy.

Senator MILLER. Do you think it is wrong for the President to want to go in one direction and for the Congress to decide to go in the other direction?

Mr. HARRIS. No, I don't think that is true in the case of the President and the Congress but on the whole we do get some integration. I think you get as much integration in the Federal Reserve.

The point I make about the Federal Reserve—I think in a general way you could argue in the last few years the Executive has been in favor of an expansionist policy. I have been very critical of Martin, but I did say to him that he did a much better job in the sixties than he did in the fifties.

In the fifties I thought he was terrible for reasons Congressman Reuss indicated. My only point on this whole issue is that if the Government is in favor of the expansionist policy as it is now, and we have had this really remarkable recovery over the 60 months or so and this recovery has been largely due to the activities of the Government, much truer than before, if this Government thinks the best thing to do is to have an expansionist policy and goes over these problems with the Federal Reserve Board as they did, the Federal Reserve Board has every right to say what is necessary and desirable but once having decided on a policy I don't think it is correct and desirable that the Federal Reserve introduce a restrictionist policy when the Federal Government is introducing an expansionist policy.

Senator MILLER. Mr. Martin testified there is absolutely no difference on the part of any members of the Board with respect to the policy, no difference at all.

Mr. HARRIS. Oh, yes——

Senator MILLER. The difference came in the means to attain the policy's goal.

Mr. HARRIS. I am willing to accept that correction, that the conflict does come in the weapons used. Everybody is willing to have stable prices, great growth, no cycles. The point is, how to achieve these. The Executive does not believe you can achieve these the way the Federal Reserve does.

Senator MILLER. They even went further to indicate that they agree with the expansionist policy but it is a very refined case of judgment of whether to put a little dampening on the expansion now, so that it will continue, or to let it continue at a faster rate than they think can be sustained and eventually having to clamp the brake down and have a real recession.

Mr. HARRIS. It is a nice question of where you increase the sustainability and where you really kill the whole thing. This is the real danger. My interpretation is that this kind of policy will not merely sustain the recovery but will end it.

This is, of course, a matter of intuition and judgment. You may be right and I may be right but this is my view.

Senator MILLER. I understand. That does not mean that this is an insane situation. I can understand the defiant situation where Mr.

Martin might say to the President, "Well, we have decided that we are not going to have an expansionary policy," but there is nothing like that. I think it is rather unfortunate to convey the impression that there was.

I just wanted to bring this out. This is a matter of refined judgment in a very, very refined area. I think most of the testimony has recognized that.

Mr. HARRIS. I think the question of conflict is not only a matter of objectives. I think it is perhaps more important how you go about it. I think the general view of the Government certainly is that the Federal Reserve is not going about it in the right way.

Senator MILLER. In your statement you said that experimentation with higher rates has not solved our balance-of-payments problem. I don't know of anybody who has suggested that it would solve the balance-of-payments problem.

There are many other facets to the balance-of-payments problem solution than just this one. But is it not possible that the balance-of-payments problem has been alleviated somewhat by what was done? President Kennedy stated that this was one of the reasons why he advocated the increase in interest rates in 1963.

Mr. HARRIS. Senator, may I refer you to a book I wrote some time ago called "The Dollar in Crisis," in which I point out there are 25 or 30 facets to this policy.

The reason I went into the interest-rate problem was because Chairman Martin went to a great deal of effort to point out that higher interest would help solve our balance-of-payments problem. We had a very high rise in short-term rates in the early 1960's. The problem of short-term capital which that was supposed to treat continued at a very high level. The only really significant improvement came in 1965 when we gave up trying to meet this problem through increasing rates but depended almost wholly on our voluntary capital movement. That is why we had improvement.

Senator MILLER. I think in fairness to the Chairman of the Board it ought to be pointed out that he listed balance of payments as only one of several factors that were taken into account. I don't believe he ever indicated that this was even the primary factor. It was one of a bundle of factors that were taken into account.

Mr. HARRIS. It was one of the important points he emphasized on why he raised the rate of interest. That is all I am claiming.

Senator MILLER. You state some precaution may be necessary but not the use of a weapon that may deny the American people $40 billion of additional income in 1966. Are you talking about net income?

Mr. HARRIS. I am talking about GNP. This is the increase in GNP expected in 1966.

Senator MILLER. So that increase in GNP certainly is far different from additional net income, is it not?

Mr. HARRIS. Well, Senator, I have spent many years teaching national income statistics and whatnot. I am aware of the difference between national income and GNP.

Senator MILLER. I just thought that we ought to make it very clear that when you talk about $40 billion additional income expected in 1966 you are talking about GNP and not net income.

Mr. HARRIS. I am suggesting this kind of policy may well destroy a good part of the $40 billion.

Senator MILLER. How much?

Mr. HARRIS. Look what happened after 1929. You had a 40-percent decline in output. I am not comparing 1929 with the present situation, however, less I be misinterpreted.

Senator MILLER. How much do you estimate of this $40 billion additional GNP will be denied?

Mr. HARRIS. It partly depends on what Mr. Martin does from this point on. I think the increase in rate will have some effect on housing and a number of other areas and, what is more, might very well—and this is a great danger in this kind of situation—might very well give the general idea that there is going to be a great inflation because Mr. Martin has raised the rate of interest and this might increase the total amount of spending and bring about inflation.

Senator MILLER. When you say it may destroy all of this $40 billion that is one thing. I detect that you are really saying it may deny the American people only part of the $40 billion.

Mr. HARRIS. I just don't know any more than anybody else does. You are taking a big gamble and you may be losing a good part of the $40 billion.

Senator MILLER. But not necessarily all of it.

Mr. HARRIS. No. When your GNP is rising four times as fast as the price level I would not worry too much about the price level increase.

Senator MILLER. When you talk tbout $40 billion are you talking about real dollar increase in GNP?

Mr. HARRIS. I am talking about GNP in current dollars. Actually, of course, the most recent estimates are $45 billion. You allow for the 2-percent price rise and you get perhaps in real terms maybe $30 billion, 4 percent real increase.

Senator MILLER. In other words, roughly a third of this——

Mr. HARRIS. In similar price it would be about $30 billion.

Senator MILLER. You are saying about a third of the estimated increase here would consist of inflation?

Mr. HARRIS. I appreciate your revealing what I really meant. I didn't want to make the paper too long. Now you have made me perhaps elaborate.

Senator MILLER. We have patience. Thank you.

Chairman PATMAN. Senator Proxmire?

Senator PROXMIRE. Doctor Harris, do you think that the practical consequence of the Fed's action in increasing the discount rate from 4 to 4½ percent was to break the successful persuasion of President Johnson in urging the banks to maintain their prime rate at 4½ percent, so that the discount rate increase this time broke the President's persuasive influence and enabled the prime rate—this key interest peg—to move to 5 percent? Do you think that was a practical and direct and immediate and obvious consequence of what the Fed did?

Mr. HARRIS. I think that is true. Somebody here did make the point that the earlier increase in 1963 and 1964 didn't have the effect of operating on the prime rate. In that sense this particular increase was a much more effective, much more potent increase and therefore in my view brought more harm.

So I think this certainly did have, did tend to damage President Johnson's attempt to deal with the problem by putting moral suasion on the bankers and saying, don't bring about a general increase in money rates.

Senator PROXMIRE. Along that line a recent table was compiled by a national magazine, U.S. News, that showed that the booms in 1920, 1929, 1937, 1948, 1953, 1957, and 1960 had all been interrupted by a successive series of increases in discount rates.

They felt in this article that the situation now is quite different because of the very strong demand in the economy. On the basis of your remarkably long and close experience as an outstanding teacher and as an observer of economic history do you think that we can learn a lesson from what has happened in the past with a discount rate increase of this kind?

Mr. HARRIS. I think if you take the history of recent years certainly and even perhaps earlier, and I think particularly you remember the 1959-60 increase which Arthur Burns said was the biggest increase we had in a hundred years of recorded history, I think that kind of policy, of course, detrimental.

That is not the only thing that causes trouble. Everybody has pointed out in the 1950's one of the great mistakes made was to allow the full employment surplus to rise and not treat it by increased spending and/or reduced taxes.

One of the things that the Democrats learned, why they have had great success, is that they treated the full employment surplus and they did not allow the interest rate to rise to a significant degree.

We have never had experience where we have had such tremendous recovery with such a relatively small increase in rate of interest until recently.

Senator PROXMIRE. Isn't it also true—this is something that I would like to have Mr. Gainsbrugh comment on also—isn't it also true that the national income accounts budget, more accurately than any other, measures the economic impact of Government spending and taxing more accurately than the administrative budget and probably about the same as the cash budget?

Isn't it true that this national income accounts budget is going into surplus, probably beginning January 1 when we have a big increase in social security taxes?

Isn't this $5 billion annual rate increase likely to result in a fiscal drag? Isn't the consequence that we should have some concern about how demand actually will work out in 1966?

Mr. HARRIS. Senator, I would agree with this. All I would say would be that the national income account and the best estimate I have seen of what is going to happen in the calendar 1966 is—not an official estimate but estimated by a very able economist—is that in 1966 we are going to have an increase in the national income budget of $11 billion in spending and $8 billion in revenues so there will be a net deficit of $3 billion which is not bad at all.

I think as you say the advantages of the national income budget——

Senator PROXMIRE. I was thinking of the first two quarters of 1966.

Mr. HARRIS. I think you are right. In the first two quarters we may have deflationary factors arising not only from the $6 billion payroll tax increase but also from the ordinary increase in revenue which has

nothing to do with change in tax structure. We will have $3 or $4 billion of additional tax revenue in the first half of 1966 which comes automatically. At least to some extent this will offset the kind of inflationary factors that have been talked about.

I don't think it is at all clear that we will have a substantial inflation in 1966.

I am willing to agree there are some signs that are disturbing.

Mr. GAINSBRUGH. I would accept the conclusion first that from the point of view of economic analysis the national income approach is by far better than the cash or the administered budget.

Secondly, insofar as the first and second quarters of 1966 are concerned, we have yet to see the dimensions of expenditures for Vietnam and the impact of this upon outlays in the first half.

I assume the outlays will be rather sharp in the first half on the basis of procurement contracts that have been placed in the third and fourth quarters of 1965.

Furthermore, in anticipation of the deflationary impact that would arise from the $5 billion on an annual basis of extended social security costs, there were various increases in social security benefits and increases in military pay. I haven't seen any estimates yet of a prospective Federal surplus for the opening half of 1966.

Senator PROXMIRE. One other question I would like to ask both of you gentlemen; Mr. Gainsbrugh first.

Monday, Governor Maisel testified to this committee that he was shocked at the lack of coordination between the Federal Reserve Board and the other economic policy arms of our Government: Budget Bureau, Treasury, and the Council of Economic Advisers.

He said that although he had, as one member, one vote which was as important as any other man's vote, he had no formal procedure for meeting with, consulting with, learning the attitudes and the opinions of the other members of the economic policymaking part of our Government.

Assuming that Congress will not enact the suggestion that Mr. Galbraith made yesterday specifying that Congress favor a different monetary policy, assuming they will not do that do you think it might be helpful for Congress to give serious consideration to some kind of formalization of the coordination process between the Fed and these other economic agencies so that barring any question of independence which is a tough thing to handle, that at least you get a greater interchange of information, a greater understanding, a greater knowledge and appreciation of each other's point of view?

Mr. Tobin brought this out to some extent in the letter that was quoted by Professor Harris earlier. I wonder if you think that this is something that is sufficiently urgent so that you feel it will be desirable for Congress to give this serious consideration?

Mr. GAINSBRUGH. My own response to that is that it is hard to believe that there is not a very close coordination between the economists within the Fed and those in the Council of Economic Advisers and in other agencies of the Government.

I was under the belief that there were internal committees on economic stability and related subject areas which brought together the key technicians in the various agencies of the Government.

Senator PROXMIRE. Governor Martin has regular luncheons with these people but the other six members have no direct formal opportunity to meet. They may have contacts and associations, the staffs work together. But the members who make the decisions, and each vote is as important as the other votes, don't have any basis on which they can operate.

In part this is a way of giving the Chairman an extraordinary power. One of the first secrets people learn in any kind of political or business operation is that the man who has exclusive information has exclusive power.

Unless you extend it to the other members of the Board the Chairman is going to have a more decisive power than he would have if the others were equally well informed.

Mr. GAINSBRUGH. I am for any steps that will increase the level of economic sophistication in any part of our society.

Mr. HARRIS. May I make one comment here to add to what you said. Mr. Tobin made this point.

When the Open Market Committee meets they don't have any members of the Government around to give them advice or attend the meetings of that sort. They are completely shut out. I think this is a point that Congressman Patman would approve of, that this is a great mistake, too.

Senator PROXMIRE. Thank you very much.

Chairman PATMAN. May I comment on what Dr. Harris said. The Open Market Committee, of course, meets every 3 weeks. They met Tuesday. That is the reason we didn't have the Federal Reserve Board here Tuesday morning; they were having the Open Market Committee meeting.

It is a secret meeting, of course. What they say is not supposed to to be made public. That Committee by law is composed of 12 members, the 7 members of the Board of Governors of the Federal Reserve System and 5 presidents of Federal Reserve banks.

Of course, one president, Mr. Hayes, in New York, is a permanent member of the Committee. So there are four that alternate. Now that Committee, instead of sitting as a 12-member Committee as it should, and as the law requires, has all the other 7 presidents in, too. I think that gives the banks a great advantage because all 12 of these presidents are selected by boards of directors; each selected by a board composed of six members that were selected by the private banks and three selected by the Federal Reserve Board.

The private banks, of course, have charge of that and they determine who will be the president. They, in effect, have 12 representatives of the banks on the Open Market Committee with 7 public members.

It is true when they actually vote only five vote, but in anticipation of arriving at what is known as the consensus they all participate in the debate and everything else. They are not the only ones that know what is going on. Consider the staffs, the staff members who are there. I would suggest that there are from 30 to 40 people who know about these meetings when they are held and know what goes on, know what to expect, when they are going to be tight, when they are going to be easy.

People could go into the market and make tremendous sums. We don't have any evidence that it has been done. I am not claiming

any abuse. But each one of the presidents goes back and naturally they are working for these nine directors. It is reasonable to assume that they will let their own directors, who select them as president, know what is going on.

Well, that is nine people at each bank. That is 108 right there. Then most of the banks have branches and they have directors, they know what is going on. I estimate at least 200 or 300 people know, almost instantly after the Open Market Committee meeting, exactly what is expected to happen in the future, whether it will be tight money, easy money, or high interest or low interest.

Of course, people who have that knowledge are in a position to make their own affairs much better than those who do not have that knowledge. So I think the Open Market Committee should be, just like many of you have advocated a long time, composed of public servants, responsible to the people or to the elected President of the people and not representative of the private banks.

Senator Miller, I believe you have some other questions?

Senator MILLER. Thank you.

Back to Mr. Harris again, in your statement you referred to the fact that we have experienced a rise in GNP of almost $200 billion since 1960. Here again you are not referring to real dollars.

Mr. HARRIS. No; current dollars. I think generally, Senator, if one does not mention the point those are current dollars, you say real dollars if you mean that.

Senator MILLER. I know that is quite often done this way. Unfortunately, the gullible, unsophisticated general public is mislead. I just want to bring out the fact that according to the Economic Indicators, which make the appropriate adjustment for stable dollars, this would not be a $200 billion increase in GNP, it would be something less than a $160 billion increase in real dollar GNP.

Mr. HARRIS. I accept that; yes.

Senator MILLER. I don't suppose you have been able to refine that into more meaningful terms in the form of per capita income?

Mr. HARRIS. You have a 2-percent increase in population, of course, which would have to be offset.

Senator MILLER. Have you any figures on that?

Mr. HARRIS. If you look at the indicators, the per capita disposable income available——

Senator MILLER. I am looking for the per capita increase in real dollars. Could you work that up for us?

Mr. HARRIS. I will add to my statement if you would like.

Senator MILLER. If you can give us the per capita real dollar increase in GNP I think it would be more meaningful.

Mr. HARRIS. You would have to cut down the $160 by 2 percent to allow for the rise in population.

Mr. GAINSBRUGH. If I may interrupt I do have a table here which shows that the per capita GNP in constant dollars when this expansion first began back in the first quarter of 1961 was $2,642. The corresponding figure again in the same constant dollar in the third quarter of 1965 was 3,128.

Mr. HARRIS. That is a 20-percent rise.

Senator MILLER. Thank you, Dr. Gainsbrugh. It won't be necessary to trouble Dr. Harris.

Mr. HARRIS. Thank you very much.

Senator MILLER. Do either of you gentlemen have a figure that, I think, would be more meaningful than just the real dollar increase in GNP in the form of your estimate of what has been the true economic growth during this period?

Mr. HARRIS. Would you eliminate Government?

Senator MILLER. Not necessarily. It is my understanding that some elements of government certainly should be taken into account.

Mr. HARRIS. You know, Senator, there have been people who have argued that this is all nonsense, the GNP, because an awful lot of things you are spending money on you should not be spending money on through the Government.

I have a colleague, Professor Kuznets, who developed this whole business. He used to argue, in fact wrote an article in 1942 in which he argued to some extent GNP was a certain amount of nonsense because it did include a lot of things that were of doubtful value, for example, military expenditures. If we wanted a real welfare concept of GNP we ought to exclude some of these things.

Senator MILLER. The reason I am intrigued in getting a figure from you is because I conferred with a group of economists some time ago. It was the consensus of the group that if we have an increase in our money supply in a greater amount than our true economic growth, then as night follows day we are going to have inflation.

Inasmuch as we had an increase in the money supply, and by that I am including time deposits and demand deposits, of about $25 billion last year, and according to the Economic Indicators it appears we had an inflation of $11 billion, that would net off around $14 billion of true economic growth.

I would appreciate any comments you might care to furnish on that approach in establishing true economic growth.

Mr. HARRIS. I think you are talking to the wrong economist. I will tell you why. This sounds like a Friedman position. I think most economists don't accept the Friedman position. Friedman used to say what you want is a 4-percent increase of money each year and then you have no problems. There is not that close association between the amount of money and price.

I think modern economists, among whom I include myself, argue it is not the question of the amount of money but the question of the amount of spending that counts. There is not such a terrible close correlation between the amount of increase and amount of spending.

Undoubtedly a large increase in amount of money would have some effect on price. But there is not the simple relationship that Mr. Friedman suggests.

Mr. Friedman is an articulate and persuasive man. He has convinced many of this general viewpoint. He has not convinced me.

Senator MILLER. May I say he was not one of the group.

One other question to Dr. Harris. You quoted the Evans and Novak article saying "The Martin affair again raises the question of whether this vital economic henhouse should be guarded by the banking forces of New York or by the public's elected officers."

As I understand it the henhouse is guarded ultimately by the Congress and if the Congress wants to do something about the Federal Reserve it certainly can do it.

Don't we therefore have a pretty good check by the public's elected officers?

Mr. HARRIS. I think Congress has been remiss on this. I agree with what Congressman Patman has been saying, there is altogether too much control of our monetary machine by the bankers. The interests of bankers and financial people are not the same as the interests of the public. Our system is developing the way President Wilson said he didn't want it to. I think, according to the newspapers anyway, there is a considerable amount of pressure on Martin by the bankers who want an increased rate of interest and increased demand for their product.

Senator MILLER. Then your criticism is more directly addressed to the Congress.

Mr. HARRIS. I want to be polite and naturally I am your guest.

Senator MILLER. I think we ought to put the criticism where it belongs.

Mr. HARRIS. Congressman Patman has been working along these lines for a long time.

Senator MILLER. Dr. Gainsbrugh, in your statement you say in the prosperous midfifties we devoted somewhat more than this proportion to defense "without any inflationary consequences."

According to my figures there have been inflationary consequences. How do you justify or back up that statement "without any inflationary consequences"?

Are you saying there was no inflation back in the 1950's? No depreciation in the purchasing power of the dollar?

Mr. GAINSBRUGH. I picked the second half of the 1950's with the specific thought in mind that the phase of price inflation was very marked from the end of World War II to around the midfifties but beginning with the mid-1950's and continuing at least through 1963 or 1964 there has been a marked retardation in the rate of price increases.

Senator MILLER. That is not the same thing as saying "with no inflationary consequences."

Mr. GAINSBRUGH. This increase in price over the second postwar decade would be partially offset if in your price indexes we had allowed for quality improvement.

This is one factor to be kept in mind in appraising price performance.

Senator MILLER. On that point may I just remind you that Mr. Ewan Clague, who until recently headed the Bureau of Labor Statistics, testified before this committee that in his judgment there had been no bias and much less could any bias upward or downward be measured.

I know it is a popularly held view which is completely unsubstantiated by way of any figures. I might point out to you that many of your own members have had automatic wage increases under escalation clauses. It is not going to do any good, as I pointed out the other day, to go to Walter Reuther and say, "Look, let us forget the wage increase because there has been no measurement of quality improvement in the price index."

He would point out that the escalation clause provides that when the retail Consumer Price Index goes up the wages must go up, and let us stop talking about this quality business.

Mr. GAINSBRUGH. The fact that we have not incorporated this quality allowance in the Consumer Price Index does not justify the continuance of this policy. There have been commissions appointed to to review the adequacy of the Consumer Price Index.

One such commission was the so-called George Stigler Commission. It did find a rather consistent bias in the index in terms of its failure to take into consideration quality improvement of a rather substantial amount.

Senator MILLER. And it overlooked the downward bias in the form of the increased cost of maintenance of the improved quality and the downward bias in the form of the price line, goods deterioration in quality.

Mr. Clague pointed this out.

Mr. GAINSBRUGH. Mr. Stigler can take care of himself.

Senator MILLER. I think Mr. Clague——

Mr. GAINSBRUGH (continuing). On this particular point.

Senator MILLER. May I point out Mr. Clague was still running the show. It was his figures, his department figures that have been used by your own members in these escalation clauses. Whether we like it or not and whether we agree, and I would be the first one to agree, and I think Mr. Clague would agree, this is not perfect measurement; still it is used for these escalation clauses and they contributed considerably to the wage-cost push inflation that you have been talking about.

Mr. GAINSBRUGH. We are bringing to a conclusion shortly a study that Jules Backman of New York University and I have authored called "Price Indexes and Price Inflation."

In it we examine the three major price indexes that are used to measure the degree of success or its lack in dealing with the problem of inflation.

One of these is the Consumer Price Index, the second is the wholesale price index, and the third is the implicit price index. We find major faults in measures of inflation in each of these three indexes. On net balance. we are inclined to agree, and this is an early conclusion and I don't mean to say it will stand up when the final text is written, that allowance for quality improvement does not offset the price increases that have taken place, even in this second postwar decade. But let us recognize the change in the rate of price increases in the second postwar decade as compared with the first. As this rate moderated it began to eat away at or undercut the harmful influences, short-run-wise at least, of price increases.

The price increases of the past 10 years have not been of the character that have exercised a major influence on investment decisions or on the form of savings. Many of the consequences that develop when you have galloping inflation are no longer present when you have the creeping type of inflation that we had from 1955 until 1964.

I think there are differences not only in degree but also differences in consequences that are important in this shift.

Senator MILLER. Instead of saying "without inflationary consequences" would it not be more accurate to say "with creeping inflationary consequences"?

Mr. GAINSBRUGH. I will accept that.

Mr. HARRIS. May I make one comment here? I want to agree with the Senator for a change. I do think there is something about what my colleague says about the quality issue. I think it is a question of what year you take. If you take the last 4 or 5 years of Mr. Eisenhower's period, these were years of serious inflation. The first 4 years of the Democratic administration you had relatively little inflation. If you take the whole 10 years you do get an improvement.

I think you ought to break these 10 years in those two periods. You do get some element of inflation in the later 1950's.

Senator MILLER. I appreciate your concurrence. But one thing I wish to bring out is this. I have refrained from talking about Eisenhower, Truman, Kennedy, or Johnson inflation. I am interested in which party is in control of the Congress of the United States. That, I think, is the most significant factor.

Now just one last question for Dr. Gainsbrugh. You said we can have both guns and butter. But then you say, "escalation in Vietnam and a tighter labor market have begun in combination to erode the stability of producers' wholesale prices that have prevailed since 1958. Industrial prices other than food or farm commodities have been climbing slowly but steadily since midyear."

It seems to me that those two statements are opposed to each other. I would appreciate it if you would clarify it.

Mr. GAINSBRUGH. The point I had in mind in connection with the industrial prices was that here we were already getting the wage-cost-price push.

Senator MILLER. As a result of the escalation of the war in Vietnam and a tighter labor market?

Mr. GAINSBRUGH. Yes; but primarily because of the higher wage costs in steel, aluminum, and related areas.

Senator MILLER. Is that not contrary to your statement that we can have both guns and butter?

Mr. GAINSBRUGH. I don't see a necessary inconsistency there. You can have the moderate price increases that we apparently are experiencing in selected areas because of the wage breakthrough and still not have the demand resulting from escalation in Vietnam cutting into the civilian sector.

Senator MILLER. But we can't have guns and butter both without a moderate increase; would you agree with that?

Mr. GAINSBRUGH. Yes, but I would not say that that is arising primarily from the escalation in Vietnam. I ascribe that to wage-cost-price pressures that were beginning to mount as we neared full employment even before the additional drain of Vietnam appeared.

Senator MILLER. Dr. Gainsbrugh, you say "escalation," and I am reading your statement, "escalation in Vietnam and a tighter labor market have begun in combination to erode the stability of producers wholesale prices that has prevailed since 1958. Industrial prices other than food or farm commodities have been climbing slowly and steadily since midyear."

To me what you are saying is that guns and butter have been bringing this about. But on the previous page you say we can have both guns and butter without encountering shortages and resulting price pressures and so on.

I can't reconcile the two.

Mr. GAINSBRUGH. As I have tried to explain it in my supplementary comments, the major cause is the tighter labor market that has been producing the price increases. It is true, however, that some of this also stems from the particular scarcities as they affect selected defense items.

Senator MILLER. You say "escalation in Vietnam and a tighter labor market have begun in combination," so you are talking about both the escalation——

Senator PROXMIRE. I think it was brought out by Mr. Gainsbrugh that he was talking about the effect of Vietnam on manpower. The drain of manpower directly affects the labor market, the cost-push side of prices which the rate increase will affect adversely.

Senator MILLER. That may well be, but on the previous page he says we can have both guns and butter. The guns implied the manpower requirement. I don't want to press you on this.

Mr. GAINSBRUGH. I see the difficulty there.

Chairman PATMAN. If you would like to expand on your statement——

Mr. GAINSBRUGH. Perhaps I can develop this more fully in the record for you.

Senator MILLER. If you will do that I would appreciate it.

(Elaboration of remarks subsequently submitted by Dr. Gainsbrugh follows:)

This brief extension of the record is offered in response to Chairman Patman's invitation. This Nation's ability to expand output is affected by current and oncoming industrial capacity as well as by the existing and prospective labor force. So far as industrial capacity is concerned, the existing capacity measures do not indicate that the requirements for Vietnam currently or in immediate prospect will be a consequential limiting factor. Prices of selected bottleneck items may respond to demand pressures. Aggregate capacity to produce, however, including the technologically superior additions of plant and equipment during 1965–66, should continue in balance if not somewhat exceed aggregate national demand, including the assumed outlays of $60 billion for defense by yearend 1966 (annual rate, fourth quarter). Past experience strongly supports the conclusion that a set-aside of 8 percent to 8.5 percent of GNP for purposes of national defense—the proportion seemingly in prospect for 1966—does not necessarily involve excessive pressures upon capacity to produce. It is in this sense that the conclusion was offered that we did not face the hard choice of guns or butter in 1966.

We do face, however, a different situation on the labor front. Here, as in the case of industrial capacity, there is a margin of unemployed resource that can be brought into production to meet the expanded output requirements of 1966. With unemployment still at 4 percent or somewhat above, again it would seem unwarranted to contend that we face the prospect of choosing between guns or butter in 1966, at least as far as manpower requirements for 1966 rising from Vietnam escalation are currently known. But my analysis does suggest that the wage bargains of 1965 and the carryover of this pattern into 1966 are such that they serve to create wage-cost-price pressures. Wage gains of 4½ percent are in excess of national productivity even in times of peace; coming as they did with an approach to full employment they do create a problem of continuing subsequent price pressures quite independent of the guns-or-butter dilema. This wage breakthrough came well before the demand pull exercised by Vietnam; it has its counterpart in past peacetime business cycles; as an expansion matures; volume so rises that fixed costs per unit are significantly reduced and profits increased, with wage gains becoming more widespread and of greater amplitude.

In summary then, the escalation in Vietnam may have pushed up some prices, particularly for defense-related items in short supply. It does not appear that the defense load in the aggregate will strain aggregate industrial capacity to produce. A greater threat to price stability comes from the wage breakthroughs of 1965 that reflect typical wage-price relationships of a maturing expansion far

more than they do the strain upon the labor resources in meeting defense requirements. This wage-cost-price push, unless contained—possibly through lowering the national wage-increase guidelines during the Vietnamese emergency—could exercise pressures upon price throughout all sectors of the economy—both nondefense and defense. The bidding up of wages by defense and defense-related industries would contribute toward such pressures. Even so, as in the case of industrial capacity, the supply-demand situation for labor in prospect for 1966 is such that it should not, again on the basis of past experience, create the problem of guns or butter. The wage-cost-price pressure that developed even before escalation in Vietnam and its continuance is the more immediate threat to price containment in the months ahead.

Senator MILLER. In conclusion I just want to point out that while I recognize that the inflation since mid-1950's on up until the present time has been moderate, that one area where it was recognized to have an impact was right in the area of social security.

Congress this year increased social security pensions 7 percent and even with that 7-percent increase the pensioners will not have as much purchasing power as they had in 1958.

So, while it may be moderate, the translation of that percent increase in social security pensions, not to mention the loss in purchasing power that occurred from 1958 up to this year with the millions of pensioners, has been very, very substantial.

That is all my time, Mr. Chairman.

Thank you.

Chairman PATMAN. Let us see if we can't conclude this particular hearing this morning. I believe Senator Proxmire would like to make a statement.

Senator PROXMIRE. As the chairman of the Statistics Subcommittee of the Joint Economic Committee I am interested in the possibility of holding hearings on the consumer price index.

I understand that the Bureau of Labor Statistics does have a new chief now, Mr. Clague is no longer in charge, Commissioner Ross has replaced him.

It seemed to me this would be an appropriate time for the committee to hold hearings. I would very much like to have the study which you say you are about to conclude. It would be most appropriate.

Mr. GAINSBRUGH. Such hearings will be very timely in the sense that a task force is at work in the Federal Reserve on the wholesale price index. There is another group also at work on this at the National Bureau of Economic Research. We have been at work on the consumer price index and the implicit price index. All three price indexes are thus under intensive examination.

Senator PROXMIRE. Any study you could make available to the committee will be appreciated.

Mr. GAINSBRUGH. One point is that you must recognize the upgrading process as it affects all three indexes, but particularly the implicit price index. That index, which is so widely used as a measure of general price trends is not a fixed-weight index. As we move up the ladder in terms of the grades of goods and services we buy, this shift to higher price lines is reflected in that index. The 1½- to 2-percent price rise in this index, that is so frequently cited, is derived by comparing real GNP with current dollar GNP.

Much of that is the consequence of higher living—of living higher rather than of higher living cost. The upgrading process has per-

meated all three indexes. In none of the three is adequate allowance made for greater consumer option as the average family income rises.

Chairman PATMAN. I assume we will conclude our hearing this morning. I doubt that there will be another hearing before we hear the administration witnesses as soon after January 20 as it is possible.

We will probably start soon after the release of the President's Economic Report. We will have administration witnesses and other witnesses whom we have not heard and who have made application to be heard.

It will probably be February before we get to them.

Senator MILLER. Could I ask, Mr. Chairman, if it was your plan to conclude the hearings on this particular problem before the committee starts in with the hearings on the President's Economic Report?

Chairman PATMAN. I do not believe it will be possible. All of us have obligations to other committees. In my particular case, as chairman of the House Banking and Currency Committee, that committee has pressing problems, urgent problems right at the beginning of the forthcoming session so I don't think I would be able to devote much time to anything else at the start.

I think the best way to consider it is that we will start soon after January 20 with the administration witnesses and continue on.

Senator MILLER. You mean on the President's Economic Report?

Chairman PATMAN. On both. They dovetail pretty well. The minority members have been wanting to hear the administration's witnesses.

Senator MILLER. This is so, but there are witnesses I understand from the Savings and Loan League who are not particularly interested in testifying on the President's Economic Report but they are vitally interested on this subject.

Chairman PATMAN. We will keep the record separate but we will go ahead and finish up.

We certainly thank you, gentlemen. You have certainly made a great contribution to our record of the hearings. We appreciate it very much.

The appendix to these hearings containing pertinent items and information from various sources will follow.

Without objection, the committee stands in recess subject to the call of the Chair.

(Whereupon, at 12:40 p.m., the hearing was adjourned, subject to call.)

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APPENDIX

The materials in this section consist of letters, telegrams, news items, and so forth, relevant to the recent action of the Federal Reserve Board and these hearings which have been received by the committee for inclusion in the printed record. The arrangement is alphabetical.

SAN FRANCISCO, CALIF., *December 11, 1965.*

Hon. WRIGHT PATMAN,
House Office Building, Washington, D.C.:

The action of the Federal Reserve Board raising the discount rate to 4½ percent is reminiscent of the hard-money policy of the 1950's when our economy suffered four successive recessions. The Federal Reserve Board decision comes at a time when, despite almost 5 years of uninterrupted and unprecedented economic growth, unemployment still persists at intolerably high levels. Applying restrictive monetary policies now threatens to halt continuing economic expansion and turn the trend downward.

Congress should study carefully this unwarranted action by the Federal Reserve Board, an action which obviously conflicts with the overall economic policy of the administration so essential to continued economic growth and a full production, full employment economy. Congress should, moreover, explore the need to establish procedures whereby decisions made by the Federal Reserve Board are consonant with and supplementary to, rather than antagonistic to, the administration's economic policies.

WALTER P. REUTHER,
President, Industrial Union Department, AFL–CIO.

PRESS RELEASE FROM AFL–CIO NEWS, DECEMBER 9, 1965

SAN FRANCISCO.—The AFL–CIO demanded that the Federal Reserve rescind its "mistaken and costly" move of increasing the discount rate from 4 to 4.5 percent, a decision for which "consumers, business, and farmers will pay the bill."

Federation President George Meany assailed the Board's action in a statement and a series of speeches to departmental conventions here warning that raising the rate at which banks borrow from the Federal Reserve will have a "depressing effect" on economic activity.

Meany noted that "this blunderbuss action" was taken on the "false premise of fighting inflation." With the unemployment rate at 4.2 percent, he stressed, the economy can be "badly hurt by such acts."

Earlier, President Johnson scored the FRB action commenting, "I regret, as do most Americans, any action that raises the cost of credit, particularly for homes, schools, hospitals, and factories.

"I particularly regret," the President added, "that this action was taken before January, when we will have before us the full facts on next year's budget, Vietnam costs, housing starts, State and local spending, and other elements in the economic outlook."

The Federal Reserve Board is an independent agency responsible for its own actions. The President appoints members of the Board. The vote on increasing the discount rate—which has an effect on interest rates at all levels—was four to three.

Those opposed to the increase maintained that it was premature in the absence "of more compelling evidence of inflationary dangers," the Board said in its statement.

The majority of the FRB said its action was geared to "prevent inflationary excesses," to overcome deficits in the balance of payments and to maintain the international strength of the dollar.

Meany, in an address to the metal trades department, declared, "There is absolutely no reason for this. They claim it is to guard against inflation, and I am telling you this is a bugaboo that they have been using on labor, on the working people of this country, for 25 years.

"Actually what it does is increase the cost of borrowing money in this country all down the line. It affects every farmer. It affects every consumer, and it affects the construction industry and the builders.

This increase, he asserted, "is going to have an adverse effect on every union in this federation, on the membership of every union in the federation."

In his earlier statement, the AFL–CIO president said, "A Federal Reserve Board on which there is no representation from labor is bound to consider unemployment as a mere statistic. To us, unemployment means troubled people and we think it is a fundamental which the FRB ignored in its ill-considered decision."

Meany called on the President to use "whatever power and authority he has to immediately reverse" the increase in the discount rate. He added:

"I think the President should go further. I think he should use all the power at his command to see to it that the Federal Reserve Board is truly representative of all elements in the American society. It was not created for the benefit of the bankers. Congress didn't act for the benefit of the bankers. They acted to bring stability into the monetary system of this country for the benefit of all the people and not to set up a board for bankers and by bankers for the benefit of bankers."

[From the Washington Report of the UAW, Dec. 13, 1965]

Blast the Bankers

JACKING OF INTEREST RATES WILL PLEASE BANKERS AND HURT WAGE EARNERS; PRESIDENT JOHNSON ASKED BY LABOR TO TAKE CONTROL OF FEDERAL RESERVE BOARD, OUST TIGHT-MONEY ADVOCATES

San Francisco.—The sudden action of the Federal Reserve Board in boosting the discount rate from 4 to 4½ percent with its ominous overtones of a revival of "tight money" Eisenhower recession days brought the strongest kind of condemnation from AFL–CIO President George Meany.

"The Federal Reserve Board's mistaken and costly move for which consumers, businessmen, and farmer will pay the bill, should be rescinded," Meany told the press after the news of the interest rate increase reached the AFL–CIO convention here.

"This blunderbluss action was taken on the false premise of fighting inflation," Meany declared. "At the time when 4.2 percent of the work force is unemployed, the economy can be badly hurt by such acts which will undoubtedly have a depressing effect on activities such as homebuilding.

"A Federal Reserve Board on which there is no representation from labor is bound to consider unemployment a mere statistic. To us, unemployment means troubled people and we think this is a fundamental which the Board ignored in its ill-considered decision."

Later Meany said the hike represented banker "greed, the search for the almighty dollar * * *. Every single activity in America that calls for credit is adversely affected—cars, refrigerators, homes, television sets, anything that is not bought with cold cash—all of these industries will be hurt."

The Board's action by the narrow margin of 4 to 3 came as a shock, if not exactly a surprise, to both labor and industry. Board Chairman William McChesney Martin, long a representative of highly conservative banker thinking, has been hinting more and more that perhaps the economy was getting too "hot" and that a boost in general interest rates—which automatically follow the central banking discount rate—would be advisable.

His talk and that of other conservative bankers who see "inflation" under the bed at every opportunity, brought strong reactions from the Johnson administration during recent weeks with Cabinet members and the President warning against any tampering with the economy which might bring a halt to the current period of expansion.

President Johnson himself was obviously deeply disturbed both at the increase in the rate and its timing.

"I regret as do most Americans any action that raises the cost of credit, particularly for homes, schools, hospitals, and factories," he said. "I particularly regret that this action was taken before January when we will have before us the full facts on next year's budget, Vietnam costs, housing starts and local spending, and other elements in the economic outlook."

The Federal Reserve Board is an independent agency entirely controlled by the leading banking interests of the country, so the President has been forced to swallow what he clearly feels is a hindrance to a coordinated policy on the Nation's financial outlook.

"Under the circumstances," he said, "I will continue to do my best to give the American people the kind of fully coordinated, well-integrated economic policy to which they are entitled, which has been so successful for the last 58 months and which I hope will preserve price stability for America's continued prosperity."

For labor economists the boost in the discount rate brought sharp memories of the recessions of the Eisenhower administration—all touched off by increases in the discount rate accompanied by automatic increases in the interest rates charged to the installment buying public as well as the seekers of mortgage loans, or the builders and industrialists in need of financing their undertakings. Already commercial bank loans have been boosted from 4½ to 5 percent by many banks.

It highlighted, too, the fact that of all the groups in the Nation's income picture, the lenders of money have been the greatest beneficiaries of higher interest rates. This includes interest on the public debt which has soared in the past 10 years as a result of the higher rates Government has been forced to pay on the public debt.

The 4-to-3 vote by the Board has aroused speculation as to whether in the long run President Johnson may hold a trump card which he can play next year. While the Federal Reserve Board is an independent agency, the President has the power to appoint its seven members with Senate approval.

Vice Chairman C. Canby Balderston, whose vote threw the majority to Martin's side, is due to retire on January 1, 1966. If the Board had waited until after January to vote on a boost in the discount rate, a new Johnson-appointed Board member may well have thrown the vote against the increase. As it is, President Johnson will have the opportunity to appoint a less conservative member more likely to go along with the three "liberals" on the Board who opposed the boost.

Voting in favor of the higher discount rate were Chairman Martin, Vice Chairman Balderston, J. Dewey Daane, and Charles N. Shepardson. Voting against were J. L. Robertson, George W. Mitchell, and Sherman J. Maisel.

The Board's action is certain to revive long current demands for reform in the Federal Reserve System especially as to membership in the Board of Governors. The labor movement has long demanded that there should be labor representation in order that labor may have a voice in the setting of national financial policies that are of the utmost importance to all workers.

In addition there have been strong demands by liberal economists that the fiscal policy of the United States should not lie solely in the control of private bankers who are in a position—as has just been demonstrated—to carry out a fiscal policy directly contrary to the policies of the Nations's highest elected officials.

"Nothing could be more unpopular than a major increase in interest rates on the ever of Christmas, when the average workingman will be borrowing money to provide gifts of joy to his wife and children. Mr. William McChesney Martin's Christmas gift to money lenders at the expense of those who must borrow money is an example of Dicken's Christmas Carol told in reverse.

"Insofar as the middle and lower income people are concerned, the increase in interest rates will extract from them everything we had hoped to do for them when we passed the $4.5 billion cut in excise taxes this year.

"The Board action follows the policies of a prior administration which, from the point of view of most Democrats, gave us too many recessions, too much unemployment; too much inflation, too much social and economic injustice." (Senator Russell Long, Senate majority whip and chairman of Senate Finance Committee.)

AFL-CIO RESOLUTION NO. 196, MONETARY POLICY, 1965

America needs a coordinated monetary policy to help achieve and maintain full employment. Contradictory and confused action by one group of men—the Federal Reserve Board majority—has already contributed to a loss of billions of dollars and millions of jobs. In 1959, the Fed's inflation psychosis and balance-of-payments confusion caused it to hike interest rates and help cause a recession that jeopardized the international position of the dollar. From 1961 to the summer of 1965, the Fed showed some signs of less restrictive policy. But since then the Fed has started to use the same dangerous medicine again by raising the discount rate to the highest level in more than a generation at a time when most interest rates are already at the highest points in 30 to 40 years. The Federal Reserve's cure for higher prices and balance-of-payments difficulties is to depress the whole economy. This Nation cannot afford to continue to allow such costly policies. The Federal Reserve Board's "independence" should not mean contradiction of other Government policies in pursuit of its own independent measures.

In regard to the December 1965 Federal Reserve Board action to raise the discount rate from 4 to 4½ percent, the AFL-CIO shares the President's "regrets" at "any action that raises the cost of credit, particularly for homes, schools, hospitals, and factories." With unemployment still at 4.2 percent of the labor force, this is no time for costly and restrictive monetary policies.

Because interest rates are a price that affects the cost of almost every product, the cost of living goes up when the discount rate rises. In the name of "fighting inflation" the Board has been driving up the price of almost everything Americans buy, the cost of doing business, the cost of the Federal debt, and the cost of State and local government operations.

Throughout the 1960's, the Nation's other money managers, such as the Treasury, have pursued many technical innovations, some of which have been rather successful. However, two elements have been lacking for an effective monetary policy to meet the economy's needs: There has been no coordinated monetary policy determined by the Congress and the President, because the Federal Reserve has abused its independence. In addition, the Nation's monetary managers have not made lower interest rates a policy objective. Instead, largely for balance-of-payments reasons, there has been a persistent tendency to maintain high and rising interest rates. The result has been unnecessary additions to the cost of credit, an unfair distribution of credit burdens, and a pattern of high borrowing costs and higher rates. Costly credit deters job creation, because it makes credit less available to consumers, businessmen, farmers, State, and local governments. It has been estimated that Americans pay $11 billion more in interest when a 1-percent difference in interest rates is added: Therefore, be it

Resolved, The AFL-CIO calls upon the Federal Reserve Board to roll back its recent discount rate increase.

The Federal Reserve Board should be required by law to act in harmony with the economic policies of the Congress and the executive branch of Government.

The term of the Chairman of the Federal Reserve Board should be coterminous with that of the President of the United States.

Membership on the Board of Governors of the Federal Reserve and on governing and advisory committees of the entire Federal Reserve System, including its regional banks, should be opened up to representation from major groups in the economy—including consumers, organized labor, and small businessmen.

The Congress should not change the 4½-percent ceiling on long-term Government bonds and should make efforts to achieve lower interest rates a matter of national policy.

Interest rates in the United States should be determined by the needs of the American economy for sustained full employment and increasing buying power—not by the monetary decisions of foreign central banks.

The increasing concentration of banking and its interlocking business connections is a dangerous economic development. Antitrust laws should be applied to banking operations, and every effort should be made to strengthen, rather than weaken, attempts to make banking more competitive and less interlocked with nonbank business interests.

EVERETT, WASH., *December 27, 1965.*

DEAR MR. PATMAN: As you can see from the attached letter, the American Security Bank in Honolulu is offering 5 percent on certificates of deposit with no minimum dollar amount. Mr. William McChesney Martin's admonitions have apparently not overly impressed this bank.

Also enclosed find the Labor Journal from Everett, Wash., which contains a small article on the subject. You will notice I have taken the liberty of quoting you in the article.

Kindest regards,

ROBERT M. HUMPHREY.

AMERICAN SECURITY BANK,
Honolulu, Hawaii, December 20, 1965.

DEAR FRIEND: In view of the current action of the Federal Deposit Insurance Corporation in allowing us to pay a higher rate of interest on time certificates of deposit, it is my sincere pleasure to inform you that we are now paying 5 percent per annum on time certificates of deposit of 6 months or more, with interest payable quarterly.

Won't you consider depositing your funds with us at this attractive new rate of interest. We shall be happy to act as your depositary here in Hawaii in the event you should decide to purchase our time certificates of deposit.

If you have any questions regarding our program, please don't hesitate to contact me or Mr. Dennis Ching, our vice president and cashier.

With kindest personal regards and season's greetings.

Sincerely,

WILLIAM K. H. MAU.

[From the Labor Journal, Everett, Wash., Dec. 24, 1965]

INTEREST RATES RISING

The recent action by the Federal Reserve Bank Board in raising rediscount rates has already made itself felt in the local Everett area, according to Robert M. Humphrey, president of First Federal Savings.

"You will notice that 5½ percent, 30-year loans have disappeared from the place of prominence in the advertising columns of the local newspapers," says Mr. Humphrey.

Mr. Humphrey also said, "Some banks are already offering 5 percent on certificates of deposit. Such funds will undoubtedly go into tax exempt bonds and into high interest rates on automobile financing and consumer loans."

The Federal Reserve decision to raise rates under regulation Q caused quite a furor in the Nation's Capital and was generally believed to have been spearheaded by pressure from eastern banks who were loaded up with certificates of deposit.

Chairman Patman, Democrat, of Texas, condemned the Federal Reserve decision as unwise and untimely.

ANDERSON LOAN ASSOCIATION,
Anderson, Ind., December 10, 1965.

THE SENATE-HOUSE ECONOMIC COMMITTEE,
Washington, D.C.

GENTLEMEN: We understand from the press that you are to meet Monday, December 13, to consider recent action of the Federal Reserve Board in connection with an increase in rediscount rates and also an increase in rates of interest for certificates of deposit. May we say that we are heartily endorsing the Federal Reserve Board's action as being most constructive and in the best interest of the country generally.

We should also like to suggest that your committee consider the possibility of reducing Federal expenditures so as to achieve not only a balanced budget but also a surplus to be used for the reduction of the Federal debt. This would further reduce the dangers of inflation that are inherent in continued deficit financing.

We have read in the press certain statements attributed to the U.S. Savings & Loan League and we suggest to you that these statements do not have the unanimous support of its membership.

In our position we are acutely aware of the damage that has been done to the thrifty people of this country by a generation of deficit financing and inflation.

The positions of the FHLBB are simply not intelligible from the press reports.

Respectfully,

JAMES SANSBERRY, *President.*

[From News Service, Chamber of Commerce of the United States, Washington, D.C.]

WASHINGTON, December 7.—President Robert P. Gerholz of the Chamber of Commerce of the United States made the following statement concerning the Federal Reserve Board's action permitting interest rates to increase:

"Businessmen should unite in support of the Federal Reserve Board's exercise of its responsibility to take independent action which it decides is necessary to maintain the stability of the country's economic and monetary systems.

"This support of the Board's exercise of authority is most important even though businessmen might differ on the technical question of the need for raising the discount rate at this time.

"A Federal Reserve System independent of the executive branch of Government can do much to maintain prosperity and the stability of the general price level. The good judgment, integrity, and broad perspective of the Federal Reserve authorities deserve respect. Moreover, they are guided by valuable experience and high traditions which the System has developed through the years."

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA,
Washington, D.C., December 9, 1965.

EDITOR, THE WASHINGTON POST,
Washington, D.C.

DEAR EDITOR: In your editorial, "The Fed Jumps the Gun," on December 7, you held that: "Power over monetary policy, for better or worse, should be invested in the incumbent administration."

The same day, Vice President Humphrey, before the Institute of Life Insurance, said: "Fiscal policy is generally the responsibility of the Government and monetary responsibility of the Federal Reserve. That, in a sense, is part of our Federal system of checks and balances."

And so it is. The Federal Reserve System is indeed answerable to Congress, as the many congressional investigations by Senator Douglas and Mr. Patman show. Its independence within Government from the executive is intended to protect the public interest in monetary stability by insulating particular decisions on monetary policy from partisan political pressures.

Surely, one of the best documented facts of monetary history is overexpansion of credit and debasement of the value of money by Government. Around 1360 Nicole Oresme published the first comprehensive treatment of the subject. Two centuries later, Copernicus saw such debasement as "tampering with the weights and measures." From the time of Sir William Petty, the subject has been part of standards economic literature.

Coordination of monetary and fiscal policies, which you advocate, is highly desirable. Though it might well be fostered by some of the changes you call for in the Federal Reserve Act, coordination is a far cry from assumption of monetary power by the executive. Vice President Humphrey's views, it would seem, deserve more consideration than your editorial suggests.

Sincerely,

CARL H. MADDEN,
Director of Economic Research.

COMMUNITY NATIONAL BANK,
Clear Lake, Iowa, December 27, 1965.

Mr. WRIGHT PATMAN,
Chairman, Senate Banking Committee,
Senate Office Building,
Washington, D.C.

DEAR MR. PATMAN: I watched with much interest the recent controversy covering the action of the Federal Reserve Board of Governors in the raising of interest payable by banks on time deposits. It is our belief that this increase in allowable rates paid to customers on time deposit money is excessive, and will result in the

inability of banks to set up proper reserves for various items and will probably bring about a competition for funds which will necessitate or at least have a bearing upon the quality of loans and investments made by bankers in order to meet the competition for funds and to set up the necessary safeguards for the operation of a sound banking system.

We are enclosing a copy of our letter to Mr. Martin, Chairman of the Board of Governors, Federal Reserve System. We believe the comments contained therein express our general feeling in this matter.

We realize that your committee does not have jurisdiction or authority to overrule the decision of the Board, however, it is thought that some safeguards should be built into the controlling power of the Federal Reserve Board, so that a general undermining of the money system of the country cannot occur in the future.

We have also written our State banking superintendent expressing our views and requesting that our Bankers Association for the State of Iowa and the State banking superintendent's office bring pressure to bear on those officials responsible for this latest change.

We would like to make our position clear. We do not argue with the necessity of raising the discount rate. We believe that this move probably as well taken. We do question greatly the wisdom of raising the rate of interest payable on time deposits under regulation Q.

Thank you very much for taking the time to consider our comments.

Very truly yours,

W. HOWARD STEWART, *President*.

DECEMBER 17, 1965.

Mr. WILLIAM MCCHESNEY MARTIN, Jr.,
Governor, Federal Reserve System,
Federal Reserve Bank,
Chicago, Ill.

DEAR MR. MARTIN: We are in receipt of your telegram of December 17, relative to the recent action of the Board of Governors Federal Reserve System in the raising of ceiling rates covering time deposits.

We believe the action of the Federal Reserve Board in the raising of the discount rate was proper and just and actually was a bit overdue. We are shocked beyond words at the additional action of raising interest rates allowable under regulation Q on passbook and certificate of deposit accounts. It is evident beyond a doubt that the pressures of the larger banks on the east coast and in Chicago have played a tremendous role in the action of your Board.

Perhaps it is not generally known by the public but it certainly is known in the banking profession, that many banks, in their efforts to meet expansion programs and loan demands of large corporations for expansion in foreign countries, have been in the open market, borrowing against debentures at 5 percent or more. It would, of course, be to their advantage if they could, by some method, such as the raising of permissable rates by the Federal Reserve, to actually be able to reduce their overhead by reducing the effective rate paid for funds, which they are procuring for their loan demand.

By the action of your Board in the raising of interest rates on time deposits, you have, without a doubt, dealt the average bank and banker a blow which might have far-reaching effects.

The pressures of the banks, above mentioned, in the money market for funds available, can have no other effect than to force the smaller banks in the smaller communities to meet the higher rates paid by the larger competitors, thus siphoning off funds that are needed so badly in the smaller communities and in the other areas of our country for expansion purposes. Actually those people who have been instrumental in affecting the decision of your Board certainly have played this thing for their own advantage. As you know, it certainly would be much cheaper to pay the interest rate just made legal by your Board on time and passbook savings, if the interest is paid on minimum balances than it would to go into the open market at the 5-percent or more debentures. The effective rate to these banks would probably be dropped from 5 percent to approximately a true 4 percent.

We have been rather candid in our opinions. We sincerely believe that the Federal Reserve Board should rescind that part of the recent change in regulation Q and go back to the more conservative, realistic figure of 4 and 4½ percent.

By your action, you will force banks to raise their interest rates to consumers in order to meet the necessary reserves for replacement of equipment, buildings, bad debts, and other items, to say nothing of perhaps forcing the banking profession to resort to the making of loans and investments which will bring in a greater revenue in order to meet competition and to set up proper reserves to insure a good operation. It is my belief that you gain nothing when you raise the rates on both ends as far as controlling inflation is concerned. Actually, you have contributed greatly to inflationary pressures.

We, at our bank, do not plan to raise our rates on either passbook or certificates of deposit unless it is absolutely necessary to hold our position. We feel that it is poor banking to do so.

We would be very much interested to hear your opinions and to see in a letter your justification of the action which has been taken. It would indeed make interesting reading.

Very truly yours,

W. HOWARD STEWART,
President.

CHICAGO, ILL., *December 10, 1965.*

Congressman WRIGHT PATMAN,
Chairman, House Senate Joint Economic Committee,
House Office Building,
Washington, D.C.:

The Cooperative League has by resolution of delegate body of cooperatives representing 15 million U.S. families repeatedly confirmed the following declaration regarding monetary and fiscal policy. "The Cooperative League believes that a high-interest tight-money policy in no way benefits the general welfare. We believe the effect of such a policy stifles economic activity and growth and harms those in the lower- and middle-income groups while benefiting those in the upper income groups. We are opposed to such a policy and support fiscal and monetary policies which seek to benefit the greatest number of individuals rather than the few." Have just written extended statement for Cooperative News Service on this matter which will be glad to submit for inclusion in hearings if desired. Strongly support position expressed by yourself as committee chairman.

JERRY VOORHIS,
Co-op League of the U.S.A.

[From the Cooperative News Service]

THE PEOPLE'S BUSINESS

(By Jerry Voorhis)

THE "VOICE" SPEAKS: ALL MUST PAY MORE FOR THE BANKERS' PRODUCT

Once more the "Voice" has been heard in the land.

It is the "Voice" of the greatest special privilege even granted by any nation to any group of private citizens in all history.

It is a "Voice" to which the wise men of the country, almost all the newspapers and commentator, the Secretary of the Treasury, and even the President of the United States listen and bow their heads and genuflect.

The "Voice" says:

"This country is too prosperous."

"There is too much money in circulation."

"Unemployment has been reduced and some industries are producing at or near capacity."

"The value of money has been going slowly down and the money value of goods and services has been going slowly up."

"These things must not be." So sounds the "Voice," the voice of the Chairman of the Federal Reserve Board.

From one point of view, these things which have been happening are bad. From every other point of view they are good.

They are bad from the point of view of the banks, which have—wrongly—been given the privilege of creating the money of this supposedly sovereign nation.

They are good from the point of view of the workers who were unemployed but who now have jobs again. They are good from the point of view of farmers, manufacturers, merchants, everybody that produces or sells goods.

But as has happened so often when the single interest of the private creators of money clashes with the interest of all the rest of the people in the country, the interest of the bankers has prevailed.

It has prevailed not through any act of Congress or the President or the Secretary of the Treasury or anybody else who is responsible to the people of this country.

The bankers have prevailed because their own private "government," the Federal Reserve Board, which is accountable to no one but itself and the private banks which own the Federal Reserve banks, has so decreed. (The only sense in which the Federal Reserve Board can be said to be accountable to any public body is that Congress could, of course, amend or repeal the law that created the Federal Reserve System.)

Even the Federal Reserve Board voted only four to three for the increase in interest rates.

Four-sevenths of a group of private bankers responsible to nobody but private bankers for their actions has decided that—

(1) Interest rates throughout the country shall be about 10 percent higher than they are now. (They increased the Federal Reserve's discount rate from 4 to 4½—an 11-percent increase.)

(2) Every home shall cost about 10 percent more than it does now.

(3) Every farmer must repay his debts in money that is about 10 percent harder to get and worth 10 percent more than when he borrowed it.

(4) The cost of everything we buy or use shall go up about 10 percent because the cost of money or credit is the one element that enters into the cost of almost everything we buy or use in all our economic life.

(5) The taxpayers of the Nation shall be forced to pay at least $1 billion more in interest on the national debt than they do now.

(6) And every piece of household furniture, every washing machine, every automobile, every other thing bought on credit shall cost the family that buys it—rich or poor—some 10 percent more than it does now. And this will happen not because any of these goods are actually worth a single penny more than they were before, but solely because four private bankers say it must—four out of seven on a Federal Reserve Board which can control the whole Nation's economic fate.

RESERVE BOARD'S ACTION MAKES MONEY LENDING MORE PROFITABLE

William McChesney Martin, Jr., who has just told the President of the United States to go sit in a corner, has an excuse. Yes. The four out of seven members of Mr. Martin's Federal Reserve Board have their standard excuse for the blow they have struck at the Nation's economy.

It is the same excuse that the Federal Reserve Board used in May of 1920 when it deliberately caused a deflation of the currency so severe that America's agriculture was plunged into a depression from which it did not recover until the middle of World War II.

It is the same excuse that was used in 1938 when most of the gains in economic activity which had been accomplished during the preceding 5 years of the Roosevelt administration were wiped out in a couple of months.

It is the excuse that "We must curb inflation."

Everybody is supposed to remember the disastrous inflation that took place in Germany after World War I. And the inflation recently suffered in Brazil. Then everybody is supposed to become frightened and to say, "Oh, yes. By all means, we must curb inflation."

But still it seems a bit odd, if we really wish to "curb inflation," to adopt measures that will absolutely assure the sharp inflation of every price and cost in the entire economy of the Nation.

This hardly seems a sensible way to prevent inflation of prices or costs.

But it does make money more valuable in terms of all real wealth. And it will make all real wealth less valuable in terms of money.

Which is the reason why it is done.

But it is a reason involving so many undesirable implications that hardly anyone—least of all the Federal Reserve Board—ever talks about it.

Another reason is being alleged. It is being suggested that the raising of interest rates will discourage American investors from investing their money abroad and cause them to invest at home, thus correcting the balance of payments. But the result, the immediate result of the action, has been to cause a slump in the stock market and in the value of almost all American securities. This is a strange way indeed to encourage investment in these sound American securities.

No. The reason for this Federal Reserve Board action is rather simple. It is taken to increase the value of money and reduce the value of everything else in our economy.

Who would want to do such a thing?

The people who deal in money, who have money to "sell" at interest, who indeed have the privilege of creating new money and drawing upon the credit of the entire Nation and all its people to give value to that newly created money.

If you are in the business of creating and lending money, as the commercial banks and the Federal Reserve banks are, then quite obviously if you can get a 4 to 3 decision to increase your income by 10 percent, all of a sudden, it's a very good thing to get done for you.

But from the viewpoint of the Nation as a whole, one or two sobering thoughts occur.

One is that every single depression or recession which we have ever suffered has been preceded by a period of shortage in the money supply. And many people believe that, far from having increased too rapidly, our money supply in very recent years has not been increasing fast enough and that this is the reason for our persistent unemployment, for the failure of many industries to operate at anywhere near their capacity, and for the flow of investment funds out of the country.

Another thought is that a number of other countries, notably Japan and Western Europe, have experienced much more rapid growth rates since the close of World War II than has the United States. And in every one of those countries the key to that rapid growth has been monetary policies which have assured a growth in the money supply which was always a little ahead of the growth of industry and commerce. In other words, these countries have brought about, quite deliberately, a controlled expansion of their money.

Some people—four-sevenths of the Federal Reserve Board among them, no doubt—might call this an inflation. But certainly it has not been a harmful inflation. Indeed, the question arises as to whether the price our country is being asked to pay to curb a bogey of inflation may not be altogether too great a price. And whether, from the point of view of everyone except the dealers in money, it might not have been better to reduce the rates of interest instead of increasing them.

THE BANKERS HAD A BETTER, SAFER CHOICE

To understand the full significance of the recent action of four-sevenths of the Federal Reserve Board in boosting interest rates, it is necessary to examine the strange phenomenon of what is called the monetary system of the United States.

It hardly deserves the name of a "system," for it is based upon no reason or logic or justice or economic wisdom.

Most of the so-called money of the United States consists of what we call bank credit. Most of our business transactions are carried on not by exchange of cash but by the drawing of checks. "Money in circulation" is regularly defined as "cash plus demand bank deposits." And seldom does the cash amount to more than a fifth or a quarter of the "demand bank deposits." In December 1964, for example, our total money supply as reported by the Federal Reserve Board consisted of $34.2 billion of currency and $125.2 billion of demand deposits.

But the really important factor is how our money is created. For it is obvious that as our economy grows and our production and commerce increase, there must be additional money brought into circulation to accommodate the increased volume of business. And indeed this was the stated purpose of Congress when it passed the Federal Reserve Act in the administration of Woodrow Wilson.

Many people think the Government of the United States creates the money of our Nation—as indeed it should and as the Constitution provides.

But the Government does no such thing—except for the pennies and dimes and quarters which we use for change.

All the rest of our money is created by the private banking system. It is possible for the private banks to create money in the form of demand bank deposits because of what is called the fractional reserve system.

This means that if a bank has $10 million of demand deposits on its books—that is, if it owes its depositors $10 million which they think they have in the bank—then the bank is required to have in actual cash money not $10 million but only perhaps $1 million or $1,500,000 or at most $2 million. The exact amount of cash reserves which banks must have behind the demand deposits on their books is decided by the Federal Reserve Board and is called the reserve requirement. It may be 10 percent or 13 percent or 15 percent or 20 percent. It is never more than 20 percent, usually much less.

Consequently, if a bank has actual cash deposits in its vaults of $1 million and the reserve requirement is 10 percent, it can have on its books as much as $10 million to the credit of holders of its demand bank deposits. In such a case it can create some $9 million or new money that did not exist before. It can do this by giving the borrowers checking accounts and entering on its books demand deposit credits for those borrowers. Furthermore, if it finds itself in need of additional reserves it can usually borrow them from the Federal Reserve Bank in its district.

Now the proper definition of money inflation, as distinguished from price or cost inflation is this: Monetary inflation takes place when the amount of money in circulation is increasing faster than the flow of goods and services to be bought with money is increasing.

And under our so-called fractional reserve system, the way we get inflation is that the banks create more new demand deposits than are needed to keep up with the growth of the economy and the flow of trade.

The theory then of curbing inflation by increasing interest rates is that if the interest rates are higher fewer borrowers will borrow from the banks and the banks will therefore create less new money in the form of demand deposits.

But even if this works, it involves so many undesirable effects that a very heavy burden of proof should rest upon anyone taking such a step. It should be taken only by a body which has a direct responsibility to the American people and which is subject to the duly elected representatives of the people.

The Federal Reserve Board is neither so responsible nor so subject. And this is why Congressman Wright Patman, chairman of the Banking and Currency Committee of the House of Representatives, has introduced legislation which would make the Federal Reserve Banks national institutions as they should be and make the Federal Reserve Board a body responsible to the Nation's duly elected administration.

Furthermore, even assuming that there is a real danger of inflation—a thesis far from proved at present—there is another very obvious remedy available to the Federal Reserve Board. This remedy is to increase the reserve requirements in the banks.

Such action would have the immediate effect of reducing the ability of the banks to create money. If they had to have, let us say, a 20-percent reserve instead of a 10-percent reserve, this would mean that their ability to create new demand deposit, or "check book," money would be cut in two.

Why is this remedy not used by Mr. Martin and his three companions? Only they can answer that question. But increasing reserve requirements would be even more certain to curb any threat of monetary inflation that might possibly exist. The one thing, however, which it would not do would be to cause the value of money to go up and the monetary value of real wealth to go down. It therefore would not give the kind of bonanza to the creators of our money supply which increasing interest rates give.

Could this be the reason why the four did not choose this course?

One additional question arises. How long should we wait to establish for our country a sound, effective monetary system, one wherein money would be created by the only agency which has a right to exercise that power—the Government of the Nation—and one wherein the possibility of either inflation or deflation could be forever prevented?

COOPERATIVES KEEP INTEREST DOWN, HELP WHOLE ECONOMY

Certain financial institutions in the United States probably won't raise their interest rates even though the Federal Reserve Board has given them an excuse to do so.

The ones that won't raise their rates if they possibly can avoid it are cooperative financial institutions—the ones that belong to their borrowers.

The reason they won't raise their rates is that they will not want to. They'd hurt their owners if they did.

Credit unions, cooperative farm credit institutions, and mutual savings banks are in business to reduce the burden of debt, not to increase it. They exist because groups of people have created them to help each other by owning together the savings and lending institutions they need. These consumers of credit are not interested in raising interest rates to make more money for investors.

Credit unions did not raise their interest rates a few years ago when the Federal Reserve Board took action similar to that recently taken. This was because credit unions are in business to help their members reduce the burden of debt—not to increase it. Their motive is different.

Banks for cooperatives and other cooperative farm credit institutions raised their rates only slightly—because they get part of their money for making loans by sale of debentures in the money market. But even if cooperative farm credit institutions do raise interest rates somewhat, the net effect upon their owner-borrowers may not be to increase the cost of credit at all. For if as a result of the higher rates a bank for cooperatives, production credit association, or Federal land bank association increases its earnings, those earnings all belong to the borrower-owners and will be returned to them in patronage refunds. So the net interest rate may not be increased at all.

The difference lies in motive. If the motive, the reason for being in business, is service and mutual aid, then a financial institution will keep its interest rates as reasonable as it can. And in so doing, such institutions are certain to exert a very beneficial competitive influence—for the protection of all borrowers, even those who borrow from investor-owned institutions.

The very fact that cooperative financial institutions are in existence provides our entire Nation with the best protection it can have at presen against really extortionate interest rates. And they provide that protection in the best way it can be provided in a supposedly "free" economic order. That way is by the competition of businesses whose motive is mutual aid and the service of people.

ENGLEWOOD SAVINGS & LOAN ASSOCIATION,
Englewood, Fla., December 14, 1965.

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

DEAR MR. PATMAN: In view of the recent action taken by the Federal Reserve Board regarding regulation Q, I thought you might be interested in the enclosed copy of a letter we received.

In order for us to pay 5½ percent on savings the mortgage rate would have to increase to 7 percent. The 5½-percent rate is one-quarter percent higher than now charged for Federal Housing Administration.

Congratulations on the stand and action you have taken.

Sincerely yours,

ALBERT J. LUNDWALL, Jr.,
Executive Vice President.

EXCHANGE SAVINGS & LOAN ASSOCIATION,
Dallas, Tex., December 23, 1965.

BOARD OF GOVERNORS,
Federal Reserve System,
Washington, D.C.

GENTLEMEN: Your action in permitting banks to pay up to 5½ percent for time deposits may be very beneficial to the banks, even though increasing their rates for time deposits will increase their cost of money, eventually to be made up by adding a burden to everyone who borrows money, and even though it will cause millions of dollars of free bank money to be turned into costly money.

But it will be ruinous to the savings and loan industry, a valuable factor in our money economy, an industry that adds to the stability of the average American by enabling him to finance his home on a 20- to 30-year-term basis at a contractual interest rate that cannot be changed by anyone.

The savings and loan industry is already adversely affected as far as our area of the county is concerned by the action of the banks in this section extensively promoting in 1965 the sale of 5-year savings certificates in very small denominations, even under $100 to yield 25.01 percent at maturity. Banks are using the subterfuge of issuing CD's to get around the ceiling rate on regular savings accounts. This action has stagnated to a great degree the savings associations in our community in their growth and ability to extend long-term financing to the homeowners at relatively low interest rates.

The new latitude you now give the banks will wreak further havoc to an industry vital to the financial health of our country.

Please consider the whole financial system of this country and not just the most powerful group in the system.

Respectfully yours,

EDWARD N. MAHER.

FARMERS' BUILDING & LOAN ASSOCIATION,
Ravenswood, W. Va., December 20, 1965.

Hon. WRIGHT PATMAN,
House Office Building,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: We wish to extend to you our sincere appreciation for your public stand on the recent unpalatable action by the Federal Reserve Board. We feel, as you do, that this was a highhanded and unwarranted decision on the part of Chairman Martin. Moreover we feel that it was merely a ruse to get some of the large banks off the hook in connection with the controversial CD's.

Had the Board used good judgment over the past few months, the present situation would never have developed. Furthermore, we are convinced that the Board not only wishes to restrain or handcuff the savings and loan business as well as to throttle all business with monopolistic powers.

Sincerely,

ROBERT K. PARK, *President-Manager.*

FARMERS UNION GRAIN TERMINAL ASSOCIATION,
St. Paul, Minn., December 8, 1965.

Hon. WRIGHT PATMAN,
House Office Building,
Washington, D.C.

DEAR CONGRESSMAN: At the suggestion of our Mr. M. W. Thatcher, general manager of GTA, I am sending you the recent radio broadcasts on the Federal Reserve hike in discount rates.

We much appreciate your good work toward keeping interest rates down. Farmers are carrying a heavier burden each year, due to these higher rates.

May we wish you success in the work of your committee in this regard.

Sincerely,

ROBERT HANDSCHIN, *Research Department.*

GTA DAILY RADIO ROUNDUP, DECEMBER 6, 1965

The big news for farmers is the unexpected boost in interest rates made by the Federal Reserve Bank Board in its surprise announcement over the weekend. This will add at least one-half a percent to rates farmers will pay for all new borrowings unless there is action by the President to make the bankers hold the line. Otherwise, farmers will have their income trimmed by this bankers' decision made in Washington.

The announced reason for giving bankers higher rates is to hold down inflation from Vietnam war spending. Most industries are running close to capacity and unemployment has been substantially reduced. The prime rate for lending

money to industry has been steady for over 5 years at 4½ percent. This increase will bring it up to 5 percent. Farmers pay more than this prime rate, but this is the base from which all other rates are figured.

With the cost of farming going up and up, this increase will cut into the better returns from livestock which we hoped would raise farmers' income next year to the best since the end of the Korean war.

In recent years farmers have had to borrow larger and larger amounts to make ends meet. Farm debt went up this year by $3½ billion, to a total of nearly $40 billion. On this big debt the interest charge now is well over $2 billion a year. That's a 10-percent increase over last year and double over what it was 8 years ago. And this doesn't include interest paid on CCC loans, or on any borrowing for family living. This interest bill also is making up a larger and larger part of total farm expense. It amounted to 7 percent of total expense this year.

If the higher Federal Reserve discount rate sticks, all these figures will go substantially higher next year.

But maybe the President will act to hold the line on this big farm expense. You will recall that President Johnson used all his powers to crack down first on any rise in steel prices, then against any rise in aluminum, and just a week ago against any rise in copper prices. And, of course, all hard wheat farmers know that the White House, through the Secretary of Agriculture, at the same time lowered the boom on high protein wheat my making all Government wheat stocks available at only a slight markup over the support prices. This holds down the price of good high protein wheat and keeps buyers of wheat from paying any higher premiums for such wheat. It prevents farmers who had such wheat from recovering any added income to make up for the smaller crop they had to plant under the Government support laws.

So farmers will wait with great attention to see if the bankers of this country have more political strength than the wheatgrowers, and the steel, aluminum, and copper producers, when it comes to raising the price of their product.

If there is no action to make the bankers back down, as the wheat farmer had to back down, then wheat farmers will suffer a double blow. On the one hand, a ceiling on the price they can get for their products, and on the other, a great big increase in the cost of farming, adding up to a real slash in their net income.

Here at GTA, we'll watch what is done and bring you a blow-by-blow account of what finally happens on this interest rate front which is so important to farmers.

All across the United States today the bankers are raising the rates they will charge for new loans. That's because of the increase in Federal Reserve bank discount rates and in the prime rates charged to the biggest borrowers. All these higher rates will boost costs to farmers, both for what they must borrow to farm, and what they may borrow for family living purposes. These higher charges will push farm interest payments next year to new record levels, and cut farmers' income by hundred of millions of dollars, just when there was hope of getting farm income back up to where it was a dozen years ago.

As late as yesterday there was some hope this was not going to happen. That was before President Johnson had talked with the head of the Federal Reserve Bank Board, William McChesney Martin. With strong words of protest, the President earlier had stopped increases in steel, aluminum, and copper prices, and through his Secretary of Agriculture Orville Freeman, had clamped down on high-quality hard wheat prices. It was hoped he would use some strong words and pressure to get the Federal Reserve Board to hold off at least for a few months until the size of next year's Federal spending could be known. But when Chairman Martin went down to the Texas ranch yesterday, along with Treasury Secretary Fowler, the Director of the Budget and other top Government financial officials, nothing happened to stop the big increase in interest rates. The President just said he regretted the decision hadn't been postponed—but he made no attempt whatever to get Mr. Martin to change his decision. In fact, the President even told reporters that while their job was to provoke a fight, "it's mine to prevent one," meaning that he wasn't going to challenge the financial stronghold at all, even though the Reserve Board's decision was by only a 4 to 3 vote, and it required changing only one vote to reverse the decision and stop the increase.

This vote might have been changed if the President had taken the advice of veteran Congressman Wright Patman, Texas Democrat, who is chairman of the House Banking Committee. Patman urged Johnson to demand the resignation of Martin if he would not cooperate with the White House. Patman pointed out

that the Reserve Board is actually "a fourth branch of Government, not subject to the electorate—not subject to the will of Congress or the executive branch of the Government" Patman said the action of the Reserve Board was particularly destructive to small business and the consumer, and that he plans to have the Banking Committee investigate in January, with the hope that Congress will strip the Federal Reserve Board of its power, as he called it, "to thumb its nose at the President."

Another voice asking for rollback action is Minnesota Farmers Union President Edwin Christianson who said the higher interest rates would cost the country far more than the metal price increases President Johnson had earlier stopped. Christianson also points out that interest costs to farmers already are far higher than what farmers spend for gas and oil, or for fertilizer, or even for farm property taxes.

But now it is clear that the Federal Reserve System is able to push up the price of its product even when the Government is against such a step, while farmers and producers of other basic commodities have their prices dictated to them by that same Government. That's a costly situation to all farmers, but especially to all those who raise hard wheat and that includes most of the 150,000 owners of GTA, the co-op way.

The battle of the interest rates moves into its third day with the big Twin City bankers upping their rates yesterday for loans to their largest customers. Next, the raise will be passed down the line to smaller banks and smaller customers. It won't take long before every lending agency, even the smallest country bank, will be asking farmers higher prices when they come in to borrow, and farmers will have to pay up.

That will cut into those better returns on livestock and crops many farmers are enjoying. Interest paid by farmers has doubled in the last 8 years. It is going up more rapidly than taxes or any other item of farm costs. If nothing is done to roll back this latest rise ordered by the Federal Reserve Board, then the added interest bill for farmers next year will be at least $100 million, and the figure will go up rapidly in following years. Besides the direct rise on new loans, farmers will have to pay higher prices on most everything else because of higher costs due to this rise.

This heavy burden on farmers and small business is one reason why Congressman Wright Patman, of Texas, leading Democrat and chairman of the powerful House Banking Committee, has summoned the whole Reserve Board to appear before his committee next Monday. At least one member of that seven-man Board is supposed to represent agriculture, but at this time we are unable to find out who that member is, if any. Patman intends to question them in detail about their sudden decision made secretly this last weekend. Patman said yesterday that it was time to "find out who is in charge in this country," the Federal Reserve Board or the President of the United States.

Another voice for holding down interest rates was heard yesterday when Vice President Hubert Humphrey told the Life Insurance Institute in New York City—there is no threat of inflation in the United States at this time, and that the Reserve Board had failed to coordinate its policies with the rest of the Government. Humphrey told insurance leaders that boosting interest rates might "add to inflationary pressure" instead of stop it. He said economic indicators point strongly to price stability, with labor costs per unit of output lower than 5 years ago, sufficient manpower still avaliable, and wage negotiations reasonable.

Humphrey hinted that tax and spending policies might have to be changed because of the interest rate hike, but he was not reported in the newspapers as saying anything about rolling back the interest hike. This lack of pressure either by the White House or the Vice President is in strong contrast to the pressure applied to hold down steel, copper, and aluminum prices in recent weeks, and to the drastic action by the administration in putting a ceiling on high protein hard wheat prices.

Perhaps the outcome of congressional hearings will be to bring the Federal Reserve Board under the responsible direction of the Congress or the executive branch of the Government, so that money rates in the future can be handled as firmly as other basic commodity prices.

But unless there is real action to roll back interest rates, wheat farmers will have had a lesson in a double standard of public morality—one rule for them and another for those whose product is money for lending. That lesson is extra costly here in the upper Midwest, where so much high-quality wheat

is raised, and where farmers will be taking less for that wheat while having to pay more for everything they must buy, and especially for what they must borrow, because of the way prices for these products have been set in Washington by the Government in recent weeks.

FIRST FEDERAL SAVINGS & LOAN ASSOCIATION,
Beresford, S. Dak., December 15, 1965.

Representative WRIGHT PATMAN,
Washington, D.C.

DEAR REPRESENTATIVE: The action of the Federal Reserve bank on the interest rates have got the savings and loan association in a very precarious position.

Perhaps the best way to show our concern over the matter is to take our own institution.

We have a small institution with about $3 million assets, which is loaned on dwellings in this town of about 1,800 population and neighboring cities. Sixty-five percent of our loans are GI and FHA loans and as you know draw 5¼ percent. We are compelled to put into our insurance fund each year out of our gross earnings 10 percent. We are paying a 4-percent dividend and after deducting our expenses there is very little left.

You can readily see what a 1-percent or even a one-half of 1 percent would do to us in case the bank in this community would follow the eastern banks or should take advantage of the leeway given them by the action of the Federal Reserve bank.

Ours is only one institution; there are many of them scattered in the Midwest.

We have taken pride in the fact that we have taken reasonable good care of the community that we serve and have made it possible for many to own their homes.

From your record in Congress I know that these matters will be brought out in the hearings you are about to have. However, I felt the urge to write you and thank you for taking the time to read this letter.

Yours truly,

C. O. PETERSON, *President.*

HULSTRAND, LANGSJOEN & ANDERSON,
Willmar, Minn., December 27, 1965.

Hon. WRIGHT PATMAN,
House Office Building,
Washington, D.C.

DEAR CONGRESSMAN PATMAN: I am a director of Citizens National Bank of Willmar, a small bank in a community of 10,000 people which was organized on October 8, 1964. Its footings now are slightly under $3 million.

This bank has received a telegram from McChesney Martin, Jr., the Chairman of the Federal Reserve Board, a copy of which telegram I enclose.

This telegram is very disturbing to me, as the action of the Federal Reserve Board on December 6 in raising the ceiling rates was very disturbing to our bank. The telegram is disturbing to me because the Chairman of the Federal Reserve Board now appears to be asking individual banks to do the thing which I feel the Board should have done in refusing to raise the ceiling rates.

I can see no benefit to our bank nor to any small bank from the December 6 action of the Federal Reserve Board. I can see no benefit to our community, a progressive and growing city in the State of Minnesota, which needs the banking services of our banks and the other smaller banks in the community.

The argument given for the action of the Federal Reserve Board is that this action will prevent inflation. I think it will have the opposite result. My experience in observing the economic factors in this community indicates that this will have a tendency to raise the price of the commodity that everyone uses. The argument will be made by merchants that their prices must be raised since they must now pay higher interest rates for the money they borrow. The argument will be made by laborers and their labor unions that they will be entitled to a higher wage because the interest rates they pay for the houses they buy and the automobiles and appliances they purchase will cost them more.

I personally do not buy the argument propounded by the majority of the Federal Reserve Board that this is a device to curb inflation. I think there are

other reasons for the action taken and I want you to know that they do not help our bank or any smaller bank; they do not help our community; and they do not help the economy of the State of Minnesota, and they will have a serious and detrimental effect in the long run on the economy of the United States of America and on the economy of the world.

I hope that the Congress will take prompt and immediate action to cancel the action of the Federal Reserve Board if the Board itself does not see fit to lower the ceiling rates to where they were.

Yours respectfully,

GEORGE E. HULSTRAND.

MINNEAPOLIS, MINN., *December 17, 1965.*

C. R. FORSTROM,
President, Citizens National Bank, Willmar, Minn.:

Federal Reserve action of December 6, raising ceiling rates under regulation Q was taken with the confident expectation that every member bank would exercise prudence in availing itself of the enhanced flexibility in competing for funds. Federal Reserve needs to be kept fully and promptly informed on bank response to regulation Q action. If you have made changes in rates and terms offered on time and savings accounts or contemplating such changes in the near future please advise general nature of action by collect wire to your reserve bank. Information for individual banks, particularly as to future plans, will be treated as confidential. Will also appreciate a prompt reply to forthcoming request from your reserve bank for more complete information.

WM. McCHESNEY MARTIN, Jr.

HONOLULU, *December 22, 1965.*

Hon. WRIGHT PATMAN,
House of Representaitves,
Washington, D.C.:

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 listing of rate controls here either by complete removal or by change of "prevailing rate" to 5 or 5.5 percent.

CLIFF KRUEGER,
President, Island Federal Savings & Loan Association of Honolulu.

SPOKANE, WASH., *December 14, 1965.*

Hon. WRIGHT PATMAN,
House of Representatives,
Washington, D.C.:

We certainly agree with you that this new raise of the discount rate and also the authorization for banks to raise their certificates to 5½ percent will cause a considerable raise in interest rates to the small borrowers throughout the country for homes, cars, and improvement loans. To say that we are disturbed is putting it mildly. We hope that you are successful in at least dropping the rate on the certificates back to what they were originally.

Sincerely yours,

RODERICK A. LINDSAY,
Chairman of the Board, Lincoln First Federal Savings & Loan Association.

MANSFIELD BUILDING & LOAN ASSOCIATION,
Mansfield, Ohio, December 22, 1965.

Representative WRIGHT PATMAN,
House of Representatives,
Washington, D.C.

DEAR MR. PATMAN: According to the Journal of Homebuilding (December issue) housing starts for the first 6 months of 1965 were off 63,000 units—the October rate of starts having been the lowest since February 1963.

Contractor-home builders have to borrow money to finance the homes they build. If they have to pay a higher rate of mortgage interest in 1966 than in 1965, they will have to raise the price for these new homes, probably build fewer because they will be harder to sell at the higher price.

Building and loan and savings and loan associations make more construction loans for new homes than all other financial institutions combined, according to latest reports; consequently they are greatly upset by the recent ruling of the Federal Reserve Board permitting commercial banks to offer 5½ percent interest on time certificates.

Since such associations' mortgages are largely at 6 percent per year interest—with no escalator clause permitting change to a higher rate—and are written for 12, 15, or 20 years—whatever additional interest these associations have to offer, above the customary 4¼ percent for savings, would have to be compensated for by interest collected on entirely new mortgages.

In other words, building and loan and savings and loan associations can't pay 5½ percent interest for the savings they collect to loan out on new homes. Unless this high rate for the benefit of commercial banks is not limited to large accounts (say $20,000 and up), the repercussions will include the syphoning of a large volume of savings from such associations into commercial banks and probably also the dumping of a large volume of Government bonds onto the market to meet heavy withdrawals.

And so we urge that you use your influence in having this 5½ percent interest rate on time certificates limited to accounts of $20,000 and up; and to not more than 4¾ percent on commercial bank time certificates of less than that figure.

Very truly yours,

H. KENNETH DIRLAM, *Secretary.*

GOLDEN, COLO., *December 13, 1965.*

Congressman WRIGHT PATMAN,
Chairman, Joint Congressional Economic Committee, and Chairman, House Banking and Currency Committee, Washington, D.C.:

Among the pertinent resolutions that were adopted by the members of Midwest Electric Consumers Association representing 1½ million consumers in the nine states of the Missouri Basin are two which will be of interest to you. All members express deep appreciation for your wonderful address. The text of the pertinent resolutions follow:

Resolution No. 32 titled "Interest Rate on Federal Securities":

Whereas, interest rate on federal securities sets the floor for all other interest rates; and

Whereas, interest rates on federal securities are higher than in 30 years; and

Whereas the banker-dominated Federal Reserve System is responsible for high interest rates; and

Whereas consumers and businesses are paying $100 billion interest charges every year; and

Whereas if interest rates had been maintained at the 1946 level public debt would be $50 billion less than it is today; and

Whereas the President has announced a need for a possible budget deficit of $7 billion in order to maintain necessary military strength and to carry out the Great Society program; and

Whereas a substantial part of this deficit is the result of rising interest charges on Federal debt; and

Whereas the effects of high interest rates always fall heavily on the farmers, the workers, and middle- and low-income consumers; and

Whereas continually increasing interest rates put pressure on the present REA interest rates essential to the survival of rural electrification: Now, therefore, be it

Resolved, That the Midwest Electric Consumers Association and its members shall communicate to the President and to the Members of Congress strong support for monetary policies which would lead to:

1. Federal Reserve System support of the Government bond market.
2. Reduction of interest rates.
3. Adequate supply of money for growing economy.
4. Retention of present interest rate levels on Federal credit program including 2-percent interest on REA loans.

Resolution No. 36 and its title is "Federal Reserve Board Action":

Whereas the Federal Reserve Board has just announced a rise in the discount rate; and

Whereas this will mean nothing more than an increase of interest rates to farmers, laborers, cooperatives, and others; and

Whereas Mr. Martin, the Chairman of the Federal Reserve Board, has revolted against the American people: Now, therefore, be it

Resolved, That Midwest Electric Consumers Association voice its disapproval of this action by (1) notifying the President, Senators, and Congressmen from the Midwest area and request them to investigate and rescind this arbitrary and dictatorial action; and (2) request of the President that the new selection of a member of the Federal Reserve Board in January and the second appointment 2 years hence be ones in keeping with the desire of the American people who time after time have recorded their desire for low interest rates and an adequate monetary supply.

FRED G. SIMONTON,
Executive Director, Midwest Electric Consumers Association.

MINNESOTA FEDERATION OF
PRODUCTION CREDIT ASSOCIATIONS,
December 14, 1965.

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

DEAR SIR: At a 2-day conference of managers and directors of 12 Minnesota and North Dakota Production Credit Associations, who represent all of North Dakota and the northern part of Minnesota, held in the Holiday Inn in Moorhead, Minn., on December 9 and 10, at which more than 65 farmer-directors and their managers were present, a strongly worded protest against recent action of the Federal Reserve Board's sudden and unwarranted increase in the interest rates of one-half of 1 percent was expressed.

The resolution passed was directed to the President of the United States and our Congressmen of Minnesota and North Dakota. It was pointed out that this raise in interest rates is simply an added burden to our farmer members who have been faced with rising costs of operation of their farms during a period of diminishing income and cannot be tolerated without protest.

Part of the resolution states, "* * * The members of this conference assembled voice disapproval of this action by notifying our Senators and Congressmen, and requesting them to investigate and rescind this arbitrary and dictatorial action."

Respectfully,

SAMUEL GENEREUX, *President.*

THE OUTLOOK FOR THE ECONOMY IN 1966 AND IMPLICATIONS FOR MUTUAL SAVINGS BANKING—PRESENTED BY DR. SAUL B. KLAMAN, DIRECTOR OF RESEARCH, BEFORE THE 19TH ANNUAL MIDYEAR MEETING OF THE NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS, NEW YORK CITY, DECEMBER 14, 1965

A new leading economic indicator has been discovered: the scheduled dates of these annual midyear meetings. There seems to be an uncanny coincidence between the timing of our meetings and important Federal financial actions. The Federal Reserve moves, effective Monday, December 6, represent the third amendment to regulation Q and the second increase in the discount rate to occur

just days before the presentation of this annual NAMSB review of trends and prospects.

The headline-making actions of the Federal Reserve, raising the discount rate to 4½ percent, and the interest rate ceiling on commercial bank time deposits (exclusive savings accounts) to 5½ percent, are dramatic recognition that the long-extended business expansion has entered a new stage. This year's $40 billion plus rise in GNP—on top of the $125 billion growth in the preceding 4 years—has brought unemployment close to the practicable minimum and industrial capacity utilization close to the desired maximum. Signs that the economy has been developing some stress and strain are shown—

In the slower rate of productivity growth;

In the advance in the wholesale price index following 6 years of remarkable stability;

In the slightly greater rise in the Consumer Price Index;

In the significant increase in both short- and long-term interest rates;

In the leveling of after-tax profit margins: and

In the increasing shortages of skilled labor in several key industries.

Thus, while 1965 will be recorded as the fifth year of uninterrupted growth, it will be remembered as the year of new departures and emerging pressures. And for 1966, the key question is how long growth can continue without disruptive imbalances in an economy whose manpower and productive capacity are already nearly fully employed. There is convincing evidence on each of the three major sectors of the economy to suggest that the expansion can roll on right through 1966.

Before the Federal Reserve action, business, consumer, and Government expenditures were all pointed strongly upward. According to the joint SEC-Commerce survey released last Tuesday, businessmen were planning to expand capital outlays in the first half of 1966, at about as rapid a rate as in 1965.

In the consumer sector, both private and Government surveys report household buying intentions, for both durables and houses, continuing at a high level. With these plans supported by record employment, incomes, and liquid asset holdings, and with population expanding, housing starts are expected to increase by 5 percent or so, following earlier declines.

In the Government sector, few things are more certain than the continued steady increase in State and local government purchases on the order of $4 to $5 billion. And Federal outlays for goods and services will clearly exceed the 1965 total by several billions, considering the Vietnam escalation and additional spending associated with urban development, education, antipoverty, medicare, and other new programs enacted by the Congress this year.

The detailed NAMSB staff analysis of 1966 prospects—completed just before December 6—added up to an overall potential expansion of some $40 to $45 billion, bringing gross national product for the year up to the $710 to $715 billion range. Perhaps now, higher costs of financing will discourage the more marginal or speculative expenditures planned before the Federal Reserve action. Businessmen, consumers, and governments, at all levels, may well reconsider lower priority purchases and programs.

In any event, we are still betting that the economy will continue its advance right through 1966 at close to a 6-percent annual rate. If so, the uninterrupted business expansion will be extended to an amazing 70 months.

PRIVATE PRESSURES AND PUBLIC POLICIES

This happy prospect can hardly be taken for granted. In fact, unbridled optimism has historically been, and will always remain, a prime threat to sustained prosperity. The danger of lapsing into a relaxed state of euphoria increases as the expansion rolls on. We are told that recurring recessions are not inevitable, but neither is perpetual prosperity. And euphoric bliss is inimical to sustained efforts to innovate, to maximize efficiency, to minimize waste, to develop new products—all essential elements of a dynamic, expanding, free-enterprise economy.

Notwithstanding the recent Federal Reserve action, concern remains that an inflationary outbreak may frustrate the realization of further sound expansion. Slower productivity growth, shortages of skilled labor and reduced profit margins may continue to generate cost and price pressures in an advancing economy. But expected large additions to the labor force and to plant capacity in 1966 should ease the developing strain on human and material resources. And cost

uncertainties will be reduced because no important pattern-setting labor negotiations are scheduled next year, as was the case in the automobile and steel industries in 1964 and 1965, respectively.

The result of these opposing forces hangs in the balance. In these circumstances, doubts about appropriate policy actions were clearly reflected in the closeness of the Federal Reserve Board's 4-to-3 vote approving the discount rate increase—mindful of controversial 5-to-4 Supreme Court decisions. Apart from other considerations, the Federal Reserve action reflects the fact that "voluntary" programs, whether aimed at prices, wages, interest rates, or the balance of payments, cannot long work if in basic conflict with inexorable economic forces. A flexible monetary and fiscal posture, sensitive to economic change, is essential.

IMPACT OF FEDERAL RESERVE ACTION

And last week's Federal Reserve action once again demonstrated the determination of the Board to respond flexibly and independently to changing economic conditions. To assess its economic impact, it is necessary to understand clearly the purpose and climate of the action taken. Both differ basically from the purpose and climate of the similar year-ago action raising the discount rate and regulation Q ceiling.

With respect to purpose, the November 1964 action was taken largely as a defensive international measure in response to the sharp increase in the British bank rate. This year's move, by contrast, was aimed primarily at the domestic scene, and secondarily at international conditions. In the words of the Federal Reserve, it took steps "to reinforce efforts to maintain price stability, and thus, to foster balance in the economy's continued growth and strengthen the dollar's international standing."

With respect to climate, the 1964 action was taken in a less fully employed economy, with interest rates generally stable. Today's climate, however, is characterized by an economy fast closing in on full employment, with interest rates—in both short- and long-term markets—already rising under the pressure of persistent credit demands and investor fears of inflation.

So, after considerable uncertainty and speculation, the other shoe has been dropped. But with what impact While we are still too close to the action to appraise it fully, certain directions are already clear. The immediate hike to 5 percent in the prime rate means that costs to business borrowers will advance all along the line. It means that short-term rates in Treasury and other money markets will also rise to higher levels.

Will short-term rate advances spill over into the long-term capital markets Even before December 6, our analysis of sources and uses of funds suggested that long-term yields would be kept under upward pressure by an advancing, nearly fully employed, economy. The Federal Reserve action reinforces this view. And while yields on both corporate and Government securities have already advanced significantly, the narrow spread between short- and long-term rates suggests that some further upcreep in these yields will occur as short-term rates advance.

Nor can the mortgage and housing areas remain isolated from these prospective developments. As you know, mortgage markets firmed last autumn after some 5 years of uninterrupted ease. The elements underlying this turnaround were appraised in the October Savings Bank Journal.

In the current new environment, at least two of the elements noted in the Journal, point to continued upward pressure on mortgage yields: the relatively rapid mortgage response to general financial change, compared with earlier years; and the exceptionally narrow spread between mortgage and bond yields.

In addition, mortgage money will become costlier if commercial banks continue to attract savings away from mortgage-oriented lenders for which the banks have outlets in high-yielding business loans. This is a basically different situation than in the early 1960's when commercial banks, flush with large saving flows, sought mortgage loans aggressively because business loan demands were inadequate. Then, mortgage yields were put under downward pressure; now they will be under upward pressure.

Finally, expected rate increases in short-term commercial bank mortgage credits—construction loans to builders and warehousing loans to mortgage bankers—will place further upward pressure on long-term mortgage rates. And now that FNMA reduced its buying price for mortgages last Friday, a step long justified by market conditions, the next question is how long can FHA hold out.

It seems a good bet, that if the tightened situation continues, FHA will increase the contract rate on its insured mortgage loans.

After some 5 years of mortgage ease, borrowers may find the firmer tone of 1966 mortgage markets unfamiliar and irritating. Some may resent the greater lender selectivity of credit risks, less liberal contract terms and moderately higher interest rates. But prospects for alleviating the twin dangers of lower standards of credit quality and of temporary overbuilding are in the longer run interest of home builders, home buyers and mortgage lenders alike.

In all of this, we should not make the mistake of assuming that increased costs of borrowing will be accompanied by reduced availability of funds. Under present circumstances, for example, it is expected that funds will be ample to finance the projected modest increase in housing activity next year. Whether this proves to be the case will depend on how the Federal Reserve chooses to implement its discount rate action by open market operations. And, in announcing the December 6 action, the Board stressed that it was designed "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."

In this framework, the Board indicated that the "action contemplates 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." Thus, while the cost of credit will increase, we are promised sufficient funds to finance further growth.

But this is not the kind of promise that carries with it an unconditional 1-year money-back guarantee. Nor should it be. For the essence of effective monetary policy is the willingness and freedom to change direction with changing conditions. And as Chairman Martin reaffirmed last Wednesday, the Federal Reserve will continue to shape its policies "with complete flexibility, firming whenever our further progres is threatened by inflation, and easing whenever that threat has passed."

The key to financial developments in 1966, therefore, will continue to lie in the course of price movements. So long as price increases are contained, and inflationary psychology forestalled, the Federal Reserve will supply commercial banks with sufficient reserves to permit further credit expansion for a growing economy. But if cost and price pressures do not abate, as the gap between actual and potential output narrows, we can expect further tightening of credit policy. In such a climate, furthermore, other actions, coordinated and integrated with monetary policy, will also be called for, including at least—

A tight rein on Federal spending;

A vigorous attack on structural unemployment;

Removal of inequities in the tax structure and conceivably even tax increases; and

Removal of the 4¼-percent ceiling on Treasury bond issues.

Above all, in an economy as delicately balanced as ours now is, the decision-maker—whether in private or public life—must remain as flexibly poised as the ballet dancer, as alert to new dangers as the hunter, ready to move quickly, but not prematurely. And as Secretary of the Treasury Fowler recently observed, it is necessary to recognize that, in the current situation "the margin for error is much smaller and the need for responsible action is much greater" than in earlier stages of the expansion.

SAVING BANKING—CLOSING THE PERFORMANCE GAP

In the vigorously advancing 1965 economy, savings banking has had a good year. Our preliminary figures show—

Total assets up 7 percent;

Total deposits up 7.3 percent;

Mortgage loans up 9.7 percent;

Earnings rates up to a record 4.87 percent of assets;

Interest payments to depositors at a record $2.1 billion;

Reserve ratios unimpaired at the 1964 level.

A good year—but hardly good enough. Not because the probable $3.5 billion deposit gain fell short of 1964's record $4.2 billion gain. This was anticipated in last year's staff forecast, which emphasized that the 1964 record reflected unusually strong, but temporary, stimulative factors. No, the year was not

good enough because our performance fell substantially short of potential. And the likelihood for 1966 is that the performance gap will continue.

This expectation is not merely a reflection of the near-term impact of recent Federal Reserve actions. Indeed, even at this early stage, the likelihood is strong that savings banks will experience another "good" year in 1966. Rather, the gap between our performance and our potential is a longer run and more pervasive problem. It will remain with us as long as we neglect to use the full range of our present powers and as long as statutory and regulatory provisions preclude us from developing broader services.

For the short run, we can expect that a high-level economy, growing by another $40 billion or so, will continue to generate a large volume of personal saving. Some shift from deposit-type saving to direct investment may occur in response to yield advances in bond markets. But there will be nothing like the 1959 surge, when rising capital market yields culminated in the famous "Magic Fives." Rather, with yields on savings accounts at record highs, and the popularity of deposit-type saving greatly increased, the shift to direct investment is likely to be of moderate proportions.

Within the savings account market, the extent of any realinement of deposit flows will depend importantly on commercial bank actions and competitive reactions by thrift institutions. While the Federal Reserve move has given commercial banks added flexibility to gear time deposit rates to money market conditions, the regulation Q ceiling on passbook savings remains unchanged at 4 percent. And hardly by accident. As Federal Reserve Chairman Martin said last week, this rate was "purposely" not raised so as "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 corporations."

Mr. Martin's statement notwithstanding, commercial banks may, of course, seek individuals' savings more aggressively through higher yield "savings certificates," "discount bands" and the like. But there is reason to be hopeful that commercial banks will not initiate an unhealthy "rate war" in the savings account market. For one thing, their savings and time deposit flows are running exceptionally high, at current interest rate levels; for another, the market for corporate certificates of deposit offers commercial banks greater flexibility in adjusting fund flows to loan demands.

Regardless of commercial bank action, savings banks must maintain a responsible competitive posture. While this means the continued encouragement of thrfit—vital in this expansive stage of the business cycle—it also means payment to depositors of interest rates that are consistent with earnings and prudent operations. As we observed a year ago in this staff presentation: "The real test of competitiveness lies in management's ability to build up longrun earning power and internal strength * * * in policies that are alert to, but not dictated by, the actions of other institutions."

If these criteria are observed, then savings bank responses to the recent Federal Reserve actions are likely to be selective rather than pervasive. Some rate adjustments have already been made, and more will follow, reflecting the particular earnings and reserve positions of individual institutions, as well as specific competitive conditions in local markets. More broadly, the use of split-rates and special high-yield savings contracts, as proven competitive instruments, is likely to spread further further. Beyond this, we do not expect any dramatic changes in current competitive relationships or further massive shifts in deposit-type saving flows. In this environment, the 1966 industry deposit gain should be close to the $3.5 billion 1965 increase, with possible declines in net new money offset by further gains in interest credited to depositors' accounts.

By historic standards, another good year. But by standards of potential performance, hardly. The test of an industry's performance is not simple. For savings banking, surely one basic test is service to an increasing number of people. And in this respect, success has not been notable, as the relatively slow growth in regular savings accounts bears witness. In each of the past 2 years, for example, savings account growth—at around 200,000—has been smaller than in any year since the early 1950's, excepting only 1961–63. And during much of that period account numbering and interest reporting discouraged new accounts. Moreover, our ability to attract new depositors in recent years has lagged behind population growth in most savings bank States.

The problems which this trend manifests, and which have limited the realization of our potential for growth and service, are not new. But they have been intensified in the new environment of broadening competitive pressures and pervasive social and economic change.

We are rapidly becoming a younger, more urbanized nation. Those of us over 29 years old are already a minority group. And in the next decade a full 60 percent of the projected 25 million population increase will fall within the 15–29 age category, more than double the rate of increase in this category in the decade now ending. The bulk of this growth will occur in the urban areas of the Nation; in fact, demographers tell us that nearly 8 out of 10 Americans will be living in cities before the turn of the century.

Who shall lead in financing the building and rebuilding of our cities and the burgeoning needs of a young population? Who better than mutual savings banks, historically oriented to urban, industrialized societies and to thrift encouragement among youth. But the realization of our potential for growth and service will continue to be frustrated until longstanding industry problems are overcome.

The problems are familiar ones: location and investment restrictions imposed by statute or regulation within our present States, and absence of authority to establish savings banks in other States. But we would be less than candid if we blamed all of our problems on legislative and supervisory restrictions. Part of the blame is ours alone for being lulled into a state of competitive lethargy by years of placid existence and unchallenged leadership in thrift.

Management was ill prepared for the onslaught on our prime position launched by savings and loans in the immediate postwar years. Geared at last to meet this challenge, we have been confronted by yet another potent poacher in our former private preserve—the commercial banks. And instead of waning, as some had thought, or hoped, this new threat has grown stronger and more pervasive.

Our response to these challenges, while perhaps slow, has not been without vigor or imagination. Consider only the many new depositor interest rate and savings plans; the vigorous new branching and mortgage activities; the increasingly successful efforts to gain broadened State powers and the strengthened drive to obtain Federal charters. But in a candid self-appraisal, can we say that our response has been vigorous and imaginative enough; that each of our banks is using its full range of powers to bring needed services to more people, to increase flexibility of operations, to build long-range earning power.

Certainly, the potential for increased earnings from the shift to mortgages has been considerably lessened as the industry's mortgage/assets ratio has reached new high ground. But as we seek broader investment outlets in consumer credit and other areas, let us not overlook opportunities for greater earnings and flexibility within mortgage portfolios. For example, how many opportunities for profitable income-property financing have been overlooked while housing demand has been slack? Only 10 percent of our industry's mortgage portfolio is secured by nonresidential property.

And in portfolio management, how many banks realize the flexibility of operations afforded by know-how in the use of various warehousing techniques? How many banks have stayed away from construction loans because of technical complexities or burdensome policing? How many smaller banks have arbitrarily turned away from large loans because of unfamiliarity with participation lending? And how many large banks have thought about mortgage servicing for others as a supplement to income? Finally, are all savings banks aware of the new lending opportunities provided by the Housing and Urban Development Act of 1965?

This only scratches the surface of increased earnings and flexibility potentials inherent in savings bank operations. Other issues need to be considered as well. One recurring issue, of course, is liquidity. And in this respect, it may be wise, at least, to examine again the advantages of access to external credit facilities as a supplement to internal liquidity. The Federal Home Loan Bank System, Savings Banks Trust Company, commercial bank credit—through warehousing or otherwise—all offer opportunities for increased flexibility and earning power, as well as a source of emergency funds.

The savings bank performance gap cannot be fully closed, of course, until we have mounted a successful dual assault against State and Federal legislative barricades. But in the interim we can move considerably closer to this goal by the maximum exercise of management capabilities, combining prudent responsibility with vigorous creativity.

We concluded our December 1961 staff presentation with the statement: "It is a steep road back to undisputed preeminence in the thrift field. But no lesser goal should satisfy us." Since then we have come a long way back up that road but have not yet scaled the heights. In our 150th year of existence what could be more appropriate than to travel that road with renewed determination—a determination to realize our potential by providing a full family financial service to the fullest number of families.

THIEF RIVER FALLS, MINN.,
December 14, 1965.

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

Farmers are alarmed and vigorously protest recent unwarranted act of the Federal Reserve Board. At a meeting in Moorhead, Minn., 65 directors and managers of Production Credit Association, who represent 12 associations serving all of North Dakota and a large portion of Minnesota, the following resolution was passed:

Whereas the Federal Reserve Board has just announced another raise in interest rates; and

Whereas Mr. Martin, Chairman of the Board, has again acted against the best interest of our American people and our national economy: Now, therefore, we hereby

Resolve, That this conference of PGA managers and directors of the Seventh Farm Credit District voice our disapproval of this action by notifying the President of the United States and our Members in Congress from this area, requesting them to investigate and rescind this arbitrary and dictatorial action and further request the President that the selection of new member of the Federal Reserve Board in January and the next one 2 years hence be chosen in keeping with the desire of the American people and the best interest of our whole national economy in mind.

SAMUEL J. GENEREUX,
President, Minnesota Federation of Production Credit Associations.

WASHINGTON, D.C., *December 10, 1965.*

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
U.S. House of Representatives, Washington, D.C.:

We congratulate you on your decision to interrogate members of the Federal Reserve Board in regard to the increase of the discount rate from 4 to 4½ percent and the increase in the rate on institutional funds to 5½ percent. With a stroke of the pen the Fed has wiped out the benefits of the farm bill. Contrary to statements of Martin and members of the financial community, the country is not threatened by inflation. Wholesale price increases have been small, only 3½ percent since 1957–59. Western European countries have had rises of 10 and 12 percent in the same period of almost full employment. We urge a full and complete investigation of the policies of the Federal Reserve Board.

GLENN J. TALBOTT,
Vice President, National Farmers Union.

DRAYTON, N. DAK., *December 11, 1965.*

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

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HENRY O. LUNDENE,
President, North Dakota Federation of Production Credit Associations.

NORTH DAKOTA FEDERATION
OF PRODUCTION CREDIT ASSOCIATIONS,
Adams, N. Dak., December 11, 1965.

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

DEAR SIR: At a 2-day conference of managers and directors of 12 Minnesota and North Dakota Production Credit Associations, who represent all of North Dakota and the northern part of Minnesota, held in the Holiday Inn in Moorhead, Minn., on December 9 and 10, at which more than 65 farmer-directors and their managers were present, a strongly worded protest against recent action of the Federal Reserve Board's sudden and unwarranted increase in the interest rates of one-half of 1 percent was expressed.

The resolution passed was directed to the President of the United States and our Congressmen of Minnesota and North Dakota. It was pointed out that this raise in interest rates is simply an added burden to our farmer-members who have been faced with rising costs of operation of their farms during a period of diminishing income, and cannot be tolerated without protest.

Part of the resolution states: "* * * The members in this conference assembled voice disapproval of this action by notifying our Senators and Congressmen, and requesting them to investigate and rescind this arbitrary and dictatorial action."

Respectfully,

HENRY LUNDENE, *Chairman.*

[Copy of telegram]

DECEMBER 13, 1965.

From: Jerry L. Anderson, acting general manager, National Rural Electric Cooperative Association.

To: Congressman Wright Patman.

On behalf of 20 million rural electric consumers throughout America we support your effort to investigate the recent decision of the Federal Reserve Board to tighten money supply and increase interest rates.

As you know, the rural electric membership has repeatedly opposed a national monetary policy of tight money and high interest rates and has reaffirmed this position as recently as this fall at the regional meetings.

We deplore a high interest rate policy as a major cause of unemployment and as an unwarranted burden upon the homeowners, businessmen, and consumers of America. We are hopeful that the public hearings arranged by your committee will lead to increased public awareness and enlightenment on this vital issue and will focus the attention of Congress on the need for early reforms of the Nation's monetary procedures.

Our experience has demonstrated that policies such as the Federal Reserve is now putting into effect slows the economy and leads to recessions. Tight money and high interest rates affect the pocketbooks of all consumers by creating higher costs for all goods and services. They are particularly hindersome to rural people who depend heavily upon a number of credit programs for which low interest is essential.

We applaud your personal leadership in this effort over the years and we pledge our untiring support.

JERRY L. ANDERSON
Acting General Manager.

OREGON-WASHINGTON FARMERS UNION.
La Center, Wash., December 6, 1965.

Hon. WRIGHT PATMAN,
U.S. Representative,
Texarkana, Tex.

DEAR REPRESENTATIVE PATMAN: It is with the gravest concern I protest the action of the Federal Reserve Board in raising the interest rates. This will reach adversely into every corner of America and slow up every segment of the economy. It will hit hardest, I believe, in the areas of housing and agriculture.

A curtailment of housing construction will hurt the lumbering industry and especially the Pacific Northwest.

The loss to agriculture, heavily dependent upon borrowed capital and with the highest debt load in our history, will be disastrous, and will nullify the gains only recently won through national legislation.

I urge drastic action to prevent this increase.

Respectfully,

ALAN HAM, *Vice President.*

(The following editorial appeared in the monthly publication of the Retail Clerks Union, Local 770, Hollywood, Calif., and was submitted by Lois McKinstry, executive administrator of the local:)

THE AMERICAN WORKER AND OUR FEDERAL RESERVE SYSTEM

Much confusion has resulted from the Federal Reserve Board's recent announcement that it was increasing its discount rate from 4 to 4.5 percent. This terse announcement was greeted with both "boos and cheers."

The bankers feel that the so-called tight-money policy should prevail at this time because of the threat of too much prosperity which might bring on inflation.

We have talked so far about the discount rate and the tight-money policy. Before we attempt to explain the philosophy behind this move, we should acquaint ourselves with the powers delegated to Congress in the Constitution.

Section 8. Powers Granted to Congress. To coin the money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures.

The Congress then, in 1913, delegated certain regulatory powers to the so-called Federal Reserve System, which is composed of seven members appointed by the President and confirmed by the Senate.

The Board's duty is to provide credit to business institutions at reasonable rates, and to anticipate emergencies in business fluctuations so as to protect business from the harmful effects of excessive expansion or contraction of credit.

This may seem like a mystery to many and maybe it is, except we don't see it. It seems that the Federal Reserve Board, as presently constituted, is composed of human beings of different political philosophies. Generally it is known to be a conservative Board, or a tight-money policy Board.

Tight money really means what the Board has recently done—namely, raise the interest rates so that it will be more difficult to establish credit. This, the Reserve Board feels, is a check on inflation, and so the future borrowers of money will have to pay more for the borrowed dollar.

This brings us to the difference between the 4 percent and the 4.5 percent so-called discount rate. This also means that any of the banks that you see on the corner in your neighborhood used to borrow money at 4 percent from the Federal Reserve Board. They now have to pay one-half percent more. This means that anyone borrowing from the corner bank will soon have to pay one-half percent more for borrowing the money than they did before.

Of course, the corner bank also has its own rates. It once loaned to big business at the rate of 4.5 percent, which they called the prime rate. No doubt the prime rate now will have to be increased to 5 percent, so we are now carrying the one-half of 1 percent to the second step.

The local bank also has other customers who are not prime borrowers, and who borrow money at a higher rate, which used to be 5, 5.5, or 6 percent. If we follow the same habit of changes, soon the new rate to the ordinary borrower will be 5.5, 6, or 6.5 percent. This now means that whoever pays the higher rate must pass it on to the consumer, so we begin a chain reaction which escalates the cost of borrowing money.

Let us take a television manufacturer as an example:

Suppose we asume that the television manufacturer is a prime borrower because his credit is extra good. Because of this status, he is able to borrow money from the corner bank at 5 percent, which is now one-half percent higher than it was before the increase. The television manufacturer must, in turn, pass this cost on to the distributor, who cannot carry in his inventory all the television sets required to conduct his business unless he borrows money. So he too runs to the bank. If he is a prime borrower, he also borrows at the privileged rate, if not he must pay a higher rate.

The television distributor will then sell to the dealer, who, in order to sell his set, must give the consumer credit, so he must also go to the bank and borrow money. Usually the corner dealer gets the higher rate, so this means that our television set will cost more money.

In simple terms, what the Federal Reserve Board has done with its tight-money policy, in our opinion, is to make a gift to the big bankers by taking it out of the pockets of the poor, or from those who are unable to buy for cash.

The interest rate does not affect the so-called man of "means" because the man of "means" has the means of passing it on to somebody else. It is the fellow down the line—the product consumer—who finally must pay the higher interest rate.

This may be retarding inflation but it is starting at the wrong end.

Instead of recommending to the Congress a higher income tax to take money out of the pockets of the wealthy, the Reserve Board is shrinking the purchasing power of the American worker so that the products of our industries will back up into the warehouses for lack of sales, and thus cause a decline in our business activity.

What we must keep in mind is that a constant fight has been going on through the ages over whether or not little people should have more or should have less. At the present time, and with this last action, the tight-money boys have decreed that the little people shall have less.

We hope the President will appoint a more liberal member to the Board when the term of one of the conservative members expires January 31. We may, at that time, have a reversal of the tight-money policy. But, how long can a dynamic economy remain dynamic when the scheme of a few men can change the course of history, and the welfare of a nation.

We laud the Honorable Wright Patman, chairman of the House Banking and Currency Committee, who has summoned the entire Federal Reserve Board for an explanation of their action, and who has proposed some remedial legislation.

Every clerk should know that his paycheck shrank by at least one-half of 1 percent of the interest he is paying for borrowed money. Every clerk should also know that if he is planning on purchasing a $20,000 home that it will cost him $1,500 more to buy that home in the form of higher interest than it would have under the previous money-lending policies.

The least that every clerk can do is to write to the Honorable Wright Patman, chairman of the House Banking and Currency Committee, and urge him to continue his fight for small business and the people's rights.

HURON, S. DAK., *December 13, 1965.*

Congressman WRIGHT PATMAN,
Chairman, Congressional Joint Economic Committee,
Washington, D.C.:

Federal Reserve Board rate hike devastating blow to rural America. Appealing to your concern for public to urge Federal Reserve Board rescind action.

BEN RADCLIFFE,
President, South Dakota Farmers Union.

(The additional material which follows was submitted by Chairman Patman. It consists of several news stories, editorials, and letters to the editor—arranged chronologically—concerning the defiant action taken by the Federal Reserve Board on December 5, 1965, when it raised the discount rate and the permissible maximum interest rates allowable on time deposits:)

[From the Washington Post, Dec. 5, 1965]

ECONOMIC IMPACT—A NEW APPROACH TOWARD INFLATION

(By Hobart Rowen)

That was a fine, brave speech President Johnson made to the Business Council, promising a record boom in 1966 without inflation. I wish him luck. But it seems to me that it's whistling in the dark to expect price stability if our goals are growth and full employment.

I doubt that Mr. Johnson has much confidence in that forecast, either. But he and his Cabinet aids naturally want to talk down prospects and talk up the need for "responsible restraint."

However, there is no such thing as absolute price stability except in a stagnating economy. The Johnson administration is faced with the problem of tolerating the probability of a mild inflation in 1966—or trying to choke it off by a resort to tight money and reduced spending.

When unemployment was high and industrial operating rates lower, such tough decisions did not confront the "new economics": expansion was the byword, and the only problem was to evolve the right (and politically acceptable) mix between a tax stimulus and a spending stimulus. Stir in right proportions, and mix with a little corn pone, and you have a happy consensus.

The problem has now become, as Otto Eckstein wisely observed, how to live with prosperity. Thus, an unemployment rate of 4.2 percent in October becomes a problem as well as an achievement. This close now to full employment, the question becomes how to deal with the hard core who have not been swept into jobs by general prosperity.

A great bulk of this problem, of course, is the final bitter fruit of a century of hate and prejudice against the American Negro, as Labor Secretary W. Willard Wirtz has reminded us more eloquently than anyone else.

But subtly, the emphasis is shifting from general expansion (which might cut the unemployment rate below 4 percent, but bring inflation with it) to a policy of moderation (with the goal of fending off inflation).

My sense of the practical tells me that this is probably a sane policy because the Puritan ethic is still dominant in this land. It is virtuous to fight inflation. Besides, rising prices would cause new trouble for industries like steel, already hard pressed by cheaper imports. And there is the inevitable balance of payments to consider, too.

My sense of other values, including a moral consideration, leads me to suggest that an upcreep in prices is an alternative worth considering. We've had an inflation running at a rate of 1 to 1.5 percent a year during the Kennedy-Johnson era, and we've survived. The remarkable economic gains of this period can be seen on all sides.

But a control-inflation-at-all-costs policy now could have a drastic effect of halting the attempt to integrate Negroes into prosperous white America.

Just the other day, Paul W. McCracken, who has good, conservative credentials (he was a member of Mr. Eisenhower's Economic Council) suggested that "it would be better to take some upward drift" in prices than to get the country involved in controls. He added that it would then be necessary at some later time "to pursue a disinflationary policy."

A conscious policy to permit some inflation would be a precedent setter. (McCracken noted that some would "recoil" at his idea.) It may not, in fact, be practical. There may be no such thing as a little bit of inflation.

But the point is this: if Mr. Johnson decides that stability must get priority, the Nation should know that there's a price tag on that, too.

[From the New York Times, Dec. 6, 1965]

DEFIANCE AT FEDERAL RESERVE

President Johnson has deplored the actions of the Federal Reserve Banks of New York and Chicago, which were approved by a 4-to-3 vote of the Federal Reserve Board in Washington, raising the interest rates that they charge to banks and, thus, to all borrowers.

Mr. Johnson's concern is understandable. The Federal Reserve's action not only openly defies the consensus policies of his administration; it ended what he considered to be an appropriate synchronization of monetary and fiscal policies for sustaining noninflationary prosperity.

These coordinated policies have worked remarkably well over the past 5 years. The Nation's money managers have made a major contribution to the present high level of economic activity by the adroit and imaginative handling of their responsibilities. They made credit readily available in order to stimulate consumer demand and business investment at home but they also pushed up short-term interest rates to discourage an outflow of capital to higher yielding markets abroad.

Yesterday interest rates were raised for the third time since the expansion got underway, this time to "prevent inflationary excesses from damaging an economy now carrying the added burden of military operations in Vietnam" as well as to demonstrate "anew the U.S. determination to maintain the international strength of the dollar." This move is a logical followup to their previous measures, but the money managers are clearly in conflict with the position of Mr. Johnson and his economic policymakers, who feel that tightening credit and raising interest rates is premature and ill-advised because inflationary excesses are not a clear and present danger.

In asserting their independence, therefore, the money managers are risking their reputations and that of the Federal Reserve itself. But this cannot be considered a banker's conspiracy. Those who voted for the rise knew what they were doing and the risks that they were running. They decided to abandon coordination because they regard the mix of policies that were responsible for creating the longest peacetime expansion in history as not the mix needed now that the economy is operating close to its capacity and while it is becoming increasingly embroiled in an expanding war.

The administration itself cannot deny that conditions have changed. It opens intervention to roll back the prices of aluminum and steel and wheat and its fresh demands for intensified voluntary restraint in curbing dollar outflows indicate its own heightened concern about the threat of inflation—and the onset of an inflationary psychosis—that up until now has been happily absent. Yet it has continued to press its own expansionary fiscal policies and has sought to have the Federal Reserve follow suit as if things had not changed and the economy was still limping along with plenty of excess plant capacity and widespread unemployment.

Sooner or later a shift had to be made. The timing of the money managers may be disputable, as it has been in the past. But they as much as Mr. Johnson are intent on keeping the expansion going strong and the dollar as good as gold. They can point out that monetary restraint will help to bolster the administration's efforts to maintain price stability. And they can claim that they have heeded the plea for restraint that Mr. Johnson has been making but has himself refused to take.

MEANY ASSAILS BANKS' GREED; ASKS JOHNSON TO BAR RATE RISE

(By Damon Stetson)

SAN FRANCISCO, December 6.—George Meany criticized today the Federal Reserve Board's action in raising the discount rate and said President Johnson should use whatever power he had to reverse the decision.

Mr. Meany, president of the American Federation of Labor and Congress of Industrial Organizations, charged that the discount rate increase would adversely affect every activity in the United States that involved credit, including the purchase of homes, cars, and television sets.

The Federal Reserve Board, Mr. Meany said, was established to stabilize the monetary system for the benefit of the entire Nation. But it has been controlled by bankers, he said, and operated as if it were for the exclusive interest of bankers and big business. He said "the naked greed" of bankers had been a factor in the decision of the Board to raise the interest rate.

Mr. Meany suggested that President Johnson not only get a reversal of the increase but that he also take steps to insure that the Board represented all elements in the Nation.

Mr. Meany attacked the Board's action in addresses before conventions of the AFL–CIO Maritime Trades Department and the AFL–CIO Trades Department. In an earlier formal statement, he had described the Board's move as "mistaken and costly."

"This blunderbuss action," he said, "was taken on the fale premise of fighting inflation. At a time when 4.2 percent of the work force is unemployed, the economy can be badly hurt by such acts, which will undoubtedly have a depressing effect on activities such as homebuilding.

"A Federal Reserve Board on which there is no representation from labor is bound to consider unemployment as a mere statistic. To us, unemployment means troubled people and we think this a fundamental which the Federal Reserve Board ignored in its ill-considered decision."

The executive board of the Communications Workers of America, another union whose leaders are gathering here for the AFL–CIO convention opening Thursday, also was critical. It warned that raising the interest rate would tend to slow economic progress and contribute to a sharp reversal of the trend toward jobs for all who were willing to work.

In his formal report prepared for delegates to the AFL–CIO convention, Mr. Meany dealt at greater length with the economic problems of the Nation. He called for a shorter workweek and a step-up in wage increases to meet the challenge of the Nation's economy. The greatest unsolved problem on the domestic scene, he said, was "jobs at good wages for all."

He added:

"Unless an immediate start is made toward a 35-hour week at no loss in earnings, plus penalty pay of double time to discourage overtime, there will simply not be enough jobs to go around no matter what other measures are undertaken."

Some who doubted this need 3 years ago, Mr. Meany said, take it far more seriously today. The administration, he observed, has directed the Federal Automation Commission to study the matter of hours.

The process, however, needs a greater sense of urgency, he said.

For some time, Mr. Meany said, there has been a dangerous trend toward an ever higher share of the national income going to profits and a shrinking proportion to wages and salaries. The trend has been partly hidden because wages and salaries have gone up he said, but too little attention has been paid to the "much faster rise" in profits.

Mr. Meany made it clear that the labor movement fully accepted the validity and necessity of business profit. Workers have little hope of achieving their economic objectives, he said, from an enterprise that is operating at a loss. But when a disproportionate share of the fruits of production goes to capital, he said, a less than adequate share goes to the consumers whose purchasing power supports the national economy.

"A purely dispassionate examination of the present distribution of the Nation's gross national product," he said, "could not avoid the conclusion that wages and salaries are too low. To be sure, lower prices and a shorter workweek are other possible instruments for correcting the balance, but a step-up in wage increases is clearly indicated."

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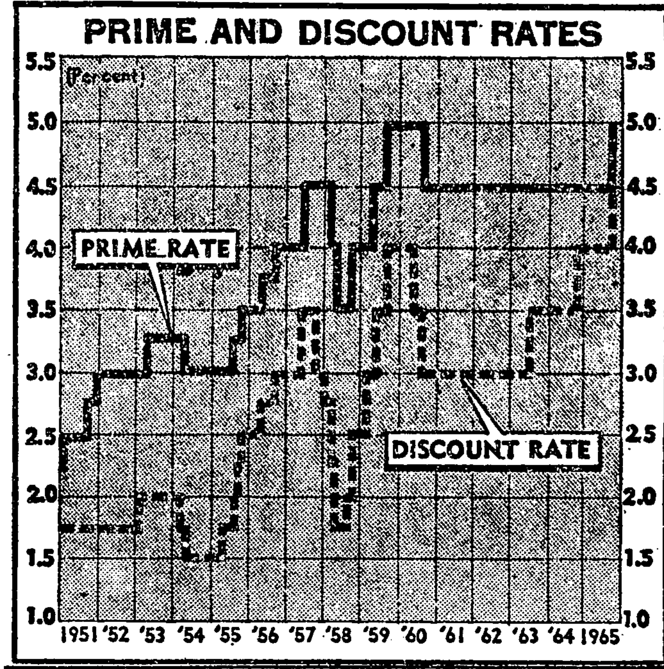
Another basic need, Mr. Meany said, is a continuation on a "far broader scale" of the concept of public investment in the United States. The Congress and the Nation have at last begun to distinguish between expenditure and investment, Mr. Meany said, even if the "die hard budget balancers and their allies in the editorial offices have not." Vastly more of this doubly profitable investment is essential in the years ahead, he said.



[From the Washington Evening Star, Dec. 7, 1965]

HOMEBUILDERS DISLIKE MONEY RATE INCREASE

(By Daniel Poole)

CHICAGO, ILL.—The Nation's homebuilders have expressed deep concern that the Federal Reserve Board's action in raising the discount rate it charges member banks will adversely affect the economy—and particularly the housing market.

Perry E. Willits, of Miami, president of the National Association of Home Builders, which is holding its 22d annual convention here, yesterday, described the action as shocking." And a leading economist called it "incredible."

"The members of the National Association of Home Builders are considering the consequences of the shocking action on the part of the Federal Reserve Board in increasing the rediscount and time deposit rates," Willits said. "We are deeply disturbed over the possible effect this action might have on the Nation's economy in general, and on homebuilding in particular."

NO COMPREHENSION

The economist, Sanford Goodkin, of Los Angeles, president of the National Real Estate Marketing and Research Organization, said the action, added to the recent rise in bank's savings account interest rates, is the worst possible news for the American consumer and the homebuilding industry.

"It bears no comprehension of the realities of today's and tomorrow's real estate and homebuilding economy, an economy which must be kept healthy if the American economy is to remain dynamic," he said.

Another economist, however, said that although the Federal Reserve Board's action is expected to increase the cost of borrowing money, it won't necessarily reduce the availability of mortgage funds.

Saul Klaman, of New York, director of research for the National Association of Mutual Savings Banks, said the action was aimed at the domestic rather than the international economic situation, and was designed to maintain stability and to dampen inflationary pressures.

"Interest rates had already moved up and this action follows rather than precedes the market action," Klaman said. "Short-term interest rates on building loans have risen, and the spread between short- and long-term loan rates has narrowed."

He added: "We can expect upward pressure on the mortgage market, and construction loans will have a higher price tag. Pressures are being passed all along. And the Federal National Mortgage Association may reduce the price on the mortgages it is buying, or it will be flooded with them."

SEES CLOSE BALANCE

Klaman said the Federal Reserve Board's action came at a time when there is a close balance between savings on deposit and demand for credit. It will reinforce the firmness that was already apparent in interest rates, he said.

Another convention speaker, Secretary of the Interior Stewart L. Udall, urged the homebuilders to create a total environment, such as in planned new towns, rather than just build shelter houses.

"Your severest critics have charged that the subdividers and homebuilders of this country have been the chief architects of urban sprawl," he said, "but what we do in the next 10 years may well be more important than what we have done in the past 30. You have the opportunity, in the next decade, to confound your critics and change the face of our cities and countrysides."

Udall added, "One exciting new approach to this challenge is a community now springing to life in the Washington area—Reston. In its concept of merging the place where one lives with the place one works, shops, goes to school, and spends leisure, Reston, and other new towns like it, may provide one answer to the urban sprawl dilemma."

He maintained that new towns can be created by groups of builders as well as single large developers, and that it can be done on smaller tracts than the 7,000 acres at Reston in Fairfax County and the 15,000 acres at Columbia in Howard County, Md.

[From the Washington Post, Dec. 7, 1965]

ECONOMIC IMPACT—OPEN WARFARE ERUPTS BETWEEN MARTIN, L.B.J.

(By Hobart Rowen)

The President and Federal Reserve Chairman William McC. Martin have probably come to the end of the road. Martin has defied Mr. Johnson by raising interest rates, and as he himself has said privately, "the Federal Reserve can't go one way while a national administration wants to go the other."

Chairman Martin played along with President Kennedy most of the time, and with President Johnson until now, although money policy was "less easy" than they would have set themselves. But Martin didn't frustrate them completely; the degree of cooperation surprised many.

But now it's open warfare, and those who know Mr. Johnson best don't expect him to do anything except fight back. Whether or not Martin in one way or another is forced off the Board—and that is possible—he may have outfoxed himself in terms of influencing policy.

First of all, if things go wrong and the Nation winds up in a recession, fingers will be pointed at him, not at the President. And secondly, by plunging ahead now instead of waiting until the January budget results are in, Martin has given the President the excuse to expand, rather than restrain, fiscal policy.

Mr. Johnson could say, in effect: "I had intended to limit Federal spending, but now the Federal Reserve has changed the mix. We have a trust to discharge.

We can't risk reducing profits and increasing unemployment. Martin gives me no choice but to try to offset his deflationary action. When Martin reverses his tight money policy, then I can get the budget pushed down somewhat."

What surprises Washington is that a smart operator like Martin took the action he did, without waiting to see whether the new budget would be truly inflationary. If it had been, he might have gotten nearly a unanimous vote for raising the discount rate.

"Martin would have looked good," says a Capitol Hill expert. "He would have gone 'down the last mile' with Johnson."

There is some reason to think, therefore, that Martin forced the issue now in the fear that the President in January would tip the majority of the Board against him by appointing a solid liberal to succeed retiring conservative member C. Canby Balderston.

For all of his anger now at Martin, the President may hesitate to force out the man who more than anyone else has been a symbol of fiscal integrity to the business community. An authentic liberal would probably line up with Govs. George W. Mitchell, Sherman J. Maisel, and James L. Robertson to provide a proadministration, four-man majority.

But Mr. Johnson can deflate the Chairman's power simply by appointing a middle-roader who would depart from Balderston's unvarying support of Martin. There would thus be two "swing men," the new man and Gov. J. Dewey Daane.

Either way, it may be that Chairman Martin has taken his last and most powerful blow in favor of his famous policy of "leaning against the wind."

He is a dedicated man, but this time he has pursued a highly questionable course—one which many economists think will lead inevitably to further increases in money rates and later to a decline in the economy.

Martin has been wrong before, notably in 1957, when the Federal Reserve fostered a tight money policy at a time that the record shows precisely the opposite tack should have been pursued.

Martin was also wrong last June to have suggested in his "disquieting similarities" speech that a new depression, comparable to the bust of 1929–30 was possible. When he raised that specter, he lost many friends, including the President of the United States.

Mr. Johnson fumed privately, and his Cabinet aids offered only restrained rebuttals. But it was the beginning of the end of the relationship, because Mr. Johnson considered it not only a gross blunder, but suspected Martin was well aware of the market impact it would have.

Now, Martin has laid down a policy challenge which conforms to the theory of his June speech. This can't be ignored, for the Federal Reserve, in Bob Roosa's and Allan Sproul's language, can only be "independent within, not independent from" the rest of the Government.

The policies of the Fed and any national administration must be coordinated. Any President is entitled to that security in making policy. And if the people don't like his policy, they can vote him out of office. But they don't have a chance to vote for or against the makers of policy at the Federal Reserve.

[From the Washington Post, Dec. 7, 1965]

THE FED JUMPS THE GUN

By raising the discount rate in advance of a scheduled meeting of the Government's policymaking "quadriad," the Federal Reserve Board has underscored the danger of investing power over monetary policy in an independent agency.

There are legitimate grounds for differences of opinion over the need for less stimulative policies, as Treasury Secretary Fowler pointed out in his New Orleans speech. But inflationary pressures can be combated by fiscal as well as monetary measures. What the Fed has done with its gun-jumping decision, taken in advance of a thorough analysis of next year's budget, is to deprive the administration of the freedom that it requires in order to conduct an effective economic policy.

If one could accept at face value the Board's claim that it will continue to supply the banking system with sufficient reserves to meet the needs of an expanding economy, the boost in the discount rate and the upward drift of interest rates in the money markets might not be so serious. But the day-to-day implementation of Fed policy is in the hands of the Federal Open Market Committee (FOMC), a

body that includes five presidents of the district Federal Reserve banks as well as the seven Governors of the Federal Reserve Board. Since the bank presidents are insulated from the authority of both Congress and the White House, the FOMC is free to pursue restrictive policies that may be sharply at variance with the aims of the administration.

President Johnson will be able to redress the balance on the Federal Reserve Board when the term of Vice Chairman Balderston expires in January, and a second opportunity will come in 2 years with the expiration of the partial term of Governor Daane. But these moves may not affect the unbridled power of the FOMC.

If Congress is to discharge its constitutional responsibility for controlling the money supply, if monetary policies are to be coordinated with the other economic policies of the Federal Government, the following reforms will be needed: The term of the Chairman of the Federal Reserve Board should be made coterminous with that of the President, a proposal that has been endorsed by Chairman Martin. The inordinately long, 14-year terms of the Governors should be reduced to 5. And, finally, responsiveness to the wishes of the electorate should be insured by limiting the membership of the FOMC to the seven appointed Governors of the Federal Reserve Board.

Congress would never entertain the notion of delegating its fiscal power to an independent agency, and by the same logic it should not surrender its control over the money supply. Power over monetary policy, for better or worse, should be invested with the incumbent administration. The Board's action, the end of which is not yet in sight, exposes the pitfalls of an anomalous system in which the President's ability to shape economic policy is sharply attenuated.

[From the Washington Post, Dec. 8, 1965]

Inside Report—Foxes in L.B.J.'s Henhouse

(By Rowland Evans and Robert Novak)

Soon after Lyndon B. Johnson succeeded to the Presidency, he received this private advice from one of his most influential advisers: "No domestic problem will be tougher than controlling Bill Martin."

The full impact of this prophecy fell last weekend like a sledgehammer.

The decision of the Federal Reserve Board, under Chairman William McChesney Martin, to boost interest rates, was President Johnson's worst political setback. Not only does further tightening of money threaten economic expansion, but the bold defiance of his wishes is a severe blow to the President's prestige.

This question then arises: Why could a President who tamed Congress, big labor, and big business not tame Martin?

The answer: The cherished independence of the Federal Reserve bank is all but unassailable. Moreover, Treasury Secretary Henry H. Fowler's yearlong strategy of appeasing Martin by avoiding an open rupture all these months was perhaps less successful than a frontal assault on the Fed.

The Federal Reserve Board—acting as a national bankers' bank—is a deviation in the otherwise symmetrical American system. Martin, a nonpolitician with rigidly orthodox economic views, need not heed the advice of the White House.

But Martin does have his own constituency: The Nation's commercial bankers—or, more specifically, the New York banking community. Martin has privately informed Administration officials of the increasing pressure on him to tighten credit. Its source: big bankers, obsessed with the bugaboo of inflation.

This banker mentality was aggressively articulated to Martin by Alfred Hayes, president of the Federal Reserve Bank of New York. Financial insiders regard Hayes—not Martin—as the gray eminence of the interest rate hike. And Hayes, an unabashed tight-money man, is concerned first with banking—not the overall economic results of higher interest rates, such as a possible rise in unemployment.

The Manhattan bankers' influence over the Fed is direct control over Washington's decision affecting their own pocketbook. In the opinion of one L.B.J. adviser, this means the foxes are guarding the henhouse.

Nevertheless, despite Martin's clear legal power, it may be argued that administration strategy in dealing with Martin only emboldened him.

From the time he took over at the Treasury last March, Fowler took the soft approach. Last spring he tacitly acquiesced in Martin's reduction of bank "free reserves"—money held in excess of money loaned out (thus tightening the money

supply). Treasury officials privately told Democratic Senators they had no intention of interfering with the Fed's regulation of the money supply.

As recently as his November 8 appearance at the Economic Club of New York City, Fowler defended—to ringing applause of the conservative-oriented audience—the Fed's independence and noted that he had been criticized by Democratic Senators for that stand.

All the while, Fowler privately urged Martin to postpone any decision on interest rates until the President's budget was released early next year. By that time, Mr. Johnson would be able to change the ideological complexion of the Reserve Board by filling a vacancy coming up January 1.

Martin apparently decided early last week to defy the President and Treasury. Although specifically asked to call the President before such action, he did not call. Rather, he was determined to raise interest rates before a scheduled meeting at the L.B.J. Ranch last Monday so that he would not have to say "No" to the President's personal appeal.

As a result, Martin informed Fowler last Friday morning at the White House that he had made up his mind. It was too late to stop him. The Federal Reserve Board voted the increase that afternoon.

Some critics of Martin hold that since there was no conceivable way for the President or Fowler to stop the Fed's action, they should have secretly agreed to the increase effective early next year, thus avoiding the political—though not the economic—defeat.

But that avoids the real issue. The Martin affair again raises the question whether this vital economic henhouse should be guarded by the banking foxes of New York—or by the public's elected officials.

[From the Washington Post, Dec. 12, 1965]

ECONOMIC IMPACT—FED INDEPENDENCE WORRIED J.F.K.

(By Hobart Rowen)

At the Democratic Convention in Los Angeles in 1960, one question that worried Candidate John F. Kennedy's advisers was: How can we handle Federal Reserve Chairman William McChesney Martin if he balks at the New Frontier program?

Inasmuch as the Eisenhower years had been dominated by Martin's tight money policy, the Kennedy men assumed that some drastic measures might be in order.

With the brashness of inexperience, some of the Kennedy "Mafia" suggested that Martin be fired, outright. But others in the brain trust evolved a more complicated and theoretically more practical plan for a "super coordinating committee," similar to the National Security Council, which would establish a uniform economic policy.

When publicized, the plan agitated the banking and business communities. But Mr. Kennedy abandoned this awkward scheme for the simple reason that Martin did not try to run a course independent of the White House. Like Mr. Kennedy's own economic advisers, Martin was concerned by heavy unemployment and idle plants.

And while he never fostered a money policy as easy as Representative Wright Patman would have desired he didn't return to the automatic tight-money posture of the Eisenhower days. So no club was needed, and Martin joined amiably with three other key Presidential advisers in what has become known as the "quadriad."

All of this is relevant because the divided course that Mr. Kennedy's advisers feared in 1960 has finally come to pass—5 years later—under President Johnson. The President, although mindful of economic factors that hold an inflationary potential, doesn't think the time has come to put on the brakes.

Martin, on the other hand, convinced by the opposite analysis, has moved to tighten money, so as to head off inflationary prices "before they have become full blown and the damage has been done."

The upshot is that a coordinated monetary and fiscal policy, so successful since 1961, is shattered—for the moment, anyway.

No one yet knows what really will happen, because much will depend on just how much credit the Federal Reserve feeds into the banking system.

The Fed can tighten up the supply of money by selling securities on the open market. That drains money from the banks—money they otherwise could lend.

The Fed, on the other hand, can increase the money supply by buying securities, thus pumping cash into the banks.

When the Fed raised the discount rate last weekend, it underscored this part of its announcement: "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 pressures * * *."

This has been confusing to some people. If the Fed's game is to slow down the economy, why does it raise interest rates on the one hand, but insist that it will provide additional reserves? It seems, at first blush, to be a meaningless exercise in which the amount of money remains the same—but at higher cost to everyone, to the pleasure of no one but the banks.

The rationale of the majority at the Fed is that the higher rate will choke off some marginal plans for business expansion. But in view of the escalating Vietnam war, the relatively small increase in the cost of borrowing isn't likely to deter many businessmen.

A spot check of economists in Washington doesn't suggest that the new forecast for skyrocketing plant and equipment spending next year will be seriously affected by higher interest rates.

One possible explanation for the seeming paradox is that bank reserves will not in reality be as ample as the Fed has promised. The level of additional credit needed for "an expanding economy" will probably be less by Martin's definition than it would be by the administration's definition.

This is the problem that the President will have to consider as he resumes the 5-year-old search for ways to box Martin in. I suggest his best route is through a gradual realinement of the Federal Reserve structure.

He might, for example, recall the 1961 recommendation of the highly respected Commission on Money and Credit, which suggested cutting the number of FRB Governors from seven to five, and limiting the term of each from 14 to 10 years, with one expiring every odd-numbered year. This would give a President a steady stream of his own appointments to the Board.

The 2-year gap which now exists between the beginning of a presidential term and the 4-year term of the FRB Chairman should also be eliminated. (Martin himself agrees that it was only a legislative accident that failed to synchronize these terms.) Whatever the mechanics, ways must be found to coordinate the role of the central bank with the rest of the Government. Any other course makes no sense.

[From the New York Times, Dec. 13, 1965]

WHAT ROLE FOR THE FEDERAL RESERVE?

(By M. J. Rossant)

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.

Money, of course, cannot manage itself; so the critical question is who should do the managing. At the moment the independent Federal Reserve has both critics and defenders. There are some who disagree with what the money managers did but, like Voltaire, defend its right to have done it. There are others who think it did the right thing but deplore its acting unilaterally.

ROLE OF THE MANAGERS

The champions of independence for the Federal Reserve argue that this is the only way to insure sound policy. Encouraged by its decision to part company at long last with the Johnson administration, they point out that continued coordination would clearly have been unsound. In this view, the money managers must be like judges, isolated from politicians and political pressures in carrying out their responsibilities.

The Federal Reserve is a creation of Congress, but it has the right to act independently of both the legislative and executive branches. Yet its control over the Nation's money supply—its ability to create or extinguish credit—is so powerful an economic weapon that it may well be too important to be left to the money managers.

This was not the case in the days when the Federal Reserve was first established. Then it was responsible only for price stabilization. Then too the executive branch took the view that it had no business interfering with the vagaries of the business cycle.

Today, the Federal Reserve is committed to promote full employment and economic expansion in addition to price stability. What is more, the White House has responsibility, as well as formidable weapons of its own, for maintaining prosperity. So there is a strong case for integrating the flexible restraint of monetary policy with the blunter weapons of fiscal policy.

Some critics in fact call for complete coordination. They do not think that the Federal Reserve should be considered as a supreme court of economic policy, with what amounts to a veto power over the party in power. Instead, they argue that the President, who is charged with formulating overall economic policy and is answerable to the electorate, must not be thwarted by a small group of men shielded from the public.

During his long reign as head of the Federal Reserve, William McChesney Martin, Jr., has generally been prepared to compromise, aware that the adoption of too independent a position might endanger his freedom of action. He has often sounded as if he were at odds with the President, but his bark has been far worse than his bite. In failing to act as independently as he talked, Mr. Martin has guaranteed his own survival—and that of the Federl Reserve. And precisely because he has been accommodating, it is probable that his present falling out of step, while dramatic, may be only temporary.

THE BANK'S POWER

Even if it is, and even if it was the right thing to do, the Federal Reserve has demonstrated that it has the means to throw a monkey wrench into the plans of the White House. Many who are not on the Johnson administration's side question whether such freedom is desirable in a democracy.

The most potent argument against giving increased authority to the executive branch is that it would encourage inflation as it did after World War II, when the money managers increased the money supply at the behest of the Treasury.

But the Federal Reserve then was under no compulsion to do so. It could have refused to cooperate, as it finally did. Indeed, there seems to be a far greater risk of swinging from defiance to subservience under its present status than if the Federal Reserve had a closer relationship with the White House—by permitting the President to choose his own Chairman and by setting up an economic general staff with a place for the Federal Reserve.

POLITICAL CONTROL

With such an arrangement, the money managers might be less inclined to disruptive talk and more to effective action. If they were a recognized part of an economic general staff, they might be more successful in making the presence felt in the inner circle of policymaking.

Some authorities believe that political control might result in greater freedom for the Federal Reserve as well as smoother coordination of economic policies. But if it did not, if limiting its independence resulted in mere subservience on the part of the Federal Reserve and unsound policies for the economy, the Nation's voters would at least be able to fix the blame.

[From the Wall Street Journal, Dec. 13, 1965]

PROSPECT OF AVOIDING INFLATION IS GOOD

(By Gardner Ackley)

It is with pleasure that I respond to the Journal's invitation to address its readers on the prospects of inflation. The steadily strengthening prosperity of recent years, the excellent prospects for further expansion of civilian markets, and the enlarging military procurement associated with Vietnam all make clear

that the ability of our economy to sustain cost-price stability is in for a test. I think we will pass that test.

Right off, let me make one central point clear: This administration keenly appreciates the key importance of price stability. The policy dilemma of the 1950's—when inflation led policy makers to pull the economy up short before its growth and employment targets could be reached—is fresh in our minds. We know that restoration of equilibrium in our balance of payments requires strong trade surplus—which can only be based on preserving or enhancing the price competitiveness of American products in the world. And we know that the American people have no tests for inflation.

Inflation talk is more prevalent in the business and banking communities today than in some time. Yet we cannot afford to jump to conclusions: Predictions of inflation must be based on facts and analysis, not intuition. Intuitions of inflation around every next corner have been with us throughout the past 4 years, and have proved again and again to be false guides in this period of unprecedented price stability.

And not all "indicators" of inflation are truly indicative. For example, in the months of June through November, the Wall Street Journal carried 171 separate stories reporting announcements of price increases by various companies. There were only 51 stories announcing decreases and only 7 reporting that price increases previously announced did not stick. No wonder that we are inflation conscious. But between June and October, average industrial prices rose only 0.3 percent, a rate of less than 1 percent a year.

THE BACKGROUND ON INFLATION

In the first 4 years of this expansion, this country enjoyed virtually perfect price stability at the wholesale level and only a modest creep (1.2 percent a year) at the consumer level. Our record was and remains unmatched in the world. In our whole history since the 1740's, there has been no similar period of wholesale price stability. A year ago, the first blemishes began to appear on that record. Nonferrous metals prices—including copper, aluminum, lead and zinc—all rose substantially. Prices continued to move up in some industries and down in others, but the decreases no longer quite offset the increases. In October of this year the average of industrial prices was up 1.3 percent over a year earlier.

Fortunately, the rise of industrial prices slowed down after June. In the strategic durables industries, there has been little price change in the past 4 months except for continued increases in some metal products and machinery, and declines at retail for autos and appliances, largely associated with the excise tax cuts.

The largest blemish on this year's price record, however, was the rise in farm and food prices, including a 4-percent rise in consumer food prices between February and July of this year. Although a quarter of this increase has since been erased, and even though foods have risen no more than other consumer prices over a longer period, any sudden rise in food prices touches every household and is quite naturally a source of concern.

Still, the most recent record of prices is reassuring. Between June and October, both the Wholesale and the Consumer Price Indexes are up only 0.3 percent.

There is no mystery about the sources of our excellent price performance during this expansion. First, labor productivity increased solidly, at a rate above the postwar average. Labor compensation per man-hour advanced at close to the same rate, producing general stability of labor costs per unit of output. In manufacturing, unit labor costs in October 1965 were lower than a year earlier, lower than 5 years ago, and exactly the same as 8 years ago. With several reductions in Federal business taxes, the Federal tax cost per unit of output fell. Material costs were also roughly stable, with some pluses and minuses. As operating rates moved from depressed toward preferred levels, capital costs per unit of output generally declined. As a result, profit per unit of output increased, even with essentially stable prices.

BASIS FOR JUDGMENT

A coolheaded judgment of the prospects for price stability must be based on analysis of the factors responsible for our good record up to now: What is happening and what will happen to productivity, to wages, to other costs, to business profit margins at current price levels, and to the overall balance between supply and demand?

Let's look first at the cost side. The good productivity trend of recent years is continuing. The year-over-year productivity gain of 1965 will be smaller than in 1964. But it will not show the substantial retardation typical of later stages of previous booms. We expect that the average productivity gain for 1966 will exceed that for 1965. Industry is continuing to invest heavily in modernization and expansion of capacity; the rate of technological advance is surely undiminished; it is clear that industry generally is not now operating beyond most efficient levels, and we expect few significant bottlenecks of capacity in the year ahead. In the past, productivity gains have slowed down mainly when production has slowed down. There is little prospect of that development at this time.

The rate of wage increase this year is also little changed from the record of previous years. Straight-time average hourly earnings in manufacturing are up less than 3 percent from a year ago. A recent survey of major new wage contracts by the Bureau of Labor Statistics shows that in the first 9 months of this year the average negotiated annual wage increase was 3.3 percent. We are now at the end of a wage round in major industries, a round which began high in auto and was virtually complete with the guideposts steel settlement. For most of organized industry, the pattern of wages for 1966 has already been determined. Some grades of labor in some areas will become somewhat shorter in supply over the coming year; but there should be no general speedup in the average rate of wage increase.

Putting together the prospects for productivity and wages, one cannot forecast with certainty that unit labor costs in manufacturing will again remain absolutely stable in 1966. Higher payroll taxes next January will have some effect. But there is now no evidence to suggest that unit labor costs will move substantially upward.

Materials costs have been the main source of price disturbances in the past 12 months, concentrated in farm products and nonferrous metals. The present agricultural outlook suggests that price increases of the scale experienced this year are not likely to be repeated next year, although there is no assurance that farm prices will remain absolutely stable.

Demand for nonferrous metals will rise substantially further next year, both because of rising civilian demands and the stepped-up military needs for the war in Vietnam. But the Government has large stockpiles at its disposal to meet this situation. Stockpile releases consistent with our national needs will promote balance between supply and demand in these markets, and thereby also aid price stability.

All in all, the prospects for costs are still good. This means that profit margins will continue to be generous at current prices. There is no reason, then, for general upward pressure on prices to restore or even to maintain adequate margins of profit.

Turn now from costs to demand. Will a general excess of demand pull prices up even if costs are stable and profit margins adequate?

First, it is clear that demand is not now overtaxing our productive capacity. McGraw-Hill reported that in September the average operating rate in manufacturing still remained at least four points below the preferred rate. In most lines, production is fully keeping pace with the inflow of new orders. The absolute volume of unfilled orders has increased, of course, along with a rising volume of activity. But the volume of unfilled orders is now equivalent to about 2.7 months' production, up just 0.2 month from the levels of 1961 to 1964, despite somewhat larger buildups in machine tools, color television tubes, and a few other items. This contrasts sharply with the buildup of order backlogs during past periods of inflation. For example, in 1956 the volume of unfilled orders reached almost 4 months of shipments.

But what about next year? In the first place, it is necessary to recall that our productive capabilities are expanding rapidly. Potential gross national product in constant prices should rise next year by around 4 percent, and some gap still remains between actual and potential gross national product. Manufacturing capacity is rising about 5.5 percent this year, and the strong rise in business investment we now seem likely to get will raise capacity even more rapidly next year. We could well have a 7-percent increase in manufacturing capacity in 1966. Meanwhile, the growth of our labor force will continue to be rapid, and one can expect strong demand for labor to pull some workers not now in the labor force into the job market. Increases in our military forces will primarily affect the least experienced segment of our labor supply, in the age groups with the highest unemployment rates.

Nevertheless, it is possible for strongly rising demand to overtax the capabilities even of an economy growing as fast as ours. Avoiding such an excessive increase in overall demand is the primary task of fiscal and monetary policies. Monetary policy has already been moved in the direction of demand restraint. So far as fiscal policy is concerned, the administration accepts its responsibility to help keep overall demand within our economy's productive potential. It takes this responsibility just as seriously as it has taken its responsibility to expand demand toward our productive potential in the years 1961–65. The fiscal 1967 budget to be transmitted next January is still under preparation. It is clear that defense requirements will be higher. But decisions both on defense and nondefense components of the budget are still under intensive review. The President has repeatedly made clear that every program, old or new, will be subjected to the most rigorous examination, and that only expenditures of the highest priority will find a place in his budget.

Moreover, it is appropriate to bear in mind that the built-in growth of revenues under our existing tax structure takes a sizable bite—at least $8 billion a year—out of rising incomes, if the gross national product expands only in line with the growth of our potential. If in addition we reduce remaining margins of unused capacity and unemployed labor over the coming year, the built-in revenue increment will be even larger. Still further, the payroll tax increase of January 1 will add almost $6 billion in cash revenues at an annual rate, which will far outweigh scheduled reductions in excise taxes.

The budget and the associated economic programs of the administration must, as always, be shaped in the light of prospective developments in the private economy. The most recent evidence—including the new Commerce-SEC survey of plant and equipment spending—all confirms that private demand will continue its solid rise. Fiscal policy decisions will be reached in the light of the best possible forecasts and projections of private activity.

On many occasions in the past several years, we have been urged to buy insurance against inflation by slowing down the expansion of overall demand. Had we taken this advice we would have sacrificed the unprecedented gains in consumer living standards, the amazing expansion in jobs, the remarkable upsurge in profits, and the fine productivity record which has brought such great rewards to the entire Nation. Fiscal and monetary policy today must proceed with even more care than in the past. But we do not need to throw the economy into reverse.

Conditions can change. Things can go wrong unexpectedly—as they often have. We should be aware of the major uncertainties clouding the price outlook. Many of these uncertainties have been present throughout these years of price stability. They call for caution and watchfulness, but they cannot be treated as facts requiring action today.

1. Aggregate demand could rise faster than the best forecast we can make in January.

2. There are, as always, substantial risks hanging over the supply of some essential imported materials.

3. Labor shortages, which so far have been limited to a few skills and localities, could become more widely felt and more difficult for employers to resolve than now appears likely. The demonstrated mobility of American labor, and the flexibility of American industry to recruit and train, and to alter production methods to utilize less skilled and less experienced workers, make this development unlikely, though it cannot be ruled out.

4. There is always the possibility of a serious strike in some key sector.

5. Even without clear reason, an inflationary psychology could take hold, although the administration's demonstrated commitment to price stability should be reassuring.

These are all risks. They should be and are being scrutinized constantly.

As a participant in the observer of Government policy for 25 years, I am convinced that no administration since World War II has been more firmly determined than this one to preserve price-cost stability in a prosperous economy. It has demonstrated through firm and not always popular action that it will exert national leadership to preserve price-cost stability. Just in the past 4 months we have seen the President help achieve a peaceful steel settlement; but unlike some instances in the past, the goal was not merely industrial peace but also a responsible settlement consistent with the national interest. The President was equally firm in insisting that the pay increase enacted for the Federal Government's own civilian employees should not exceed the wage guideposts. Releases of aluminum and copper from the stockpile show that this important national resource can help maintain supply-demand balance in critical areas.

A COMMITMENT OF POLICY

Public policy is clearly committed to the cause of price-cost stability. But private policies must also do their part. Our view of the proper relationship of private and public policies is expressed in the guideposts for noninflationary wage and price behavior set forth in our annual reports since 1962. Given an overall environment in which aggregate demand and supply grow together in high-level balance, general price stability can be maintained if the average advance in labor compensation does not exceed the average advance in productivity—thus keeping unit labor costs stable on the average—and if producers with pricing discretion do not attempt to widen already adequate profit margins by raising prices or by failing to pass along to buyers cost reductions from exceptional productivity advances.

In a buoyant economy, the opportunities and the temptations for irresponsible action by either labor or management become more frequent. But we have also learned that the rewards of responsibility are handsome indeed.

I believe that labor, management, and the public have been learning that our economy can advance along a smooth path of matched growth of supply and demand, of steady productivity advance, and of good real wage gains based on moderate money wage settlements. This improved understanding is reinforced by important economic forces also at work on the side of stability. International competition is more keen today in many industries than ever before, and the steady expansion of capacity strengthens the force of domestic competition. Technological change, improved manpower policies, and increased concern with job security are having a substantial effect on wage trends.

As in any good partnership, we need to remind each other now and then of our respective responsibilities. The administration will not hesitate to remind both labor and management what is expected. And I know we can count on this editorial page to help keep us aware of our part in the enterprise.

If we all do our part, the prospect for avoiding inflation is excellent.

[From the New York Times, Dec. 14, 1965]

INTEREST RATE DEBATE

Secretary of the Treasury Henry H. Fowler has opened up an old debate with his observation that the Federal Reserve's increase in interest rates would probably not be effective in stemming the outflow of dollars abroad. There is a school of thought that holds that the only solution to the dollar drain is high interest rates, but Mr. Fowler pointed out that investors were not deterred by the Federal Reserve's two previous rises in short-term rates. He went on to suggest that the latest increase might be self-defeating because Western Europe will simply adjust its own rates upward.

Mr. Fowler is right in saying that interest rates alone will not eradicate the deficit in the Nation's balance of payments. The only way that they might conceivably do so would be by raising them to very high levels, which would almost certainly cripple the domestic economy. Clearly the Federal Reserve has no intention of going to such extremes; it too recognizes that there is no "natural way" to close the interest-rate gap. The United States, with its highly developed capital markets and its reliance on fiscal as well as credit policies, is inclined toward low interest rates, while Europe, with its segregated markets and its experience with frequent bouts of inflation, favors high rates.

But while the interest rate rise in the United States cannot do it all, it can do something. The latest moderate rise is a sign to skeptical Europeans who hold dollars that can easily be exchanged for gold that the United States is determined to defend the dollar. And it is proof to American corporations that have been asked to show restraint in making dollar investments abroad that they have the support of the Nation's money managers.

These beneficial effects are not being helped by Mr. Fowler's comments. Obviously he does not like what the Federal Reserve has done or the manner in which it did it. But now that higher rates are here, he is not aiding his own cause by calling it ineffective. Higher rates may not bring a marked improvement in the balance of payments, but they are certainly more effective in protecting the dollar than the level of rates that prevailed before the Federal Reserve acted.

[From the Washington Daily News, Dec. 15, 1965]

LETTERS TO THE EDITOR—BRAKE (NOT BREAK) FOR THE ECONOMY

The Washington Daily News approves the recent bank-rate increase. I deplore it. May I say why?

The raise in the interest (borrowing) rate will cause, after the dust settles, a fall off in business and greater unemployment.

The increased bank rate will halt the integration of Negroes into the prosperous white community, will reduce the impact of the Great Society programs, and will reverse the trend toward a society in which more and more of the people share in the general prosperity. Also, the higher rates of interest will put pressure on business and labor (through increased mortgage costs) so that the chances of greater industrial unrest will be increased.

Once upon a time the needs of society were placed above the greeds of big bankers when, under F.D.R., the interest rate stood at only 2½ percent for 12 years. In order to build a truly democratic society today we need a lower—not a higher—interest rate.

In time of war we all agree that what is physically possible must be made financially possible. At this time when we are all supposed to be fighting a war on poverty, I deplore the imposition of a higher bank rate and ask the Congress to place the power over the bank rate where the responsibility lies. The President is responsible for the overall performance of the economy. He should have a Federal Reserve Board responsive to his economic outlook.

The people elected the President of the United States. They had no influence over the selection of the president of the American Bankers Association, yet he and his puppets on the Federal Reserve Board can defy the President and veto the Great Society.

LOUIS K. MATHER,
Teamsters Union.

[The New Republic, Dec. 18, 1965]

T.R.B. FROM WASHINGTON

INTOLERABLE?

We think it is pretty silly to have an independent FRB. The powerful Bank of England is not independent. No other central bank is. Our system would be thought intolerable in any other country. The Constitution gives Congress control over money, but in 1913 it delegated it to the FRB. The theory is that this takes it out of politics and that the FRB is a kind of Supreme Court. The analogy, however, is false. The Supreme Court has the Constitution to interpret and guidelines of ancient precedents. Managing money is quite different. It involves social-value judgments between lenders and borrowers. Furthermore it is only one oar of the boat; the Government holds the other, in its power to spend or retrench. How can the boat maneuver if one oar thrashes one way; the other, the other way? There is a whole literature of academic protest against the system. Even Chicago University Economist Milton Friedman, Goldwater's adviser, attacked FRB independence in testimony here in March 1964. "Such dispersal of authority is likely to do more harm than good," he said, "as in the past." Nevertheless the public isn't convinced. Martin is as much a totem as J. Edgar Hoover.

We don't dislike Chairman Martin. He just had a thing on inflation. He's affable and has humor. He doesn't see the 30 percent of Negro youths unemployed, however; he just sees a stable dollar. The issue here, we guess, is perspective. The country often has to make a harsh choice: Would you rather have stable prices, and unemployment, or rising jobs and a little inflation? Martin, we guess, would nearly always pick the first; L.B.J., the second.

Having said this, let us add that we believe there is danger of inflation. Quiet estimates are going out that Vietnam is becoming a $15 to $20 billion a year war, requiring 400,000 men. You will hear more of this soon. The FRB's vote, 4 to 3, boosting the cost of money, seemed to us precipitate, but we do not expect any brute strength showdown with Mr. Johnson. The congressional autopsy by Representative Wright Patman could make Martin a martyr.

Leon Keyserling, who has been right as often as any economist we know in Washington, deplores the FRB's action, but doesn't think it will bring immediate grief. His anxiety goes deeper. It is real anguish. He thinks the Kennedy-Johnson regime has poured tax benefits on corporations and the rich, who are translating it into glittering new plants and factories. This is material "growth" all right, but who will buy the products of these plants a year or two hence if wages aren't raised, and who will prevent more revolts like Watts, if unemployment among Negroes isn't down.

Anyway, to finish it off, the signs we see point to more growth, more strain, higher prices and—if demure politician Johnson wants it—a chance to blame the FRB for interfering.

RAISING THE COST OF MONEY

From now on, relations between Lyndon Johnson and William McChesney Martin, Chairman of the Federal Reserve Board, seem likely to resemble those between President Jackson and Nicholas Biddle at the time of the controversy over the Bank of the United States. On December 2 the President said, "We expect next year to be another record year for the American economy. We are ever alert to danger signs, of course, and when we see them we will act accordingly. But we do not anticipate any major problems that confidence and cooperation cannot solve." Three days later, the Federal Reserve Board raised its discount rate—the basic rate for money that underlies the country's credit structure—from 4 to 4½ percent.

Economic expansion without inflation has been maintained for a record 58 months, but its course has been accompanied by changes and there will be more if the Vietnam war intensifies. Unemployment is still serious among untrained teenagers and the most unskilled adults, most of them Negroes, but the market for skilled and semiskilled workers is tight: the jobless rate of the most stable element, married men with families, is down to about 2 percent. Government action has held down prices of aluminum, steel, and wheat, but all items except food in the latest Consumer Price Index showed a slight rise. Investment next year is estimated to run about $57 billion ($44.9 billion in 1964, $51.8 billion this year), and hourly wage rates in construction are pushing up costs.

The FRB claimed it was "backing up the Government's efforts to prevent inflationary excesses from damaging an economy now carrying the added burden of military operations in Vietnam," but the President regretted that the FRB had acted "before January, when we will have before us the full facts of next year's budget"; he would have preferred budget restraint to boosting the cost of credit.

Conservative circles, however, say amen to the FRB move, for they believe that higher interest rates will dampen industrial borrowing for plant expansion and modernization. In 1962, to induce more investment, business got a 7-percent tax credit and many companies reduced their withheld earnings and now must seek funds outside. That's where the new rates will be effective. Most of the country's big banks raised their rates within 24 hours of the FRB announcement.

The finance companies who lend to consumers will have to pay more for their money and will therefore exercise more caution. Consumer credit outstanding tops $81.5 billion, $64.4 billion being installment credit.

But if some potential borrowers are given pause by the new rates, others will cover their outlay by raising their prices. Also, it will cost State and local governments more for schools, highway programs, and urban renewal; and it will take more of the national budget to service the national debt. Over time, the new rates will work their way into the mortgage market, depressing it, though housing is by no means booming now.

The President if he wishes to make the FRB a whipping boy can put on it the onus of an unbalanced budget, should he offer one. If evidence of an economic pause appears, he can recall the FRB's tightening of credit in August 1957, that began the decline of 1957–58.

He can welcome (he did not have to seek) the vociferous reaction on the Hill of his fellow Texan and easy money advocate, Representative Wright Patman, who is chairman of the House Banking Committee and this year's chairman of the Joint Congressional Committee on the Economic Report. (The Republicans on the joint committee recently asked for hearings on prices; the Democrats may now oblige with hearings on the price of credit.) In the Senate, Russell

Long, the Democratic Whip and successor to Harry Flood Byrd as chairman of the Senate Finance Committee, is a populist-minded stalwart and Proxmire and Douglas denounced the FRB within hours of its action.

A more delicate move which the President both can and must make concerns an upcoming appointment to the Federal Reserve Board's 7-man membership. The nonrenewable term of Canby Balderston of Philadelphia expires in January. Balderston was one of the members who voted for last week's 4 to 3 decision. In recent months, Dewey Daane, an associate of Secretary Dillon at the Treasury until his appointment to the board, has frequently been the swing man in close decisions. If the President appoints an easy money advocate, he could be sure of an FRB policy alined comfortably with the administration views. Yet this assurance would carry a price. Quite possibly, Chairman Martin might resign rather than continue in a minority position. Even if he didn't, the appointment could alienate the banking and business community.

Sweetness and light seemed to be exuded at the December 6 meeting, with the President at the ranch, of Chairman Martin, Secretary of the Treasury Fowler, CEA Chairman Ackley, and Budget Director Schultze. Yet, not since the quarrel under President Truman, when the FRB's determination to remove its postwar peg of Government bond prices was terminated in the famous Fed-Treasury accord, has there been so sharp a confrontation. It is interesting that this agreement was negotiated on behalf of the Treasury by its then Assistant Secretary, William McChesney Martin.

[From the New York Times, Dec. 22, 1965]

Central Bankers Differ in Powers

DEGREE OF AUTONOMY VARIED AMONG EUROPEAN OFFICIALS

(By Richard E. Mooney)

Paris, December 21.—Ten years ago, Sweden's central bank raised its discount rate without notifying its Socialist Government in advance.

A mighty storm broke around the head of Per Asbrink, the bank's newly appointed president, then just 42 years old. He survived. He is still there, and has been in office longer than the head of any other major central bank except William McChesney Martin, the Chairman of the Federal Reserve Board.

The much discussed "independence" of Mr. Martin and the Federal Reserve System is thus not unique. On the contrary, in Germany—to cite the strongest example—the deutsche Bundesbank is virtually the master of national economic policy. Karl Blessing, 65-year-old head of the bank, exercises a policy influence that makes Mr. Martin look weak.

SPECTRUM OF AUTHORITY

There is, in other words, a spectrum of central bank authority in Europe, and not a general rule. Among the major powers, the German, Swiss, and Dutch central banks are strongest. The Banque de France ranks at the weak end. The Bank of Italy and the Bank of England are somewhere in between.

But strong or weak, when they talk about Mr. Martin's apparent defiance of President Johnson's wishes, even the strong ones admit surprise. At monetary meetings here last week, U.S. officials explained that the split was more apparent than real—in short, that the whole sequence of events was arranged mutually.

To judge by the reactions of a few, the Europeans remain puzzled that a central bank's policy would be openly contrary to that of the ultimate political authorities.

Banks and bankers and central bankers are traditionally more powerful in Europe than in the United States.

One reason is that they always have been. Another, in the case of continental banks, is that they double as commercial banks and investment banks. They straddle the sources of finance for industry, not to mention the common man.

Political conditions are also relevant. In Switzerland, the powers of the regional cantons are preserved so religiously that the Federal Government is relatively impotent, and national economic authority falls to the Swiss National Bank or to no one. Switzerland also preserves the sanctity of banking like no other country, but this can weaken the central bank as much as strengthen it.

Curiously, conservative Switzerland has the lowest discount rate in all the world—2½ percent. It is frankly a political rate, kept low to keep mortgage rates low. The discount rate is thus rarely used for monetary policy—and there is, incidentally, some support for this approach in international financial circles.

STATUS IN ITALY

The Bank of Italy, also a minimum exerciser of its discount rate, has been particularly strong in recent years because the Government of Italy—a center-left coalition—has been particularly weak. It is commonly agreed on both sides of the ocean that if a government's budget is too far out of balance, it must be compensated by tighter reins on credit.

The Bank of Italy tightened up so much on Italy's inflationary boom 2 years ago that the country was knocked into a recession from which it has not yet recovered. Germany's Bundesbank has been tightening up for more than a year while the government, preparing for last September's national election, cut taxes.

The position of the Earl of Cromer, head of the Bank of England, is probably most comparable to Mr. Martin's, though the British make no fetish of the word "independence." The Bank of England is, as Mr. Martin has often said of the Federal Reserve, "not independent of the Government, but independent within the Government."

Coincidentally, there are the beginnings of talk in London now about replacing Lord Cromer when his term expires next June. Like Mr. Martin, he is a holdover from a Conservative administration. Like Mr. Martin, he has gotten along rather well with the successor administration, though both administrations and both men have chafed at it.

And like Mr. Martin, he is greatly admired in financial circles abroad as the one dependable protector of his country's currency, which makes it more difficult to attack him.

NEWSDAY SPECIALS—"STATE OF AFFAIRS"—DECEMBER 21, 1965

(By Clayton Fritchey)

When Congress reconvenes nothing startling is likely to come of the Joint Economic Committee's inquiry into the Federal Reserve Board's defiance of the President, but it is a fascinating situation to all the foreign observers in the Capital. For it couldn't happen in any other country.

They know the Secretary of the Treasury cannot veto President Johnson; nor can the Director of the Budget; nor the Chairman of the Council of Economic Advisers. But the fourth member of the economic-monetary "quadriad," the Chairman of the Federal Reserve Board, can with impunity reject the considered policy of the President and the entire administration, and signal a raise in interest rate for money.

This has happened before, but seldom so crudely. Foreign officials, who are also affected by the FRB's actions, simply cannot understand how any board with such enormous powers over the Nation's money supply, can be independent of the people, the President, and of Congress itself, although the Board is a creature of Congress.

Congress is notoriously jealous of its powers. It doesn't hesitate to ride herd on the President, it joyously badgers the Cabinet, and it constantly interferes with the regulatory agencies. Recently, it has even been trying to hobble the Supreme Court.

It makes just these exceptions: the FBI, the CIA, and FRB. For years Congress has been infatuated with all three. They can do no wrong. Money and power and independence are heaped on them, and no questions asked. They are like governments in their own right. How so?

The FBI vividly identified itself with cracking down on kidnapers and Communists, the CIA achieved indispensability by its spookish, adventurous role in the cold war. And the FRB was established at a time (1913) when most Amer-

icans were taught to believe that money was much too important to be entrusted to politicians.

But time is running out for the FRB. It may escape this time, but the feeling is steadily growing that the Government must be in a position to manage the whole economy in what it considers to be the national interest, regardless of the views of the FRB members, who are beholden to nobody.

When the FRB was created the financial capital was not Washington but Wall Street. Nobody, including the President, had the impertinence to suggest that Government had either the right or competence to meddle with money or manage the economy. Decide on war or peace, yes, but no interference with really important matters like money. Since the great depression there has been, even in the business community, an increasing acceptance of the Government's responsibility to promote and guide the economy. But it is still unresolved as to who is going to have the last say. The President or the FRB? A showdown has been put off for years; maybe the time has come to settle the question.

It is enlightening to note that in the past, even as now, the struggle between the Board and the Government has always been roughly the same: the Board favoring "tight" money, the Government "easy" money. The Board has consistently been accused of fearing inflation more than deflation and unemployment.

From the New Deal to the Great Society, the Government has opted for gradual, progressive inflation. The orthodox banking community may sincerely feel this is a misguided policy, but it has produced undreamed of affluence. The people, foolishly or not, like it—and, after all, it's their country. Or at least that's what they have been told.

Now, the issue is beginning to assume political significance. George Meany, president of the AFL–CIO, says, "A Federal Reserve Board on which there is no representative from labor is bound to consider unemployment as a mere statistic."

Strong words, but no stronger than those of Congressman Wright Patman, the powerful chairman of the Congressional Joint Economic Committee, who says, "Once again we are seeing the folly of allowing a handful of banker-dominated members of the FRB dictate the economic future of the country."

The Republican spokesman, Congressman Thomas Curtis, of Missouri, snapped back, "We should all thank our lucky stars we have an agency that is independent of political pressure from any partisan administration."

When Congress convenes next month, we will see if either party presently wants to fight this issue to a finish. A good guess is, "No."

Perhaps a still better guess is that the present 4-to-3 Board majority against the Government will be changed by new appointments, and that, in any case, the Board will ultimately face up to reality and voluntarily modify its legal right to absolute independence.

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(The following material is made part of the record at the request of Representative Curtis:)

[From the office of Congressman Thomas B. Curtis, Dec. 15, 1965]

CURTIS' QUESTIONS TO THE ABSENT JOHNSON ADMINISTRATION WITNESSES

Released today is a list of questions which Congressman Thomas B. Curtis, senior House Republican on the Joint Economic Committee, would have posed to the members of the Johnson administration had they not failed to appear before the committee studying the increase in Federal Reserve rates.

The St. Louis County Republican stated he felt individual American consumers, housewives, farmers, workers, stockholders, retirees, and others were entitled to know the Johnson administration position and he was going to try to find this out if their spokesmen would appear before the Congress.

For the third day Johnson administration officials have failed to attend the Joint Economic Committee hearings. In view of this, Congressman Curtis released some questions which he felt would illustrate that the policies of the Federal Reserve and the Republican members of the JEC were designed to fight inflation and protect the purchasing power of the dollar. Correspondingly, these questions would also bring to light the fact that the Johnson administration's loose fiscal policies and huge budgetary deficits were leading to a weakening of the value of the dollar and so cutting its purchasing power.

Some of the Curtis questions for the absent administration officials are listed as follows:

1. The New York Times reported on December 8, 1965, that President Johnson knew about a week before the Federal Reserve Board's December 3 meeting that the discount rate was on the agenda and that an increase was likely. Is this report true? If so, was information relayed to the Federal Reserve Board by the Johnson administration during that week on the likely outlook for the budget, Vietnam spending, housing starts and other elements in the economic outlook?

2. Would you describe the pattern of day-to-day coordination which now exists between the Federal Reserve Board and officials of the executive branch? Do you have any suggestions on how that coordination might be improved?

3. The Johnson administration has said that the Federal Reserve Board should have waited until January to get the 1967 budget figures. Aren't the budget figures for the current fiscal year also relevant? The administration already has announced that spending will be $5 to $7 billion more than anticipated and that the budget deficit for the year will be between $7 and $8 billion, compared to an estimate last June of just over $4 billion. Shouldn't this have been a factor in the Federal Reserve Board's decision?

4. In a period of heavy private demand for credit, what effect will the administration's need to finance a larger than expected deficit have on the level of interest rates and on the availability of credit for private needs?

5. It has been said that the Federal Reserve Board acted prematurely and should have waited a month or so before raising the discount rate. Aside from possibly serious economic consequences of waiting, isn't it true that raising the discount rate in January would have adversely affected the Treasury's traditional January and February borrowings?

6. HHFA Administrator Robert Weaver said on December 8 that de doubted whether the increase in the discount rate would worsen the mortgage situation as far as builders are concerned. This Johnson administration official also said that he felt there would be no more stringency in the mortgage market in the next 4 or 5 months. Is this the Johnson administration position?

7. How would you evaluate the impact on the economy of the discount rate increases in 1963 and 1964? Did they help to create a sustainable and steady expansion or did they blunt the drive to full employment?

8. For many consumer items, such as automobiles, excise taxes have been reduced and further reductions will take place next year. Will these reductions

offset to a large extent any increases in the cost of credit which may occur as a result of the Federal Reserve Board's action?

9. By word and deed, the Johnson administration has repeatedly called attention to our continuing balance-of-payments problem and the fact that the domestic economy is on the verge of overheating. In spite of this, the Democratic administration has resisted the use of monetary and credit restraints and has chosen instead to resort to ad hoc controls. Whether we are aware of it or not, the country is moving steadily toward a system of exchange controls which can only damage the international standing of the dollar. Domestically, we have the wage-price guidelines and the use of stockpiles to enforce government policy. What is happening is that equilibrating economic forces are not being allowed to operate. Distortions in the economy persist or grow even worse and call for further controls. Wouldn't the use of general policy instruments, such as monetary and fiscal policy, be preferable to these selected controls?

10. Should the economy begin to overheat seriously in the next several months, would the administration favor a cut in expenditures, an increase in taxes or a further tightening of credit?

11. The administration continues to claim that excess capacity exists as a buffer against inflation. Recent signs indicate a slowing down in the rate of increase of productivity in the economy. Isn't one reason for this the fact that industry is now beginning to bite into high-cost inefficient capacity? Couldn't this exert an inflationary impact on prices?

12. Has the administration made an evaluation of the impact on poorer families of a 2-percent increase in the consumer price index? Isn't it true that the poor are least able to protect themselves against rising prices?

13. The full-time labor force unemployment rate in November 1965 was 3.7 percent; for married men, 2 percent; and for all males over 20, 2.8 percent. In the light of these figures—as well as widespread complaints about shortages of skilled labor—how much room is left for noninflationary increases in aggregate demand? Wouldn't too rapid an increase in demand put more pressure on the already tight labor market for experienced and skilled manpower?

14. How effective can the programs of "voluntary" controls on capital be if the monetary system is not supporting the program by preventing an overexpansion of liquidity in the domestic economy?

15. Does the administration favor the continuation of the independence of the Federal Reserve Board or would it like to see the Board subject to a greater degree of control by the Executive?

16. Certain individuals such as myself have been concerned about inflation for some time. I have urged vigorous support of policies designed to protect the value of the dollar on behalf of American consumers, housewifes, farmers, workers, stockholders, retirees, and others. The administration, on the other hand, supports policies which contribute to the weakening of the purchasing power of the dollar. Therefore, are the American people entitled to learn the real reasons why the Johnson administration is so reluctant to join Republicans in fighting against inflation?

17. In view of the fact that Democrats control the House and the Senate by 2-to-1 majorities, why is the administration afraid to come before study committees such as the House-Senate Joint Economic Committee, and share with the Democratic and Republican Members of the House and the Senate, the administration thinking on these important economic matters? Does the administration intend to disregard Congress and avoid appearances before its committees on an ever increasing scale in the months ahead?

18. Freedom of thought and of speech are key to a strong America. The Members of Congress are the representatives of the people. They are entitled to be given the facts as the administration sees them so that they can weigh various points of view and reach some decisions. Why does the administration want to avoid discussion of difficult problems facing the people of our Nation, all the way from the lack of congressional hearings about the Vietnam problem to the ever-rising cost of living and increased inflation under this administration?

19. Sound scholarship is one of the best ways to move this country forward. There must be hundreds of competent economists, businessmen, labor officials, State, county, and local government officials and civic leaders who have first-hand knowledge about the problem of how to control inflation and what fiscal policies in their communities really are. Surely it would help to have an intelligent dialog about the important matter of full employment, the cost of living, based on the Federal Reserve Board action while Congress is out of session and

before the administration programs flood the news in January. Why is this potential constructive discussion being choked off by the refusal of the administration to discuss intelligently the facts of economic life.

20. As I listen to individual Americans talk and read the mail, I think many of our citizens are deeply disturbed whether their Government is telling them the truth about Vietnam, the Dominican Republic, and economic policies, among other subjects. This is known as the creditability gap in the Johnson administration. In view of the fact that a strong America must be an honest, candid, and decent country, is the silence of the administration to be interpreted as the fact that they have things to hide and just cannot share with the American people the economic facts of life as they really are? If this is sadly the case, then the minority has still more the responsibility of alerting the press, and other thought leaders, to have a full discussion of the Federal Reserve Board decision and other important economic matters which help provide jobs for our people and keep the cost of living stable. I favor constructive economic policies for a better America and I just cannot understand why a powerful administration seems to be running away from intelligent discussion with Members of Congress of both parties.

Congressman Curtis said in connection with the questions for administration officials, "The hearings have developed that the coordination that exists between the Federal Reserve Board and the administration to insure that fiscal and monetary policy are moving in the same direction comes from periodic meetings of what Federal Reserve Board Chairman, William McChesney Martin, Jr., has referred to as a quadriad. The quadriad consists of the Chairman of the Federal Reserve Board, the Secretary of the Treasury, the Director of the Bureau of the Budget, and the Chairman of the President's Council of Economic Advisers. This quadriad was established by Secretary of Treasury Robert Anderson when he was Secretary of Treasury in the Eisenhower administration and has been continued since."

The senior House Republican on the House-Senate Joint Economic Committee, stated "inasmuch as the Joint Economic Committee has heard from one member of the quadriad under cross-examination in public hearings, it is very important to get the complete picture that the other three members of the quadriad can give by testifying under cross-examination in public hearings and at the very least responding to a series of questions which can then be placed in the record of these hearings."

(Representative Curtis also supplied the following:)

Who Is Interested in Interest?

Much discussion of monetary policy, and the concern of public policy with respect to interest rates, seems to emphasize the cost or payment aspect of interest and interest rates. This concern tends to neglect the fact that for every interest payment or interest cost there is elsewhere in the economy an interest-received item or interest-income aspect.

This one-sided concern probably results from the fact that most homeowners and businessmen are more aware and reminded of the monthly payments coming due on mortgages and notes payable than they are of their share in the interest income which accrues to them on life insurance policies, pension incomes, savings bonds and accounts, or other interest-bearing holdings. The interposition of these financial intermediaries between the individual as a debtor who must pay interest, and the same individual as a creditor who benefits indirectly from interest received, may be the reason why the cost aspect tends to be emphasized and the income aspect overlooked. We tend to think primarily about higher interest costs and forget, for example, that the recent high rates on savings accounts mean increased income to savers (often the same persons who pay interest), and help to generate savings which in turn become available to finance home mortgages and businesses. This same situation involving intermediaries and differences between credit obligations and equity positions makes it difficult for us to balance the two quantities of (1) who pays interest on the one hand, and (2) who receives this interest on the other hand.

A table in the Federal Reserve Bulletin of October 1964 giving the sector statement of "financial" assets and liabilities throws some light on this subject. It is not argued on the basis of the table that interest payments or interest income are precisely proportionate to these "financial" liabilities or assets since

interest rates may differ from contract to contract and, indeed, some assets or liabilities carry no interest charges at all.

It is noteworthy from the table, however, that "households" own more than twice as many financial assets as those which they owe. Interest earnings credited to or received by households are presumably of a magnitude nearly double the interest paid. It is significant, too, but not surprising, that the interest-earning assets and the deposits of commercial banks, not all of which bear interest of course, are substantially the same amount. Principal debtors, on balance, are governments and nonfinancial businesses.

Sector statement of selected financial assets and liabilities,[1] *Dec. 31, 1963*

[In billions of dollars]

	Assets (interest earning)[1]	Liabilities (interest cost)[1]
Households	$694.1	$269.2
Farms	7.1	29.7
Business (nonfinancial)	254.5	362.6
Commercial banks	262.4	258.8
Savings and loan associations	107.4	100.2
Mutual savings banks	49.7	44.6
Life insurance companies	133.8	116.9
Other insurance companies	25.8	----
Pension funds (noninsured)	23.1	----
Finance companies	36.2	27.0
Brokers and open-end investment companies	13.0	8.0
U.S. Government	77.4	295.0
State and local governments	69.0	121.4
Rest of world	34.8	29.5

[1] Estimated amounts involving interest payments or receipts (in the case of demand deposits for service and availability costs). Corporate stocks, direct investments of foreigners in U.S. gold stocks, etc., although "financial assets" have been excluded.

Source: Federal Reserve Bulletin, October 1964, pp. 1343–1348.

The material which follows was supplied by the Federal Reserve Board in response to the request of Representative Reuss. References to individual banks were deleted from some of the memorandums.

[Excerpt from the Monthly Review of the Federal Reserve Bank of New York, April 1963]

Time and Savings Deposits in the Second District Since the Change in Regulation Q*

Viewed against the experience of the last decade, the growth of interest-bearing deposits[1] at Second District member banks in the last three years has been remarkable (see Chart I). At the end of December 1962, these time and savings accounts stood at $18 billion, almost 70 per cent above their level at the end of 1959. Moreover, the rate of gain tended to accelerate during the period: in 1960, Second District members added $1.4 billion; in 1961, $2.4 billion; and in 1962, a record $3.4 billion.

The key factor in the sharp acceleration of growth in 1962 was the revision of Regulation Q, effective January 1 of that year, which raised the maximum rates member banks may pay on time and savings deposits (see Table I). Banks in the District reacted immediately by increasing interest rates paid on such deposits. Coming at a time when general economic and financial conditions were already favoring the growth of interest-bearing deposits,[2] the higher rates drew a quick and sizable response from the public.

The rise in commercial bank rates on time and savings deposits was, of course, not limited to this District. Banks throughout the country offered higher rates that enhanced the attractiveness of such deposits relative to other liquid assets that the public might have chosen to hold. Especially in the first several months after ceilings were raised, commercial banks were apparently successful in diverting funds from the markets for Treasury bills and municipal securities. As the year progressed, they also tended to capture a share of the funds that investors withdrew from the stock market. Indeed, a notable feature of 1962 was that the relatively large increase in bank deposits normally associated with a period of credit ease was concentrated to an unusual degree in interest-bearing rather than demand deposits.

But the growth in interest-bearing deposits was more rapid in the Second Federal Reserve District than elsewhere. This reflected in part the greater interest rate sensitivity of the large depositors prominent among the customers of the District's banks, and also the aggressiveness of many of these banks in exploiting this new avenue of competition. Moreover, time deposits of foreign governments, central banks, and official institutions increased after Regulation Q ceilings on such deposits were suspended for three years, beginning October 15, 1962, and Second District banks gained the greatest share of that increase.

This article examines in greater detail the nature of rate and deposit developments in the Second District during 1961 and 1962. It focuses, in particular, on variations in the behavior of rates and deposits among different types of institutions and areas.

Table I

MAXIMUM INTEREST RATES PAYABLE ON TIME DEPOSITS

In per cent per annum

Type of deposit	January 1, 1957 to December 31, 1961	Effective January 1, 1962
Savings deposits of:		
1 year or more	3	4
Less than 1 year	3	3½
Other time deposits payable in:		
1 year or more	3	4
6 months to 1 year	3	3½
90 days to 6 months	2½	2½
Less than 90 days	1	1

* Leonard Lapidus had primary responsibility for the preparation of this article.

[1] This article employs the term "interest-bearing deposits" to describe the aggregate of time and savings deposits at commercial banks. The term "time deposits", which is frequently used in reference to the combined series, is here used only in a narrower sense to describe deposits that usually have a specified maturity which in no case can be under thirty days and that are either in the form of a certificate of deposit or open account. "Certificates of deposit" are for specified amounts and are evidenced by either a negotiable or a nonnegotiable instrument. "Open account" time deposits are evidenced by a written contract, and funds may be added or withdrawn (subject to a restriction of at least thirty days) during the life of the contract. "Savings deposits" are distinguished from time deposits in that they may be held only by individuals or nonprofit institutions; a notice of withdrawal is not mandatory, but a notice of at least thirty days may be required at the option of the bank.

[2] For a general discussion of the factors influencing the growth of interest-bearing deposits, see Richard G. Davis and Jack M. Guttentag, "Time and Savings Deposits in the Cycle", *Monthly Review*, June 1962, pp. 86-91.

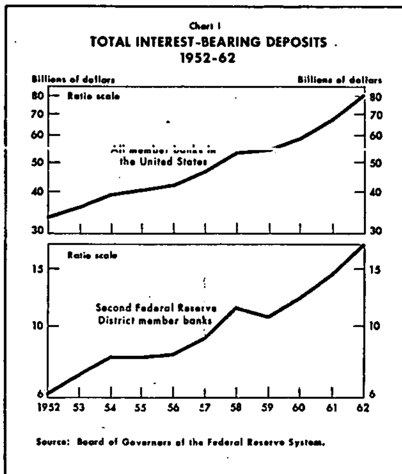

Chart I
TOTAL INTEREST-BEARING DEPOSITS
1952-62

Source: Board of Governors of the Federal Reserve System.

THE SITUATION IN 1961

By the end of 1961, interest rates at Second District member banks were pressing against Regulation Q ceilings. Reports to this Bank from a large sample of District banks indicated that in 1961 rates on savings deposits, in both the over- and under-one-year categories, averaged 2.95 per cent, a scant fraction below the 3 per cent ceiling; nine out of ten banks were at the ceiling. On open account time deposits, 91 per cent of the banks were offering the maximum legal rate on maturities of one year or more, and rates on negotiable time certificates of deposit (C/Ds) were also close to Regulation Q ceilings. Indeed, in 1961, almost eight out of ten commercial bankers surveyed in New York State felt that Regulation Q ceilings then in effect did not provide enough "headroom" for them to compete effectively for savings.[3]

The large urban banks, even more than other banks in the District, felt the need to foster the growth of interest-bearing deposits. Over the postwar period, these banks—especially those in New York City—had experienced a relative decline in their share of the nation's demand deposits. Corporate cash balances, which are particularly important to these banks, had been declining during 1959 and 1960 and, despite the business recovery starting in 1961, had failed to grow until the last few months of 1961. Gains in time and savings money seemed to offer such banks a means of increasing their deposit growth and thus, over the long run, a possibility of meeting more fully the credit needs of the large national corporations that are among their most important customers.

In 1961, the desire of these large banks to promote the growth of time and savings money was reflected not only in their posted rates on savings deposits, which were the highest in the District, but also in their introduction of C/Ds. The latter step represented a major policy move to attract time money, especially of domestic corporations; up to that time the large banks had rarely accepted interest-bearing time deposits from domestic firms.

This new instrument was immediately successful, and time certificates became a major element in the substantial growth of interest-bearing deposits in the District during 1961.[4] Time certificates at District weekly reporting member banks grew by $1 billion in 1961, accounting for over 70 per cent of the increase in these banks' time deposits and for just under half of the increase in their total time and savings deposits (see Table II).[5]

This growth, however, was not continuous throughout the year. By their nature, C/Ds are highly sensitive to competing open market interest rates and, as a result, their increase slowed down in the second half of 1961, when Treasury bill rates started to rise. Outstanding C/Ds at New York City banks had expanded from virtually nothing at the outset of 1961 to $1 billion at the end of July, but thereafter the rise in Treasury bill rates toward the Regulation Q ceiling narrowed the margin between bill yields and C/D rates on six-month maturities to only ⅛ of a percentage point in December 1961. Largely because of this, the volume of outstanding C/Ds stopped growing and then began to recede, falling back to the July level by the year end.

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[3] New York State Bankers Association, *Growth Aspects of Savings Deposits*, December 1961, pp. 10-11.

[4] For a detailed discussion of the growth of certificates of deposit and its relationship to rates, see R. Fieldhouse, *Certificates of Deposit* (Boston: Bankers Publishing Company, 1962), Ch. 6.

[5] There are thirty-seven weekly reporting member banks in the District. These banks are among the largest and are located in the District's major cities. Their combined time and savings deposits accounted for 72 per cent of interest-bearing deposits in the District at the end of 1962. Separate data on their time and savings deposits have been available on a weekly basis since July 1959. Such a separation is available for all members in the District for call report dates, but only since the first quarter of 1961.

Table II

ANNUAL INCREASES IN INTEREST-BEARING DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT

Based on end-of-year balances

Type of deposit	1960	1961	1962	1960	1961	1962
	Billions of dollars			Per cent		
Second District — all members.	1.4	2.4	3.4	13	20	23
Weekly reporting member banks:						
Total	1.0	2.1	2.7	14	26	27
Savings deposits	0.3	0.7	1.3	7	15	24
Time deposits	0.7	1.4	1.4	27	44	30
Negotiable time certificates of deposit	*	1.0	1.4	*	*	*
Other member banks	0.4	0.3	0.7	10	8	15

* Because C/Ds grew rapidly from very low levels, percentage increases for 1961 and 1962 are not significantly comparable with the percentage increases in other categories of interest-bearing deposits. For 1960, exact figures are not available but growth was insignificant.

Indeed, time accounts generally experienced slower growth in the latter part of 1961, as depositors sensitive to interest rate differentials—particularly business establishments, foreign official institutions, and state and local governments—turned to Treasury bills (see Chart II). On the other hand, savings deposits at weekly reporting banks grew strongly throughout the year, though with some tendency toward a slower rate of gain as the year progressed (see Chart III).

THE SITUATION AFTER THE CHANGE IN REGULATION Q

After the revision of Regulation Q at the beginning of 1962, the banks immediately responded by raising rates, thereby clearly demonstrating their willingness to pay a considerable price for an increased volume of time and savings money. According to a mid-January 1962 survey, almost 85 per cent of District member banks had already made upward changes in offered rates. Many had also added to, or improved, the "fringe" benefits they offered on savings deposits—for example, the payment of daily interest and the introduction of "grace" days at the beginning and end of interest periods. On the other hand, it appears that banks that did not raise their rates in January never raised their rates at all.

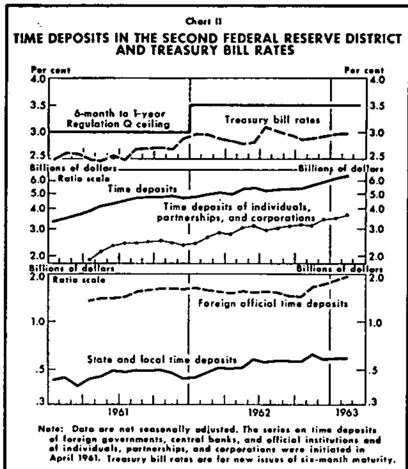
Typically the rate on savings deposits was raised from 3 per cent to 3.5 per cent for deposits of both under and over one year. Fully 80 per cent of District member banks moved to the 3.5 per cent maximum on "new" (under one year) savings deposits, and 60 per cent to that rate on deposits of one year or more. Only 20 per cent posted the 4 per cent maximum on deposits of one year or more, and these banks were concentrated in the New York metropolitan area, northern New Jersey, and Buffalo.

Rates on C/Ds were increased by about ⅛ of a percentage point for six-month to nine-month maturities and by ⅜ of a percentage point for maturities of one year and over. Rates on time deposits (open account) rose about ¼ of a percentage point.

The effect of the more attractive rates paid on interest-bearing accounts at District banks was an acceleration in the growth of savings deposits and a renewed expansion of time deposits. In contrast to 1961, savings deposits played a significant role in the over-all increase of interest-bearing commercial bank deposits; they doubled their 1961 gains during 1962 and accounted for half of the total rise in interest-bearing deposits at large District banks.

Savings deposit gains at commercial banks were especially strong in January and February 1962. In subsequent months, too, the rate of growth remained well above that of 1961. In 1962, even the smallest monthly gain in seasonally adjusted savings deposits exceeded nine of the twelve monthly gains in 1961 (see Chart III).

Larger flows into savings accounts benefited all thrift institutions in 1962. For example, deposits of District mutual savings banks and the dollar volume of shares of savings and loan associations grew somewhat faster in 1962 than in 1961. The total of these two forms of savings at the 1962 year end stood 8.3 per cent above 1961, whereas the gain in 1961 had been 6.2 per cent.



Note: Data are not seasonally adjusted. The series on time deposits of foreign governments, central banks, and official institutions and of individuals, partnerships, and corporations were initiated in April 1961. Treasury bill rates are for new issues of six-month maturity.

However, the acceleration of the growth of savings deposits was even faster at local commercial banks than at competing thrift institutions. In 1960 and 1961, additions to savings accounts at weekly reporting member banks had amounted to 19 and 38 per cent, respectively, of total additions to accounts at mutual savings banks and savings and loan associations in the District. In 1962, they accounted for fully 50 per cent. These gains presumably were in part due to the erosion of the rate advantage previously enjoyed by other savings institutions. In 1960 the rate on new savings deposits at mutual savings banks and the return on shares at savings and loan associations in the District typically amounted to 3½ per cent, ½ percentage point above Regulation Q ceilings. After January 1, 1962, member bank rates generally moved to 3½ per cent, and savings institution rates to 3¾ per cent. Thus the rate advantage on new savings has been trimmed to ¼ of a percentage point.

Moreover, mutual savings banks in New York State cannot for the time being re-establish a wider differential on new savings, since their rate on these is limited by regulation to a maximum of 3¾ per cent. Recently, many of the mutual savings institutions in the larger cities have moved to 4¼ per cent on one-year savings[6] in order to be able to compete with the 4 per cent generally offered by commercial banks in these localities.

Time deposits have also responded to the more attractive interest rates now available. From the beginning of 1962 to the end of June, such deposits grew by $0.7 billion in an irregular pattern, which reflected a sensitive response to monthly fluctuations in Treasury bill rates. Their growth then ceased, partly for seasonal reasons, but it was renewed in the last two months of 1962, which saw a sharp rise of $0.7 billion in such deposits (see Chart II). Nearly half of this reflected additions to the time accounts of foreign official institutions, following the October suspension of Regulation Q ceilings on such accounts,[7] but there was also an apparently contraseasonal jump during December in time certificates issued to corporations. Gains in the volume of outstanding certificates carried through the first quarter of this year.

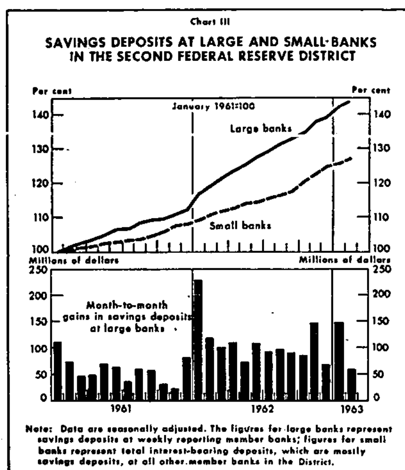


Chart III

SAVINGS DEPOSITS AT LARGE AND SMALL BANKS IN THE SECOND FEDERAL RESERVE DISTRICT

Note: Data are seasonally adjusted. The figures for large banks represent savings deposits at weekly reporting member banks; figures for small banks represent total interest-bearing deposits, which are mostly savings deposits, at all other member banks in the District.

Even more than in 1961, expansion in the volume of C/Ds was the dominant form of time deposit growth in 1962. The increase in the volume of these certificates during the year accounted for the entire $1.4 billion gain in time deposits at weekly reporting banks. Not surprisingly, the growth was predominantly in maturities greater than six months, on which Regulation Q was liberalized, rather than in the short maturities, on which maximum rates were unchanged.

BANK SIZE AS A FACTOR IN DEPOSIT GROWTH AND INTEREST RATES

Within the District, most banks participated in the growth of interest-bearing deposits during 1962, but the larger banks did so much more than the smaller ones.[8] For this there were several reasons. First, the forces making for the growth of interest-bearing deposits had, since 1960, been stronger in urban than in rural areas. Perhaps

[6] New York State banking authorities have not exercised their authority to set a maximum rate on these deposits. Rate increases, however, are subject to their review.

[7] Before October, these foreign official time deposits declined, in sharp contrast to those of other depositors sensitive to interest rates (see Chart II). This probably occurred because foreign official institutions prefer short-term claims and Regulation Q ceilings on maturities of less than six months had not been raised in January. Rates on time deposits of such maturities were not competitive with open market rates.

[8] However, the growth of interest-bearing deposits at the smaller banks made about the same relative contribution to total deposits as did the growth of such deposits at larger banks. This was due to the fact that for nonweekly reporting banks the share of interest-bearing deposits in total deposits was about twice as great as for weekly reporting banks.

Table III

GROWTH OF INTEREST-BEARING DEPOSITS, AND AVERAGE OFFERED INTEREST RATES ON SAVINGS DEPOSITS IN THE SECOND FEDERAL RESERVE DISTRICT, BY SIZE OF BANK

Bank size (total deposits, millions of dollars)	Percentage increase August 1961 to August 1962 of interest-bearing deposits	Average rates on savings deposits			
		Under 1 year		1 year and over	
		1961	1962	1961	1962
		Per cent per annum			
Less than 5	10.5	2.90	3.35	2.90	3.41
5 to 20	11.6	2.96	3.40	2.96	3.52
20 to 100	11.8	2.97	3.41	2.97	3.56
100 to 1,000	18.7	3.00	3.46	3.00	3.61
1,000 or over	19.6	3.00	3.50	3.00	4.00
All banks	17.5	2.95	3.39	2.95	3.51

the most significant influence on the growth of interest-bearing deposits at city banks was the fact that, from the middle of 1960, open market rates of interest were stable at levels below commercial bank time deposit rates, encouraging investors to shift from Treasury bills to time deposits, especially C/Ds. Secondly, after the change in Regulation Q became effective, the large urban banks in the District made the largest changes in interest rate offerings on savings deposits; thus, to a greater degree than other District banks, they reduced or overcame the relative advantage of other investment instruments and of other savings institutions in their communities. Finally, the upturn in foreign official time deposits, consequent on their three-year exemption from Regulation Q, was registered almost entirely at large New York City banks, where such accounts are concentrated.

Interest-bearing deposits at weekly reporting banks in the District (all of them large banks) expanded over 27 per cent in 1962, in sharp contrast to a 15 per cent increase at the smaller banks that do not report weekly. As in 1961, both time deposits and savings deposits at these large banks outstripped the growth rate of over-all interest-bearing deposits at other member banks.

Time certificates of deposit, which played so great a role in the growth of time deposits during both 1961 and 1962, are issued almost exclusively by large banks.[9] In fact, it was not until 1962 that the practice of offering C/Ds spread in any significant degree beyond the original New York City issuers to other large banks in the District. During 1961 all of the $1 billion growth in outstanding C/Ds was accounted for by nine New York City banks. During 1962, however, other weekly reporting banks entered the new-issue certificate market and contributed $0.5 billion to the $1.4 billion increase in the District's total volume of outstanding C/Ds.

For savings deposits, too, weekly reporting banks showed greater relative gains than smaller banks in 1961, and widened the differences in 1962 (see Chart III). But, perhaps even more significantly, the smaller banks' savings deposits showed neither the acceleration of growth nor the unusual January and February gains evident in 1962 at the larger banks. Rather, the savings deposits of smaller banks apparently grew at about the same pace in 1962 as had been registered toward the end of 1961.[10] Part of the reason for this contrast is the fact that the large banks made greater inroads into the rate advantage of competing savings institutions than did smaller banks. As was indicated above, in New York City and Buffalo this advantage has typically narrowed to ¼ of a percentage point, whether the savings deposit is for under or over one year; moreover, in these cities many of the commercial banks offer daily interest payments and grace days. Outside these major centers, commercial banks have also generally reduced to ¼ percentage point their competitors' advantage on new savings, but still fall ½ point short on one-year savings. While grace-day arrangements are widespread, daily interest is rarely paid and many banks credit interest semiannually rather than quarterly.

Table III shows the close relationship of bank size (and therefore community size) to the increase of interest-bearing deposits. And it indicates that this factor is also important in explaining interest rate levels.

Interest rates paid by District commercial banks on savings accounts necessarily varied only slightly before the lifting of Regulation Q ceilings. Within this narrow range, however, the influence of bank size was clearly evident: rates were consistently higher in the progression from very small banks to the very large banks. After the increase in ceilings this pattern of rates was maintained, though with larger differentials, because the larger banks made greater upward changes than the smaller ones.

These rate spreads doubtless reflected traditional differences between different geographical markets which vary in their competitive temper. In and around urban areas, various factors keep rates competitively high—

[9] This pre-eminence of large banks results from the fact that the demand for such negotiable instruments comes largely from national corporations whose primary banking relations are with large banks. In addition, C/Ds issued by small banks are not so readily acceptable in the secondary market and, if traded, will be subject to a larger discount than certificates of well-known "money market" banks.

[10] This inference is based on data for total interest-bearing deposits at the smaller banks, since separate monthly data on savings deposits at these banks are not available. The inference seems reasonable, however, because almost 90 per cent of interest-bearing deposits at nonweekly reporting banks are savings accounts—a proportion that remained stable from September 1961 to September 1962.

including the concentration of savings institutions and also the easy access to organized investment markets. But such specifically urban characteristics were by no means the only factors in the 1961-62 contrasts between the rates paid by large and small banks.

There is good reason to believe that the banks which posted the largest increases in rates on savings deposits were those with sound loan and investment opportunities that would go unsatisfied unless deposits grew more rapidly. The large banks' deposit growth had failed to keep pace with that of other banks during the postwar period; and their loan-deposit ratios, which were among the highest in the nation, indicated that the large banks were finding it more difficult to meet the entire growth of loan demand. Thus in 1961, dissatisfaction with Regulation Q among commercial bankers in New York State was found to be directly associated with bank size and with the level of loan-deposit ratios.[11]

On the other hand, there is no evidence that reluctance to bear the cost of higher interest rates (as measured by the ratio of interest-bearing to total deposits) played any significant part in determining which banks raised rates and which did not. Banks with a high proportion of their deposits in time and savings accounts raised rates with the same relative frequency, and by as much, as did banks with a low proportion.

Why were banks willing to accept large relative increases in their costs? Certainly, some banks—especially those subject to competition from New York City and Buffalo banks—considered the higher rates necessary to protect existing deposits from competitors. Nevertheless, the fact that rates were increased so quickly after ceilings were raised (in contrast to a much slower response to a previous change in the interest rate ceiling in January 1957) probably indicates that the desire to take advantage of lending opportunities was an important motive. Indeed, many District bankers are convinced that, with demand deposits growing relatively slowly, only active promotion of time and savings deposits can sustain the kind of growth of commercial bank resources that is needed to maintain or improve their profits prospects over the long run. It is worth noting that, despite sharply higher interest costs, net income of the average Second District commercial bank in 1962 actually was slightly higher than in 1961.

[11] New York State Bankers Association, *op. cit.*

SUMMARY

The growth of interest-bearing deposits in the Second District since the lifting of Regulation Q ceilings has been strongest at large banks in large cities, in both time and savings deposits. The response to the Regulation Q change was a broadly based, general rise in interest rate offerings, with the large deposit-seeking city banks making the greatest upward changes on savings accounts. A substantial effect of the higher rates was the renewed growth of negotiable time certificates of deposit, which at the end of 1961 had lost their competitive advantage over Treasury bills. Another result was an acceleration in the upward trend of commercial bank savings deposits, stemming mainly from the significant cut in the rate advantages of competing savings institutions. At the higher rate levels, time and savings accounts also became an attractive investment for a considerable flow of funds diverted or withdrawn from securities markets during 1962.

[Excerpt from the Monthly Review of the Federal Reserve Bank of New York, November 1965]

The New York City Banks' Share in Commercial Banking

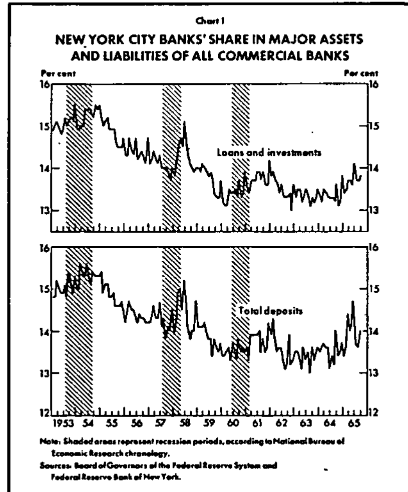
By Francis H. Schott and Rudolf Thunberg*

The large New York City banks occupy a special position within the nation's banking system. In addition to providing local banking services, they extend a substantial part of the credit used by firms with nationwide operations and are a focal point of the country's network of correspondent banking. They also do the bulk of the country's international banking business — financing foreign trade, rendering financial services to foreign dollar holders, and trading in foreign exchange. Furthermore, as one of the primary sources of bank credit to dealers in United States Government securities, they are a major link in the transmittal of the impact of Federal Reserve System open market operations throughout the financial structure. This article discusses some recent developments in the share of this important group of banks in the nation's commercial banking.

TRENDS IN THE NEW YORK CITY BANKS' SHARE IN COMMERCIAL BANKING

At its zenith, in 1941, the New York City weekly reporting banks' share in the total loans and investments and total deposits of the commercial banking system had risen to almost 25 per cent.[1] During the ensuing two decades, although the New York City banks grew substantially in absolute terms, their share in total credit and deposits followed a generally declining trend—as shown, for the years since 1952, in Chart I. During the 1960's, however, that downtrend has been arrested and to some extent reversed, as also shown in Chart I.

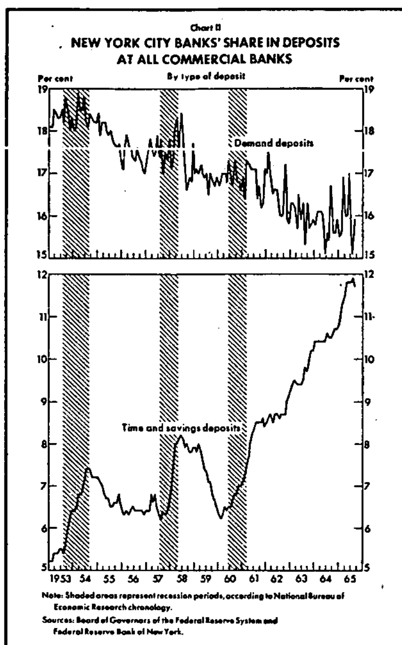
A number of factors contributed to the lagging relative growth of New York City banks until recent years. The population of the Northeast increased rather slowly in the postwar years. New York City's population, in particular, grew by only 4 per cent between 1940 and 1960, compared with an increase of almost 36 per cent for the nation as a whole. In addition, the composition of the population of the city underwent a change, as many middle-income depositors moved to the suburbs and were replaced by low-income groups. Laws covering branch banking prevented New York City banks from opening branches in the growing suburbs. Furthermore, corporate working



Note: Shaded areas represent recession periods, according to National Bureau of Economic Research chronology.
Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

* Manager, Research Department, and Economist, Research Department.

[1] The New York City weekly reporting banks, presently thirteen in number, are those which provide the Federal Reserve with balance-sheet information each week. They include six of the country's ten largest banks, three other large banks, and four banks of intermediate size. All have their headquarters in New York City.



balances were gradually more widely spread through the nation's banking system since industrial growth was centered in the West and the South. Meanwhile, corporate treasurers became increasingly sophisticated in the management of liquid funds and tended systematically to minimize noninterest-bearing balances. The New York City banks—where corporations had traditionally held a large part of their liquid funds—for these reasons failed to participate as fully as previously in the growth of total deposits, although their share in total corporate deposits remained substantial.

Cyclical changes sometimes retarded and at other times reinforced the declining trend. Chart I shows that the percentage of total commercial bank loans and investments and deposits held in New York City tended to rise during recessions and to fall during expansions of economic activity. On the deposit side, the cyclical pattern was largely confined to time deposits, as shown in Chart II.[2] One possible explanation of this pattern is the following: prior to the introduction of negotiable time certificates of deposit (C/D's) at New York City banks in 1961 (discussed below), foreign holders of dollar assets and other interest-sensitive investors found time deposits an attractive outlet for their liquid funds primarily during recessions and not during expansions. Time deposit rates were considerably more stable over the course of the cycle than rates on Treasury bills and other money market instruments. This meant that time deposits became a relatively more attractive short-term investment medium as Treasury bill rates moved downward in recessions, and less attractive during expansions when bill rates moved upward.[3] The shifts in the form of holding liquid funds among different types of short-term assets that were thus induced had important implications for the relative shares of various groups of banks in total time deposits. In particular, the share of those banks that especially serve large and interest-sensitive customers tended to be enlarged during recessions and reduced during expansions.

The cyclical pattern of the share of New York City banks in the nation's banking business may also reflect differences among banks in the degree of utilization of available reserves. Large city banks manage their money position in such a way that they have minimal excess reserves at any time. During expansionary periods, therefore, these banks have typically had to satisfy at least part of any heavy loan demand by liquidating holdings of securities, merely substituting one form of bank credit for another. "Country" banks, on the other hand, have generally tended to hold excess reserves, which are usually especially large during recessions. Therefore, a portion of their portfolio growth during the ensuing economic expan-

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[2] The demand deposit share of New York City banks (also shown in Chart II) appears to be affected only slightly by the cycle. One exception to this generalization occurred toward the end of the 1957-58 recession when the New York demand deposit share rose considerably along with the time deposit share. Unusually large Treasury financing operations in 1958 resulted in a temporary buildup of United States Government balances, concentrated for a time at large banks.

[3] See Richard G. Davis and Jack M. Guttentag, "Time and Savings Deposits in the Cycle", this *Review* (June 1962), pp. 86-91, as well as "Movements in Time and Savings Deposits, 1951-1962", Federal Reserve Bank of St. Louis *Review* (March 1963), pp. 5-10, and William R. Bryan, "Recent Trends in Time Deposits", *ibid.* (June 1964), pp. 7-11.

sion could be financed by reducing excess reserves. Consequently, country banks have tended to be more able to increase their total credit during expansions than New York City banks, and hence have gained relatively on New York City banks in these periods.[4]

In striking contrast to these earlier patterns, the downtrend in the New York City banks' share of commercial banking has been arrested over the course of the current prolonged period of economic expansion. Following a rise in that share during the 1960-61 recession, which was in accord with the historical patterns, the rise in the New York share continued well into 1961 (the early phase of the expansion), which was contrary to the historical pattern. Furthermore, the decline which then began appears to have been arrested since about the end of 1962. Indeed, after a period of substantial stability lasting until roughly mid-1964, the New York share began to rise and this movement continued through mid-1965. As a consequence, the New York banks' share, at roughly 14.5 per cent of total deposits and 14 per cent of total loans and investments of all commercial banks, in June reached about the highest levels since early 1959.

PRINCIPAL REASONS FOR RECENT IMPROVEMENT IN POSITION OF NEW YORK BANKS

The growth of the commercial banking system as a whole is influenced by a host of variables. These include especially the amount of additional reserves supplied by the Federal Reserve and technical factors such as reserve drains into additional currency in circulation, as well as the required ratio of reserves to deposits, and the deposit "mix" (if a difference exists—as it does—between reserve requirements on various types of deposits). The relative growth of any one bank or group of banks within the banking system, however, is determined primarily by relative success in attracting deposits. Beginning in the early 1960's, New York City banks began to take positive steps to halt the decline in their relative position.

Perhaps the most important of these moves was a change in attitude toward time and savings deposits. Before 1961, the large New York City banks generally took a negative attitude toward time deposits of corporations, and some although not all were quite indifferent to savings deposits. Since then, they have been bidding aggressively for temporarily idle corporate funds as well as for savings of individuals. Practically all the deposit growth of large New York City banks in recent years has in fact been in the form of time and savings deposits. Between September 1960 and September 1965, total time and savings deposits of the New York City weekly reporting banks increased by about 240 per cent ($11.8 billion), while demand deposits at these banks grew by only 8 per cent ($1.9 billion). In terms of the New York share in total deposits, this time deposit gain more than offset a further relative decline in demand deposits, as is evident from a comparison of New York's total-deposit share (Chart I) with the breakdown of this share by type of deposit (Chart II).

For reasons already noted, cyclical variations in the deposit share of New York banks have tended to be confined largely to time deposits. Therefore, a downturn of the New York share in time deposits would have been predicted for early 1961—the beginning of the current economic expansion—but no such downturn materialized. On the contrary, that share has been rising almost continuously, from barely 7 per cent at the beginning of 1961 to almost 12 per cent by mid-1965.

Once their decision to compete aggressively for time deposits was made, the New York banks achieved success largely through the medium of negotiable time certificates of deposit (C/D's). After being used locally and regionally for some years, mostly in the West and Southwest, this new money market instrument was thrust into national prominence in February 1961—at the trough of the last recession—when the large New York banks began to issue negotiable certificates for time deposits of substantial size. Almost simultaneously, Government securities dealers established a secondary market in C/D's, and the other major New York City banks as well as large banks around the nation began issuing these instruments.[5] Within a few months, the C/D had become a major money market instrument, and by early 1964 the volume of negotiable C/D's exceeded that of commercial and finance company paper and bankers' acceptances combined. Since then, C/D's have continued to gain, both in absolute amounts outstanding and relative to other

[4] The substitution of credit for excess reserves on the part of country banks during expansions may enlarge only their share in total bank credit and not necessarily their share in total deposits. Most likely, however, the banks at which the creation of additional credit takes place will retain a somewhat larger share of the deposits associated with this credit expansion than they generally hold, partly because of compensating-balance requirements against loans.

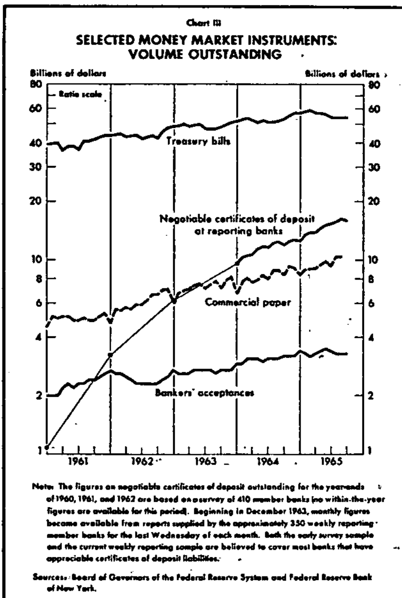
[5] See Richard C. Fieldhouse, "Certificates of Deposit", this *Review* (June 1963), pp. 82-87, and the updated version of that article in this Bank's *Essays in Money and Credit* (December 1964), pp. 42-46.

money market instruments (see Chart III). In mid-October 1965—after a seasonal dip in September—the total amount of negotiable C/D's outstanding at all weekly reporting member banks exceeded $16.3 billion.

The negotiable time certificate has greatly contributed to a broadening of the competition for bank deposits from the local and regional to the nationwide level. Furthermore, the competition for profitable loans and investments has also been broadened, since the C/D market facilitates the search for the needed resources once the lending opportunity arises. The large money market banks have turned out to be strong competitors, particularly because a C/D possesses greater marketability if it is issued by a bank of national repute. This criterion is readily met by the large New York banks, which are therefore able to obtain deposits by issuing C/D's at somewhat lower interest rates than smaller and less well-known banks. The competitive strength of New York "prime banks" is reflected in the absolute and relative growth of their outstanding C/D's. For all New York City weekly reporting banks, the total has grown from virtually zero in early 1961 to almost $7 billion in early September 1965; and the New York share among all weekly reporting banks has risen from a negligible percentage in early 1961 to more than 40 per cent by mid-1965 (see Chart IV).[6]

Chart III

SELECTED MONEY MARKET INSTRUMENTS: VOLUME OUTSTANDING



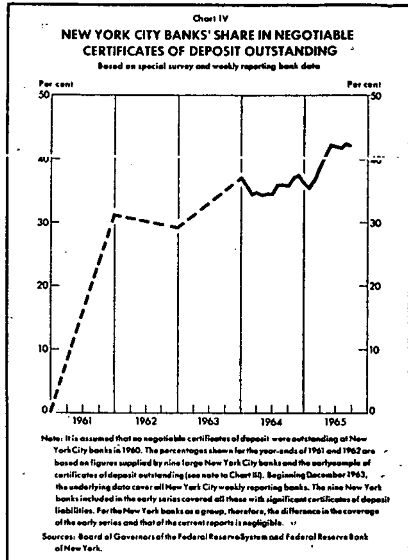
Note: The figures on negotiable certificates of deposit outstanding for the year-ends of 1960, 1961, and 1962 are based on a survey of 410 member banks (no within-the-year figures are available for this period). Beginning in December 1963, monthly figures become available from reports supplied by the approximately 350 weekly reporting member banks for the last Wednesday of each month. Both the early survey sample and the current weekly reporting sample are believed to cover most banks that have appreciable certificates of deposit liabilities.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

Chart IV

NEW YORK CITY BANKS' SHARE IN NEGOTIABLE CERTIFICATES OF DEPOSIT OUTSTANDING

Based on special survey and weekly reporting bank data



Note: It is assumed that no negotiable certificates of deposit were outstanding at New York City banks in 1960. The percentages shown for the year-ends of 1961 and 1962 are based on figures supplied by nine large New York City banks and the early sample of certificates of deposit outstanding (see note to Chart III). Beginning December 1963, the underlying data cover all New York City weekly reporting banks. The nine New York banks included in the early series covered all those with significant certificates of deposit liabilities. For the New York banks as a group, therefore, the difference in the coverage of the early series and that of the current reports is negligible.

Sources: Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York.

[6] The relative rate of growth of C/D's outstanding at various groups of banks appears to have become closely linked to the relative strength of various types of loan demand. The reason is of course that relative loan demand influences the degree of aggressiveness with which banks bid for C/D funds. For example, business loan demand has been very active in 1965, and New York banks make proportionately more business loans than other groups of banks. This factor has been particularly important during 1965 in leading New York banks to compete aggressively for deposits. As a consequence of this and several other factors, the rise in the New York City bank share in outstanding C/D's was especially pronounced in the first half of 1965.

MAXIMUM RATES PAYABLE ON TIME AND SAVINGS DEPOSITS UNDER FEDERAL RESERVE REGULATION Q*

In per cent per annum

Type of deposit	Jan. 1, 1936–Dec. 31, 1956	Jan. 1, 1957–Dec. 31, 1961	Jan. 1, 1962–July 16, 1963	July 17, 1963–Nov. 23, 1964	Nov. 24, 1964–Present
Savings deposits:					
1 year or more	2½	3	4	4	4
Less than 1 year	2½	3	3½	3½	4
Other time deposits:					
1 year or more	2½	3	4	4	4½
6 months or more but less than 1 year	2½	3	3½	4	4½
90 days or more but less than 6 months	2	2½	2½	4	4½
30 to 89 days	1	1	1	1	4

* Since October 15, 1962, time deposits due to foreign official institutions have been exempt from interest rate ceilings under Regulation Q.
Source: Board of Governors of the Federal Reserve System.

The Federal Reserve has facilitated the spectacular growth of C/D's by allowing banks to pay time deposit rates competitive with those on other money market instruments, and this is precisely what the banks have been doing during the current sustained period of economic expansion. Since 1961, the maximum rates payable on time and savings deposits under the Board of Governors' Regulation Q have been raised three times (see table). The most recent revisions, in July 1963 and November 1964, have emphasized liberalization of rates on time deposits of short-term maturities. Although these Federal Reserve policy changes were occasioned by the need to keep permissible time deposit rates in line with other national and international money market rates, they also permitted a demonstration of competitive strength on the part of money market banks, which may be especially well situated to capture short-term corporate funds. Additionally, the exemption from interest rate ceilings on time deposits of foreign official institutions since October 1962 was primarily designed to make dollar deposits attractive to such foreign authorities. Nevertheless, it may also have had the effect of enlarging the New York banks' share of total deposits, since these banks in fact hold the bulk of the official foreign deposits in United States banks.[7]

ADDITIONAL FACTORS STRENGTHENING THE NEW YORK BANKS' POSITION

It has already been pointed out that the relative improvement in the position of New York City banks over the past few years cannot be attributed to strength in attracting demand deposits, for the share of New York City weekly reporting banks in total demand deposits of the banking system has still generally declined. Nevertheless, it should be noted that this decline might have been worse (and the over-all gain of the New York banks less) without the reductions in reserve requirements on demand deposits of "central reserve city" banks from 18 per cent to 16.5 per cent in 1960 (made effective in two steps in September and December of that year).[8] A reduction of a bank's reserve requirement tends to result in a substitution of loans and investments for cash reserves at that

[7] More generally, it is likely that large New York banks—well-known outside the country—would be the deposit institutions favored by all categories of foreigners. Both official and private foreigners were substantial gainers of dollar deposits over the course of the major United States balance of payments deficits of the years 1958-64.

[8] The "central reserve city" category of banks, which was terminated and merged with the "reserve city" category in July 1962, included the largest banks in New York and Chicago. The reductions of the central reserve city bank reserve requirements were accompanied by an increase in the reserve requirement on demand deposits of "country" member banks—from 11 per cent to 12 per cent—in November 1960. Also during 1960 and the preceding year, however, all vault cash was gradually made eligible for inclusion in legal reserves. (This action by the Federal Reserve's Board of Governors was permitted under the same law of Congress that required an end to the central reserve city category of banks.) The inclusion of vault cash in legal reserves most benefited country banks, which as a group hold much higher ratios of vault cash to deposits than do money market banks. The reserve requirement on time deposits has long been uniform for all member banks, and has been 4 per cent since late 1962 when it was lowered from 5 per cent.

bank, and a higher ratio of earning assets to liabilities in turn will make deposits potentially more profitable, thus encouraging the bank to intensify its competition for deposits.[9] Therefore, the reduction in the reserve requirement for central reserve city banks has perhaps tended to retard the relative decline of demand deposits at New York banks.

The long duration of the current expansion is, in itself, a factor that has recently tended to halt the decline in the relative position of large banks as the smaller banks have gradually drawn down and utilized the excess reserves with which they typically enter a period of economic expansion.[10] During the first three years of the current expansion, country banks again increased their earning assets by reducing their cash reserves in relation to deposits, but since early 1964 the excess cash ratio of country member banks has remained virtually unchanged. New York City banks, however, have reduced their excess reserve-deposit ratio only negligibly during the entire expansion.

It should also be noted that the development of the Federal funds market over the past few years has provided a means of mitigating the cyclical pattern of relative credit and deposit gains of country banks in an economic expansion. The possibility of rapid redistribution of reserve balances through that market has enabled the New York City banks to buy and use excess reserves previously held idle at country banks. The New York City banks have, in fact, generally been net purchasers of Federal funds.

Liberalized laws with respect to branch banking may also have been responsible for some of the improvement in the relative position of New York City banks. Prior to the passage of the New York State Omnibus Banking Act in 1960, banks with headquarters in New York City were not allowed the privilege of branching outside the city. Since 1960, New York City banks have been allowed to open branches in two adjacent counties as well as in the five counties in the city. Even today, however, the major New York City banks have relatively few branches outside the city, and it is possible that the deposits of these branches may partly represent only funds transferred from city offices rather than net additions to total deposits of these banks. Nevertheless, it is well to keep in mind that the share of the New York banks in the national totals currently represents a somewhat larger geographic area than, say, ten years ago.

CONCLUDING COMMENT

The recent competitive gain of the New York City banks represents the reversal of a long-term trend. For this reason, it is a noteworthy development that deserves close observation and further study. Yet, the previous trend lasted so long and was so consistent that a few years' change cannot be accepted as a definitive turn.

It can be argued, for example, that the shift from a local to a national deposit market implicit in the development of time certificates of deposit is a once-and-for-all change that may already have spent its main force in affecting the relative shares of various groups of banks in the banking business. There could well be some truth in this reasoning. Although the total volume of C/D's was still generally advancing through the first nine months of this year, their rate of growth has leveled off somewhat in 1964-65, compared with 1961-63. Meanwhile, large banks in New York and elsewhere have again found novel ways of attracting resources, such as nonnegotiable "acknowledgments of advance" and negotiable unsecured promissory notes. Provided the New York banks can compete in a nationwide market for loanable funds, they may well be able at least to maintain the gains already made.

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[9] As noted previously, there is also the more general possibility that compensating balance requirements on loans will tend to keep somewhat higher deposits at the banks originating the loans than these banks would obtain from credit and deposit creation throughout the banking system. Cash reserves released by a reduction in reserve requirements are of course initially available for credit expansion at the particular banks for which the regulations have been changed.

[10] There are of course other important differences between the current and earlier expansions besides the greater duration of the present one. One such difference is that monetary policy has generally been easier. For example, total member bank reserves increased at an annual rate of 4.0 per cent from the cyclical trough of February 1961 through September 1965, compared with 0.6 per cent in the April 1958-May 1960 expansion and 1.0 per cent in the August 1954-July 1957 advance. However, the significance of this difference for relative shares in banking of various groups of banks is by no means clear.

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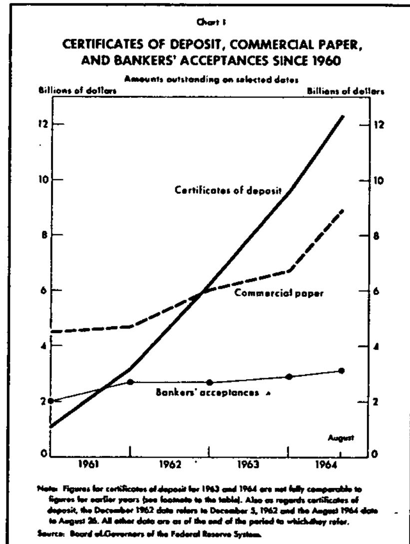
[Excerpt from "Essays on Money and Credit" issued by the Federal Reserve Bank of New York, December 1964]

Certificates of Deposit*

By RICHARD C. FIELDHOUSE

During the past three and a half years the financial community has witnessed the extraordinary growth of a new money market instrument: the negotiable time certificate of deposit. While certificates of deposit existed for many years prior to 1961, they were offered only on a relatively small scale. Indeed, many commercial banks were unwilling to issue certificates to corporate customers or, in fact, to accept time deposits in any form from corporations. The early certificates did achieve some importance in areas where they were aggressively offered, but they failed to acquire national significance. They were often nonnegotiable, either by written notice on the face of the instrument or by tacit understanding between the issuing bank and its customer. Even if they were negotiable, transfers of these early certificates were severely limited by the lack of a secondary market.

In February 1961, however, a large New York City commercial bank announced that it would offer negotiable certificates of deposit to both its noncorporate and corporate customers. At the same time, a Government securities dealer indicated that he would maintain a secondary or trading market for these new instruments. Shortly thereafter, many other commercial banks throughout the country began to bid for time deposits by offering negotiable certificates of deposit to corporate and other customers.[1] At the same time, additional Government securities dealers established positions, and other securities dealers, banks, and corporations began to participate in the secondary market. Since 1961 the growth of corporate cash flows, which generally outstripped the pace of business expansion, provided a favorable atmosphere for the growth of the new instrument (see the table). As of the end of August 1964 the volume of time certificates of deposit outstanding totaled more than $12 billion, of which about two thirds is estimated to represent corporate deposits. Thus, after less than four years since their introduction, certificates of deposit are second in volume only to Treasury bills ($52 billion outstanding) among money market instruments, having surpassed bankers' acceptances and commercial and finance company paper (see Chart I).



Note: Figures for certificates of deposit for 1963 and 1964 are not fully comparable to figures for earlier years (see footnote to the table). Also as regards certificates of deposit, the December 1962 data refers to December 5, 1962 and the August 1964 data to August 26. All other data are as of the end of the period to which they refer.
Source: Board of Governors of the Federal Reserve System.

* This article is reprinted—with certain revisions required to bring it up to date as of August 1964—from the June 1963 issue of this Bank's *Monthly Review*. For an additional discussion, see R. C. Fieldhouse, *Certificates of Deposit*, Bankers Publishing Company, Boston, 1962.

[1] A special Federal Reserve survey of 410 member banks, covering the characteristics and growth of the new-issue market in 1961 and 1962, was the subject of an article in the April 1963 *Federal Reserve Bulletin*, pp. 458-68.

CERTIFICATES OF DEPOSIT OUTSTANDING ON SELECTED DATES
In millions of dollars

Date	Total certificates outstanding	Distribution by total deposits of issuing banks			
		Under $100 million	$100-500 million	$500-1,000 million	$1,000 million and over
December 31, 1960	1,095	139	366	477	114
December 30, 1961	3,223	151	690	804	1,578
December 5, 1962	6,181	296	1,400	1,744	2,742
August 19, 1964	12,193	173	1,946	2,026	8,048

Source: Board of Governors of the Federal Reserve System. The figures for 1960, 1961, and 1962 are not fully comparable to figures for 1964. The earlier data represent all denominations and were tabulated from a special survey of 410 banks, including 351 weekly reporting member banks. Figures for 1964 represent negotiable certificates of deposit in denominations of $100,000 or more at the weekly reporting banks.

THE OFFERING OF CERTIFICATES AND REGULATION Q

Certificates were offered primarily in order to enlarge the issuing bank's lending power. The availability of reserves for the banking system as a whole is, of course, essentially determined by Federal Reserve policy. The individual banker could anticipate, however, that the offering of certificates would enlarge his share of total reserves by attracting a larger share of total deposits.

The offer of certificates also represented an attempt to increase the stability of deposits. Deposit totals had been increasingly subject to wide fluctuations as bank customers, especially corporate treasurers, became more adept in the methods of "scientific" cash management. Bankers felt that the money market character of the new certificates would enable them to compete for the interest-sensitive funds that corporations, state and local governments, and other public bodies were putting into the short-term securities markets. The time deposit funds thus acquired would become available for bank use during the life of the certificate, thereby providing a relatively stable pool of funds which would safely permit the extension of loan and investment maturities. This relative stability would be enhanced in cases where maturing certificates were rolled over into new certificates.

Such results, however, were by no means assured. The maximum interest rates payable to domestic depositors under Regulation Q of the Board of Governors of the Federal Reserve System posed the threat that the demand for new certificates would fade if money market rates approached the "ceilings". In such circumstances, outstanding certificates would be redeemed at maturity, as depositors sought more attractive rates elsewhere. During 1961, therefore, bankers approached the issuance of certificates cautiously, and often limited the amount they were willing to create. Toward the end of that year, three-month Treasury bill rates edged upward and exceeded the 2½ per cent ceiling in effect for three- to six-month time deposits. As a result, commercial banks could no longer offer certificates of these maturities at competitive rates. (The 1 per cent ceiling on 30- to 89-day time deposits ruled out the issuance of certificates of this term at any time in recent years.) Only the six months' or longer certificate, on which a 3 per cent maximum rate applied, remained competitive. Even in this maturity category, certificates began to lose their investment appeal as rates on six-month Treasury bills approached 3 per cent. Banks faced the prospect of losing the sizable time deposits that they had built up through the issuance of negotiable certificates.

On January 1, 1962, the schedule of maximum rates under Regulation Q was raised. The ceiling for six-month time deposits was raised from 3 to 3½ per cent, and a 4 per cent ceiling was placed on a new maturity category of twelve months or longer. Rates for 30- to 89-day and 90-day to six-month deposits were left unchanged at 1 and 2½ per cent, respectively. These ceilings permitted commercial banks to issue six months' or longer certificates at competitive rates, but not shorter certificates. Time deposit ceiling rates were revised again on July 17, 1963, concomitant with an increase in the discount rate from 3 to 3½ per cent. The new schedule raised the ceiling rates for 90-day to six-month and six-month to one-year deposits from 2½ and 3½ per cent, respectively, to 4 per cent. Rates for 30- to 89-day deposits again were left unchanged at 1 per cent. The 4 per cent ceiling in effect for deposits of 90 days or longer generally provided ample leeway for the successful issuance of certificates of deposit. The possibility remains, of course, that ceiling rates under Regulation Q may at some point again limit the banks' ability to attract, or retain, interest-sensitive money.

NEW CERTIFICATES

Certificates of deposit are designed to compete for funds that have already found, or are seeking, employment in the short-term securities market. For this reason, bankers are reluctant to issue certificates if there is reason to believe that the customer plans to draw down his demand balances below "normal" levels in order to purchase a certificate. There is, of course, no desire to pay interest for funds that ordinarily would be held as noninterest-bearing demand deposits. Most banks, to avoid such competition with normal balances, have set minimum limits

to the size of the individual certificates they will issue.[2] These limits are frequently related to bank size. As bankers to national corporations and other large organizations, the money market banks generally issue certificates in denominations no smaller than $0.5 million or $1.0 million. Smaller banks issue certificates for $100,000 or less. It is felt that these relatively high dollar limits discourage large-scale shifts out of demand balances. Any funds available in these amounts, over and above the customer's operating requirements, probably have already found employment in the short-term securities markets.

The deposit of time funds at commercial banks is guided both by interest rate considerations and by bank-customer relationships. Many corporations prefer to place funds only with banks at which they maintain working balances or important credit lines. Within this framework of bank-customer relationships, these firms put their funds with the banks offering the highest certificate rates.[3] Some corporations, in addition to setting a limit on their over-all certificate holdings, have set limits to their holdings of certificates of individual banks. These limits are often directly related to the importance of each bank within the pattern of the corporation's over-all banking relationships. Such corporate guidelines apply not only to new certificates acquired by the placement of time deposits, but also to the purchase of certificates in the secondary market. On the other hand, some corporations are guided almost entirely by interest rate considerations in their placement of time funds. They may go rather far afield to locate banks offering the highest certificate rates.[4] These differing approaches to the placement of time funds seem to be related to the preferences of individual investment officers rather than to the nature of the corporation itself.

[2] Upper limits to individual certificate denominations are a matter of concern only to relatively small banks. These banks are often unwilling to issue large certificates, for they believe that by doing so their deposit totals might become subject to the decisions of a few customers who may not wish to renew maturing certificates. For the large money market banks, in contrast, even very sizable certificates are not likely to exert an important influence on deposit totals.

[3] There is no evidence that large corporations expect favored rates from their banks of account when these banks are not actively seeking time deposit funds.

[4] Occasionally, a bank aggressively seeks time deposit funds outside its normal sphere of customer contacts by offering its certificates, both directly and through brokers, at particularly attractive rates. The deposits thus gained will in all likelihood be withdrawn at the maturity of the certificate if issuing rates for new certificates are lowered or permitted to become less competitive, compared with other short-term rates. This very aggressive offering of certificates has been an important source of deposits to the relatively few banks that have pursued this technique.

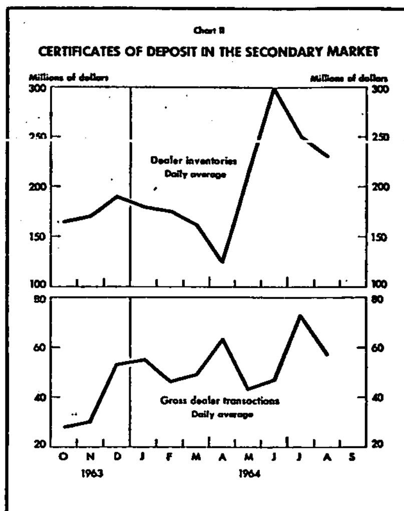
The frequent preference for the certificates of banks with which "important" account relationships exist has tended to create two classes of certificates: "prime" and "nonprime". These designations do not necessarily imply evaluations of bank soundness, but generally are appraisals of the relative marketability of bank certificates. Prime certificates are those that many large corporations purchase for their certificate portfolios; they are issued by large, nationally known banks, commonly called prime-name banks. Since a relatively large number of the most active participants in the certificate market are authorized by their investment committees to buy these certificates, such instruments can be sold and resold in the market more quickly than those of less well-known or nonprime-name banks. Many observers recognize degrees within the prime category itself; some prime certificates are "more prime" than others, i.e., more readily marketable.

The lesser marketability of nonprime certificates is reflected both in the interest rates at which they are originally issued and in the rates at which they trade in the secondary market. Smaller commercial banks are obliged to offer certificates at rates generally ⅛ to ½ of 1 per cent higher than those offered by prime money market banks. In the secondary market, nonprime certificates are usually traded at rates from 5 to 25 basis points (1/20 to ¼ of 1 per cent) above rates on prime certificates of comparable maturity. This spread may be larger if the denomination of the certificate is less than $1 million, since the large corporations active in the secondary market usually avoid small denominations unless interest rates provide an incentive for their purchase. The certificates of many strictly regional banks, though negotiable, are essentially nonmarketable. Unless they carry unusually high coupon rates, they are not likely to enter the secondary market, since dealers have no desire to acquire instruments for which there is only limited likelihood of resale. Normally, therefore, such certificates must be held until maturity.

Market rates for prime certificates are often about ¼ of 1 per cent higher than rates for Treasury bills of comparable maturity.[5] Spreads between prime and nonprime certificates and, more generally, between certificates and Treasury bills vary from time to time, chiefly in response to changing appraisals of the outlook for short-term inter-

[5] Certificates of deposit are issued and traded on a yield-to-maturity basis, while Treasury bills are issued and traded at a rate of discount from face amount. The rate-of-discount basis understates the actual investment return of Treasury bills. Hence, comparisons of market rates overstate the actual yield differential between Treasury bills and certificates.

est rates. These spreads tend to narrow when a trend toward lower interest rates (higher prices) is anticipated. At such times, market participants feel more assured of the relative marketability of higher yielding (though less liquid) instruments—e.g., certificates as compared with Treasury bills. Accordingly, they bid actively for these higher yielding instruments in order to maximize income and with an eye to their greater potential for profits should interest rates decline as expected. When higher interest rates (lower prices) are expected, instruments providing a lesser degree of liquidity become relatively less attractive and spreads tend to widen.



THE SECONDARY MARKETS

The secondary market for certificates has expanded as the volume of outstanding certificates has mounted. Today most Government securities dealers make markets in certificates. In recent months dealers' inventories of certificates have ranged between $175 million and $325 million, with an average level at about $250 million. The daily volume of certificate trading by dealers has varied widely, ranging between $15 million and $110 million, with an average of $50 million to $60 million (see Chart II). This compares with inventories of United States Government obligations maturing within one year (largely Treasury bills) which range between $2.2 billion and $3.8 billion, with daily trading volume typically ranging between $1.1 billion and $2.0 billion during the third quarter of 1964.

Despite its moderate size, the certificate market is broad enough to assure certificates a considerable degree of liquidity, especially if they are prime or nearly prime. Most corporations with certificate holdings apparently view them as a source of secondary liquidity, and rely on their holdings of short-term Treasury securities to provide funds for emergency needs. Day-to-day adjustments between cash and short-term investments are likely to be conducted in the Treasury securities market, either through outright purchase or sale or via repurchase arrangements with United States Government securities dealers. In these circumstances, certificates need not be sold until it is convenient to do so. In fact, many corporations hold their certificates until maturity and rarely, if ever, enter the secondary market; it is enough to know that the certificates can be sold if necessary. Of course, the liquidity of time certificates has not been tested in a period of marked decline in general liquidity and sharply rising interest rates, when perhaps many holders would be seeking to reduce their certificate commitments.

Dealers' spreads in certificate trading (the difference between bid and offered rates) recently have been about 3 to 5 basis points, which amounts to $75-125 per million dollars for a 90-day maturity. By comparison Treasury bill trading spreads usually range between 1 and 3 basis points. Certificate trading spreads have less bearing on dealer profits if the certificate has been part of the dealer's inventory for a number of days or weeks. In these cases, trading profits—as for other instruments—are increasingly related to interest accruals, financing costs, and any movement of short-term interest rates.

Dealers not only maintain a spread in favor of certificates, compared with Treasury bills, but also take into account the rates at which banks are currently issuing new certificates. For example, if prime-name banks are offering six-month certificates at 3⅞ per cent (i.e., 3.875 per cent), a dealer may not wish to bid lower in rate than 3.95 per cent for a certificate of this maturity. His bid must be high enough above bank-issuing rates to permit him to offer the certificate at a rate (sale price)—in this example, probably about 3.90 per cent—that would provide him with a trading profit.

The secondary market has performed an important

function in providing certificates to those organizations that prefer to hold only very short-term instruments. The 2½ per cent maximum rates prescribed by Regulation Q for three to six months' deposits effectively prevented banks from issuing certificates of this maturity throughout most of 1962 and early 1963. Banks have been able to issue three- to six-month certificates at competitive rates since July 1963, when Regulation Q ceiling rates were raised to 4 per cent for deposits of 90 days or longer. However, the issuance of certificates of shorter than 90 days has been precluded by the 1 per cent ceiling in effect for deposits of this maturity. The secondary market has provided the only means whereby investors could acquire short-term certificates—previously those shorter than six months and more recently those shorter than three months —at attractive rates.

Until mid-1963, some corporations made a practice of acquiring certificates maturing in six months or more, in order to take advantage of profit potentials that developed when, with the passage of time, the certificates became due in less than six months. These corporations offered their certificates for sale at lower rates (higher prices) than those at which they were acquired, thus making a profit in addition to the interest earned during the period the certificates were held. (This technique of establishing profits—termed "riding the yield curve"—may, from time to time, be available with other debt and money market instruments as well.) The fact that Regulation Q ceilings in effect until mid-1963 prevented, in practice, an increased supply of new certificates of maturity of less than six months enhanced the possibilities of such profits in certificates. Since July 1963, this same technique has been used with shorter maturities. Corporations acquire certificates maturing in three months or more and sell them when their maturities are reduced to less than three months. Corporations that favor this means of increasing their investment return usually obtain certificates with attractive maturity dates, such as a tax or dividend date. Some dealers also establish rate profits in this way, purchasing certificates that they originally prompted their customers to acquire. (Many banks, including the large money market banks, will not issue certificates to securities dealers.) This technique for increasing the effective return on certificate holdings also enables banks to tap, through the operations of corporations and dealers, funds in those short-term maturity areas in which ceiling rates prescribed by Regulation Q still constitute a barrier to direct bank competition.

CONCLUDING COMMENTS

The successful offering of certificates of deposit has demonstrated that commercial banks can effectively compete for interest-sensitive funds, particularly those of corporations. It has also contributed importantly to the shift in deposit structure toward a heavier proportion of time deposits, which has tended to permit the extension of bank loan and investment maturities. As long as market interest rates remain below the Regulation Q ceilings, certificates are likely to experience further growth and to play an increasingly important role in providing funds for investing and lending purposes. If the issuance of new certificates were curtailed for any reason, the volume of certificates would decline, but only as outstanding certificates mature and are not replaced. The drain on deposits would thus be spread over a period of months. Banks experiencing this net certificate reduction would, of course, have to remain alert to the liquidity pressures that might be occasioned by these deposit withdrawals.

Certificates have also had an influence on the cost structure of the banking industry. Interest expenses have mounted as a result of both the enlarged volume of time and savings deposits and the higher rates paid on such deposits. Certificate interest expenses, per deposit dollar, probably have been lower than those of savings deposits, since certificate rates, partly reflecting the value of the instrument's negotiability, are often lower than the rates paid for savings deposits. Certificate rates are also more flexible than those on savings deposits. They may be raised or lowered in response to money market rates and, most importantly, in response to the individual bank's desire for time deposit funds; in contrast, interest rates for savings deposits tend to be relatively inflexible. Certificates can be offered aggressively when it is profitable to do so, and less eagerly when profitability declines. In the latter circumstances, banks might permit issuing rates for new certificates to become noncompetitive, relative to other money market rates.

In addition to their implications for the operations of commercial banks themselves, certificates have exerted an influence on interest rates. By absorbing funds that otherwise would probably have entered the markets for other short-term instruments, they have exerted an upward pressure on short-term interest rates, thereby contributing to Treasury and Federal Reserve efforts to maintain these rates and to reduce incentives for short-term investments abroad.

REPORT OF THE AD HOC COMMITTEE OF THE FEDERAL RESERVE SYSTEM ON NEGOTIABLE CERTIFICATES OF DEPOSIT TO THE COMMITTEE ON BANKING AND CREDIT POLICY,* MAY 22, 1962

BACKGROUND

Time certificates of deposit have been issued in negotiable form for many years by some banks outside New York City, but they have become a significant money market instrument only since February 1961 following the announcement by the First National City Bank of New York that they would actively seek such business. The recent expansion of certificates of deposit was motivated by efforts of large New York City banks to attract corporate short-term funds that would otherwise be invested in instruments that were readily marketable, such as Treasury bills or prime commercial paper. Thus, banks now provide a money market instrument and thereby may influence the terms and conditions under which short-term U.S. Government securities are bought and sold. The liberalization of regulation Q at the beginning of this year gave further impetus to the development of this instrument.

The System has a special interest in keeping in close touch with developments in the market for negotiable certificates of deposit. Trading in negotiable certificates of deposit has become an integral part of money market activity. At the same time, developments in these certificates have effects on the banking structure, possibly leading to significant changes in the volume or distribution of bank credit and money. Board authority to regulate rates offered on these certificates makes it desirable for the System to keep continuously informed on the place of this instrument in the financial structure.

Because they are readily marketable, negotiable certificates of deposit issued in large denominations by well-known banks compete directly with other money market instruments, such as short-term U.S. Government securities, commercial paper, sales finance company paper, and bankers' acceptances. The development of a secondary market, particularly one in which Government securities dealers are at the center, adds a new dimension to the money market and to the environment in which the open market desk operates. It provides an additional instrument which investors can buy and sell in competition with short-term U.S. Government securities. The certificates are traded in a developing secondary market, which currently is made by several Government securities dealers in New York. While one of them is particularly active, other dealers contribute to the functioning of the secondary market. Indeed, the formation of a secondary market was integral to the development of the instrument. Any further significant growth in amounts outstanding will no doubt be accompanied by a broadening of the secondary market. Certificates of deposit are now usually issued in a fairly standardized negotiable form. To increase their marketability, some of the certificates issued by banks in other cities are also payable through their New York correspondents. To facilitate secondary trading, large deposits are normally represented by several certificates in amounts of $1 million each. Transactions are normally settled in Federal funds.

The outstanding amount has grown rapidly in the past year. As of the last Wednesday in April 1962, there were $1.3 billion of negotiable certificates outstanding issued by leading New York City banks—three times as much as a year earlier, when figures were first collected. Another $400 million was outstanding from Chicago banks which started reporting in October 1961. Secondary market sources have estimated that perhaps another $1 billion of certificates issued in marketable form was outstanding from other banks throughout the country. The total outstanding during the early spring this year, therefore, may have been in the order of $2.5 to $3 billion.

The amount of negotiable certificates of deposit outstanding is already comparable in magnitude to several other kinds of money market paper. Outstand-

* The membership of this special committee follows: George Garvy, chairman; Ernest T. Baughman, Philip E. Coldwell, Lewis N. Dembitz, and Stephen H. Axilrod, secretary.

ing commercial and finance company paper placed through dealers amounted to more than $1.5 billion and directly placed finance company paper to over $3.5 billion in early spring. Outstanding bankers' acceptances were in the order of $2.5 billion.

The further growth of negotiable certificates of deposit, which seem to be issued largely to businesses and others sensitive to relative interest yields, will be strongly influenced by the trend of rates on other competing securities and, indeed, the future of this market could in large part depend on what changes, if any, are made in regulation Q in the course of time as market conditions change.[1]

Unlike other money market instruments, variations in the amounts of negotiable certificates of deposit outstanding may also influence the reserve position of banks. Purchase of newly issued open market paper normally does not involve any change in bank reserves since the transaction is usually consummated by an exchange of demand deposits. Acquisition of new negotiable time certificates of deposit, on the other hand, often may involve a switch from demand to time deposits and thereby an immediate reduction of bank reserve requirements.

The widespread issuance of negotiable certificates of deposit by banks also raises questions related to general bank liquidity and safety; it definitely has implications for bank supervision.[2]

Negotiable certificates of deposit are thus an instrument which influences and is influenced by several different aspects of System monetary policy simultaneously. Of all the ways in which negotiable certificates of deposit interact with monetary policy, perhaps the most important at the moment, and the one for which additional data would be particularly useful, is the place of negotiable certificates of deposit in the money market. The subcommittee has focused on this aspect of the problem. In so doing, it has concluded that certain current data should be collected from both the primary and secondary markets—that is, from banks and dealers. Our recommendations as to the specific data to be collected follow after a brief further discussion of the function of negotiable certificates of deposit.

FUNCTION AND USE OF NEGOTIABLE CERTIFICATES OF DEPOSIT

Negotiable certificates of deposit are a source of funds to the banking system, an investment medium for corporations and others, and a money market instrument. These three functions will be considered in turn.

Source of funds to banks

Barely a year after their introduction as a money market instrument, negotiable certificates of deposit have become a large proportion of time deposits at New York and Chicago banks. In April of this year, the proportion of reported negotiable certificates of deposit to time deposits other than savings deposits at weekly reporting member banks in New York and Chicago amounted to 33 percent. A major portion of the week-to-week change in time deposits at these weekly reporting banks is also accounted for by negotiable certificates of deposit. But there have been periods (January 1962, for example) in which reported negotiable certificates of deposit have changed in one direction and total time deposits in another. Moreover, these reported certificates of deposit are only a small proportion of the level or change in time and savings deposits at all commercial banks (time deposits other than savings deposits are not reported separately for all commercial banks).

The increasing sophistication of corporate portfolio managers in the postwar years has resulted in reduced placement of temporary funds in bank deposits and more emphasis on various kinds of market instruments. Banks began to promote negotiable certificates of deposit so as to retain corporate funds that

[1] The rise in rates at the beginning of this year on time deposits payable in 6 months or more was accompanied by a sharp expansion in amounts outstanding from reporting New York and Chicago banks. This expansion came after several months when amounts outstanding had been little changed and was no doubt partly related to banks' ability and willingness to raise the rate on such deposits relative to rates on 6-month bills and on 9–12-month issues.

[2] There is also the separate problem of whether acquisition of such certificates by banks should be counted in the calculation of reserve positions. This problem is outside the frame of reference of this subcommittee. It has been the subject of some discussion between the staffs of the Federal Reserve Bank of New York and the Board of Governors, in the course of which it was concluded that no change in the procedures of reserve accounting is now appropriate.

would otherwise move into other money market instruments and to acquire such deposits from other banks.

Basically, negotiable certificates of deposit do not have any different effect on the structure of bank liabilities than do nonnegotiable time deposits (including certificates issued in nonnegotiable form). Like other time deposits, they tend to reduce the volatility of liabilities, thereby increasing the extent to which banks may be willing to invest in long-term assets. However, because negotiable certificates of deposit can be sold in a secondary market, they may, in fact, be considered as a more stable liability than other time deposits.

Banks have a considerable amount of control over the inflow of such funds through changes in the interest rates they offer. To make these certificates profitable, banks will have to invest the proceeds in higher earning and, therefore, usually longer term assets than, for example, Treasury bills. This may raise problems of bank examination and supervision. So may two special aspects of negotiable certificates of deposit which may be mentioned. One has to do with negotiable certificates of deposit that arise as compensating balances.[3] Another is the impact of negotiable certificates of deposit on the competitive position of medium-sized and large banks, large banks are at an advantage for two reasons. First, their name is widely known, and this makes their certificates more readily marketable. Second, they can more easily issue certificates in the large face amounts appropriate for secondary market trading. Medium-sized banks have to compete vigorously and perhaps offer premium rates if they are to have a share of the market.

Investment medium

Negotiable certificates have several characteristics which make them attractive to investors. First is their rate. This has generally been above the yield on Treasury bills of comparable maturity. The development of the negotiable certificates of deposit in the future thus depends on banks' continuing ability to offer competitive rates. A second advantage of negotiable certificates of deposit is their liquidity. Yet another advantage is the possibility of obtaining tailormade certificates for specific dates and fitted to the investing needs of the purchasers. Since rates and amounts are negotiated, corporate and other treasurers can take advantage of regional differences in the availability of funds and the related pattern of rates.

Some certificates are sold before maturity not because the buyer needs funds, but to take advantage of the appreciation possibilities inherent in the steeply sloped yield curve on time deposits now set by regulation Q. The original holder of a 6-month certificate, for example, can sell it to an investor who desires to invest funds for less than 6 months. The original holder can obtain a yield larger than the (say) 3½-percent original contract rate, because he will find a buyer willing to pay a premium in order to obtain a (say) 3-month instrument which yields more than a new time deposit of comparable maturity. A buyer would be able to obtain only 2½ percent if he put his funds in time deposits for 90 days to 6 months (and 1 percent for less than 90 days), but by purchasing a negotiable certificate of deposit with that time to run he can obtain a larger annual yield. Such possibilities tend to generate certificates destined to be sold in the secondary market.

Negotiable certificates of deposit are particularly attractive to large investors with surplus funds available for temporary investment, such as large corporations, State and local governments, and large nonprofit organizations. They also could become an important form of investment for foreign governments and official institutions.

The general preference of the secondary market for certificates in large denominations limits the range of potential buyers. While negotiable certificates of deposit in amounts as low as $100,000 have been issued to corporations, the basic trading unit in the secondary market is $1 million. Corporate buyers apparently prefer to trade in such units, and these units receive more attractive bids in secondary markets than smaller ones.

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[3] These stem mostly from link financing arrangements, whereby a third party agrees to leave on deposit the funds which the banks require as compensating balance by the borrower. Non-interest-bearing negotiable certificates are sometimes issued against these funds (the interest being paid by the borrower rather than by the bank). The chief advantage to the bank is the lower reserve requirement against time deposits. Such certificates may be sold in the secondary market at a proper discount.

Holders of negotiable certificates of deposit tend to be sophisticated investors who would be sensitive to changes in yield relationships. Under these circumstances, one would expect the volume of primary as well as secondary market activity to fluctuate, depending on the attractiveness of certificates of deposit in relation to other money market instruments.

Money market instrument

Negotiable certificates of deposit have already become a significant market instrument which competes basically on a rate basis with other short-term liquid instruments. It may become even more widely used in the money market as trading volume expands and as dealers seek to develop the market further. Some dealers are, in fact, developing techniques, such as repurchase agreements, to make certificates of deposit more attractive as a money market instrument. Past experience shows that, once established, a money market instrument is continuously adapted to the changing needs of the market.

DATA REQUIREMENTS FOR MONEY MARKET ANALYSIS

The ad hoc committee has concluded that System interest in negotiable certificates of deposit centers on their role as a money market instrument. Other aspects, however, such as their relation to bank competition for funds, to the composition of banks' liabilities, or to the liquidity of corporate and other holders, are also important. Indeed, negotiable certificates of deposit have grown rapidly because they can serve so many different purposes.

Data designed to meet needs of money market analysis will also prove useful in other respects. Some additional data particularly useful to the study of certificates of deposit in relation to banking structure might be collected at little extra cost.

For money market analysis, data on certificates of deposit will supplement already available data for yields and outstanding amounts of other market instruments. Relating negotiable certificates of deposit to the structure of time and savings deposits, however, would require a large amount of additional information on the ownership and rates for other types of time and savings deposits.

Information currently available

Weekly reports on amounts outstanding are now collected from nine principal banks in New York and five in Chicago. These banks also report the rates of interest being offered for typical maturities. Data are collected on a voluntary basis by telephone.

Weekly reporting banks include negotiable certificates of deposit in "other time deposits" (other than savings deposits) of IPC depositors. For New York and Chicago banks, certificates of deposit represent a large proportion of the more inclusive total which often moves fairly closely with negotiable certificates of deposit. The correspondence is neither close nor consistent. Furthermore, there is no reason for assuming that "other time deposits" outside New York and Chicago can be taken to indicate changes in the volume of negotiable certificates of deposit outside the two financial centers.

New data possibilities

The existing data do not adequately cover important money market aspects of negotiable certificates of deposit. It would be desirable to institute a regular reporting system to obtain currently a minimum of information required for money market analysis. Some definitional and conceptual problems will be encountered, but these do not seem insuperable. A proper cutoff point in reporting and limiting reporters to the larger institutions would itself tend to eliminate certificates of deposit which are in practice not likely to be negotiated, either because of size, bank of issue, or characteristics of investors.

A list of relevant statistical data for negotiable certificates of deposit that would help in relating them to other money market instruments follows:

(1) Total amount outstanding.

(2) Amounts entering the secondary market (i.e., no longer held by the original purchasers).

(3) Rates available on new certificates, by broad categories of issuing banks and by size.

(4) Rates (for typical maturities) at which certificates are traded in secondary markets.

(5) Maturity distribution of certificates outstanding and traded.

(6) Distribution of certificates of deposit by broad categories of original buyers and by holders.

(7) Distribution of certificates of deposit by issuer (geographically, size of bank, etc.)

(8) Certificates held in dealer portfolios.

Clearly not all of the information so far mentioned can or need to be gathered at present. Priorities have to be established so that information will be first gathered which most effectively helps the System to carry out its monetary policy responsibilities, as effectuated mainly through open market operations.

Other possible aspects of certificates of deposit, on which the System might want to be posted, but not necessarily through systematic and periodic reporting, include minimum denominations entering the secondary market, typical dealer spreads (by maturity), spreads related to size or location of issuing bank, typical frequency of turnover of certificates of deposit traded in secondary markets, frequency with which maturing certificates of deposits are reissued (rolled over), etc. Much of this information would shed light on other aspects of certificates of deposit aside from their money market use.

Information might also be desirable on changes in attitude of banks toward issuing certificates of deposit (depending on changes in rate structure and degree of market tightness), existence of internal ceilings for amounts that a bank will issue (in absolute terms or in relation to its total liabilities), or a corporation will hold, etc.

In view of the System's interest in certificates of deposit as a money market instrument, definitional as well as reporting problems could be solved along these lines:

(*a*) Cover only certificates of deposit issued in amounts of $500,000 and over (or similar cutoff point). Such a lower limit would eliminate the overwhelming bulk of certificates of deposit issued in negotiable form, but which are unlikely to enter the secondary market. The smaller certificates are likely to include many that are issued to individuals, small businesses, charitable institutions, and local governments which are not likely to be sold before reaching maturity. The cutoff limit would result in reporting substantially all the really marketable negotiable certificates of deposit issued.

(*b*) Require current reporting only from banks that have a certain minimum amount, say $5 million, in certificates of deposit outstanding.

A combination of (*a*) and (*b*) would reduce the number of reports (thus assuring more current availability of data), without reducing the reported aggregate substantially below the true national total of negotiable certificates. It may be assumed that movements of the reported amounts would parallel that of the national total sufficiently closely to meet all foreseeable analytical needs. Blowing up of reported amounts to national totals by the use of benchmark data is not recommended.

Certificates of deposit could be reported either as a memorandum item by weekly reporting banks or on a special report; we favor the first alternative. Voluntary compliance, reinforced by bank examination activities, would be relied upon to bring subsequently into the reporting group additional banks that increase their certificates of deposit sufficiently to meet criterion (*b*). Alternatively, benchmark data could be obtained periodically (say every 2 or 3 years), for instance through a proper supplement to the Call report, perhaps in connection with the collection of other data on time deposits.

An alternative approach would be to break out all certificates of deposit from "other deposits" on the form for all weekly reporting banks. In this case, all banks in the sample would report, irrespective of the amount outstanding. By including a number of banks which are quite unimportant in the market this would increase the reporting burden unnecessarily. It may also involve definitional difficulties if the banks are to be instructed to eliminate certificates that are not really negotiable.

RECOMMENDATION

Before proceeding to the establishment of any regular reporting system, it would be useful to make a one-time survey in order to obtain a clear idea about the total amount of negotiable certificates outstanding and the number and location of banks now issuing such certificates. We recommend this to be done by instructing each Federal Reserve bank to ask all weekly reporting member banks, and in addition any nonreporting banks that may have issued a substantial volume of negotiable certificates of deposit, to report the volume outstanding as of a given Wednesday.

The subcommitte expects such a survey to support its conclusion that the importance of negotiable certificates of deposit and their use as a money market instrument justify initiation of a regular current reporting series on the following basis:

(1) On the basis of a national survey, a reporting group should be determined which would include only banks which have $5 million outstanding (rules for dropping banks that for a specified period of time fall below this limit will have to be specified) with all certificates of $500,000 and over outstanding (not issued during the reporting period) to be reported. This would cover the bulk of all certificates of deposit issued and practically all that may be traded.

(2) The basic series should be weekly.

(3) There might be sufficient interest in the maturity distribution of certificates issued or outstanding to warrant collection of such information. In view of the way records are kept by the issuing banks, a breakdown of all certificates outstanding by time remaining to maturity would be easily feasible. It would, however, complicate the reporting form by requiring a memorandum item on the weekly member bank report. We do not recommend collection of such data, but if it is done, we suggest consideration of the following breakdowns: from 3 to 6 months, 6 to 9 months, 9 to 12 months, and 1 year and over. If maximum rates on the shortest certificates are raised, an additional bracket: "under 3 months" would be required.

(4) There does not seem to be any pressing need for a breakdown by broad categories of buyers (such as manufacturing corporations; other nonfinance corporations, insurance companies, etc.), at least not at the start. Sufficiently reliable information to meet any trading desk needs can be obtained from time to time from the dealers handling the bulk of trading.[4]

(5) Collection of data through the individual Reserve banks would automatically yield a breakdown by district, if desired.

(6) Rate information on a weekly basis should be collected for the secondary market only; obtaining such data from three or four New York dealers would presumably be sufficient, and their cooperation could presumably be secured with no great difficulty.

It seems desirable to obtain the yield to maturity on the basis of offer prices for certificates traded with 3, 6, and 9 months to maturity; currently, no 12-month certificates of deposit are traded in the dealer market.

Two alternatives for quotations may be considered. The yields could represent the central tendency for the week (based on the mean or the mode; in practice, one would ask the dealer for a "representative" or "prevalent" yield). Alternatively, yields for a single day (Wednesday) could be collected. We recommend the second alternative. Yields should be obtained for certificates of deposit issued by leading ("prime") money market banks.

(7) There is considerable doubt that issuing rates quoted by individual banks are, in fact, the ones at which the bulk of certificates are actually issued. Ranges of quoted rates are fairly wide and therefore difficult to interpret. Weighted averages would impose considerable reporting burdens on banks. In any case, dealer rates would be more meaningful for money market analysis.

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[4] Form B-1 on liabilities to foreigners shows in a footnote the amount of negotiable certificates of deposit issued to foreigners. These data should be tabulated and made available together with other data on certificates of deposit to be collected.

Weekly rate information on issuing rates presently collected from New York and Chicago banks should be continued, since it is readily available, even though its analytical significance is quite limited.

(8) Dealer inventories should not be collected at the start. They are relatively small and not of sufficient analytical significance.

(9) It may be desirable to obtain at a later stage trading volume during the week from dealers, although perhaps not by maturity brackets. For the time being, occasional direct checking with dealers will meet trading desk needs to follow significant changes in trading activity.

While potential growth of negotiable certificates of deposit will raise a number of questions for bank management and bank supervision, their solution will require focusing on individual institutions. There does not seem now to exist any need to envisage collection of data on a national basis to assist in the analysis of the impact of certificates of deposit on the management of banks.

MAY 22, 1962.

GEORGE GARVY, *Chairman.*
ERNEST T. BAUGHMAN.
PHILIP E. COLDWELL.
LEWIS N. DEMBITZ.
STEPHEN H. AXILROD, *Secretary.*

NEGOTIABLE CERTIFICATES OF DEPOSIT

The attached draft memorandum by Miss Dingle, largely prepared several months ago, brings together material of various types relating to negotiable time certificates of deposit. The body of the memorandum considers the history of the recent expansion in certificates of deposit and the nature of some of the problems presented from the standpoint of monetary policy. Attached are two appendixes covering asset and liability changes for two groupings of weekly reporting banks over two time periods. The first studies weekly reporting banks by Federal Reserve districts over the period May 1961 to May 1963; and, the second covers weekly reporting banks grouped by ratio of time certificates of deposit to total deposits over the period December 1960 to December 1962.

The basic problem related to time certificates of deposit arises from the fact that banks now have as a relatively permanent part of their liability structure a sizable amount of time deposit liabilities that are very sensitive to changes in short-term market rates of interest. Banks have meanwhile invested in long-term assets, but few have made provisions for increased liquidity to meet any drains from these deposits. To retain these deposits requires adjusting to rising short-term rates, which may require carrying securities at negative yield spreads, if they are not to be liquidated at losses. Moreover, such deposits are heavily concentrated on the part of holders that may draw down interest-bearing liquid assets in periods of economic expansion.

The magnitude of the problem will, of course, depend not only on the extent of further increases of time certificates of deposit, or of other types of time deposits with similar characteristics, but also on changes in short-term rates and in needs for funds by corporations and on bank responses to such changes. Based on current levels of outstanding time certificates of deposit and on corporate reductions in interest-earning assets in the past, the reduction in time certificates of deposit might be $1½ to $2 billion in a period of cyclical expansion.

While the problems are likely to be greatest in the event of corporate reduction of interest-earning assets, this problem is not distinct from that of a general increase in short-term rates while corporate holdings of such assets increase. Even with some liquidation of corporate portfolios, there would probably be some rate of interest that would permit the maintenance of time certificates of deposit at an unchanged level. Similarly, even without a reduction in corporate portfolios, there would be some increase in short-term rates that would make banks unwilling or unable to maintain deposits, choosing instead to sell securities at a loss or to increase their discounting with the Reserve banks. In either case, the question becomes the susceptibility of changes to monetary control and the effects of the means of adjustment selected on bank profits and losses.

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Implications of Recent Increases in Corporate Time Deposits

Recent years have seen revolutionary developments in both the assets and the liabilities of commercial banks. On the one hand, time and savings deposits have been increasing sharply as a percentage of total deposits. On the other hand, holdings of long-term assets, including particularly State and local government securities but also U.S. Government securities and real estate loans, have been increasing as a percentage of total loans and investments. On August 28, 1963, time and savings deposits at all commercial banks were equal to 42 percent of total deposits, compared with 33 percent 3 years earlier. In the same period holdings of securities other than U.S. Government securities increased from 10 to 14 percent of total loans and investments and long-term U.S. Government securities and real estate loans increased substantially. The change has been particularly great for city banks, which in recent years have had principally demand deposit liabilities and have held relatively small volumes of long-term securities and real estate loans.

The growth in time and savings deposits reflects in part increasingly effective competition with savings and loan associations and mutual savings banks for the funds of the small saver. It reflects also effective competition with short-term Treasury securities, finance company paper, and other short-term paper, for funds particularly of businesses but also of foreign accounts, State and local governments and wealthy individuals. Both developments were fostered by increased interest rates made possible by an increase in the maximum permitted under regulation Q. The attraction of business and foreign funds was also fostered by the decision of city banks to make available negotiable time certificates of deposits and by the decision of Government security dealers to make a market in them.

The discussion in this paper will be confined largely to increases in time deposits other than savings deposits, particularly time certificates of deposits held by businesses, and their implications for bank soundness and the operation of monetary policy. It should be noted, however, that the distinctions among types of time deposits are not always clear cut. While savings deposits are by regulation confined to individuals and nonprofit associations, either ''me certificates

of deposit or time deposits, open account, are held by a wide variety of holders, including individuals as well as businesses, foreign accounts, State and local governments, and miscellaneous investors. The form in which expansion of time deposits takes place depends on relative interest rates on the various types as well as restrictions respecting type of holder, size, or other characteristics imposted on the various types. Moreover, the extent of change in various asset items, particularly long-term investments, accompanying increases in time certificates of deposit or time deposits, open account, depends on the extent to which funds are also available from savings deposits as well as the strength of demand for various types of loans.

CHARACTERISTICS OF THE MARKET FOR CD'S

Early history and current outstandings

Some banks, notably the large banks in the 11th Federal Reserve District, had been using the device of negotiable time certificates of deposit to attract business funds before 1961. The sharp expansion was triggered, however, by the announcement of the First National City Bank of New York early in 1961 that it would issue such certificates and that it had made arrangements with a large Government security dealer to make a market in outstanding certificates. Other New York banks followed suit quickly, as did large banks in most other Federal Reserve districts. Some small banks have also issued such certificates. The market, however, has been largely confined to transactions of $500,000 or more—in the early days, $1 million or more—thus limiting the issue of effectively marketable certificates to relatively large banks. As of December 5, 1962, banks with deposits of $500 million or more accounted for 73 percent of all negotiable time certificates of deposit outstanding and 80 percent of all denominations of $500,000 and over. Many large corporations are unwilling to consider small certificates of deposit or certificates issued by other than money market banks, and many banks discourage issuance in denominations below $500,000. Smaller banks have also competed actively not only for savings deposits but for other time deposits, but substantially less is known of the characteristics of the owners of such deposits than of the negotiable time certificates of deposit of large money market banks.

Since early 1961, time certificates of deposit, and time deposits of businesses, corporations, and foreign accounts generally, have expanded sharply. The focus of the greatest strength has shifted from time to time, with expansion tapering off or being reversed at some banks at the same time that other banks showed acceleration growth rates. A few banks, including one major New York bank, have taken steps to reduce their outstandings below an earlier maximum, and outstandings at a number of banks have leveled off at least temporarily. On the other hand, a number of banks that had entered the field relatively late and on a small scale have increased their outstandings very rapidly in recent months.

Position of banks

The introduction of time certificates of deposits by New York banks did not come at a time of acute pressure for funds. Loan demand had slackened after mid-1960, time deposits had already picked up somewhat, and New York banks in particular had been able to make considerable progress in replenishing depleted holdings of U.S. Government securities by early 1961. On the other hand, the banking system's demand deposits had been increasing only slowly for a number of years, and New York banks had failed to share in the limited secular growth and had experienced a cyclical decline in late 1959 and 1960. Past developments suggested that the major opportunities for bank expansion might be expected to lie in the field of time deposits, and city banks had long been seeking some way to attract a larger share of corporate liquid assets, which for a number of years had been held to a decreasing extent in demand deposits and to an increasing extent in Treasury securities and finance company paper. The monetary policy which prevented short-term rates from falling so far as in earlier recessions both prevented an increase in demand deposits of the magnitude that might otherwise have been expected and made feasible the competition by means of time certificates of deposit.

The motivations causing individual banks to enter the area and the uses initially made of funds were varied. Certainly the mere desire for bigness and the unwillingness to be left out of a new type of development were not insignificant factors. Some banks feared an impairment of customer relations, and pos-

sibly a loss of demand deposits, if they did not make available time certificates of deposit, or they hoped to use time certificates of deposit as a wedge for attracting other types of business. Some banks that were losing demand deposits or that had to meet strong loan demands saw in time certificates of deposit a convenient means of meeting seasonal or longer run needs without liquidating securities or drawing on correspondents. Some banks without strong immediate needs for funds initially kept a large part of the funds raised through time certificates of deposit in the form of short-term U.S. Government securities or brokers' loans. Others frankly eyed from the beginning what they believed to be profitable long-term investment prospects.

Whatever the initial motivation and the initial use of funds, however, funds raised in this manner, at least by the larger banks, went far beyond any short run or structural needs of the banks, and holdings of short-term money market paper did not prove profitable. The large volume of funds attracted and pressures for profitable use led to their employment in long-term investments, particularly State and local government securities but also long-term U.S. Government securities and, most notably for city banks, real estate loans. The pressure of this demand was a major factor in downward pressures on yields, particularly on State and local government securities, which together with increases in rates on time deposits have reduced profit margins substantially.

Position of corporations

From the standpoint of corporations with available funds, the time certificates of deposit had the advantage of safety, attractive yields, convenient maturities and marketability. Rates offered by New York banks have generally been above those on Treasury bills of comparable maturities and competitive with finance company paper, and some corporations have made a practice of trying to place funds with smaller banks at higher rates. Most banks have been willing to make certificates available with any desired maturity and maturities have been consequently chosen with reference to tax and dividend dates or other corporate needs for funds.

The role of the negotiability feature and the existence of a market in the developing importance of time certificates of deposit has been somewhat ambiguous. The market has been thin compared with that for Treasury securities and some offerings have remained on dealers' shelves for a substantial period. On the other hand, the relatively small volume of transactions has reflected to a substantial extent limitations of supply rather than demand. There can be little doubt that most holders of time certificates of deposit have relied upon the selection of convenient maturity dates, as they have for finance company paper, in which no market exists. On the other hand, finance companies have on occasion redeemed paper prior to maturity, a practice which is prohibited to banks. The market in time certificates of deposit does provide a possible outlet in event of need, but one that is largely untested thus far.

Uncompetitive rate ceilings under regulation Q effectively prevented the issuance of certificates maturing in less than 6 months and now similarly restrict the issuance of certificates maturing in less than 3 months. These restrictions have created some demand for short-term certificates that can be satisfied only in the market and, particularly before recent increases in short-term rates, encouraged interest arbitrage on the part of some holders that were willing to buy certificates with long maturities for sale prior to maturity. As long as significant numbers of banks are willing to make available time certificates of deposit at the holders' choice of maturity dates and at competitive rates, there seems to be little reason to expect the development of substantial demand for longer term certificates to be satisfied in the market. On the other hand, as long as overall demand for certificates remains strong, there seems no reason for a holder to have to accept a substantial sacrifice compared with going rates to dispose of certificates in event of need. The division of the initial impact between the market and issuing banks in event of a sudden corporate desire to reduce their holdings is uncertain. As long as transactions are confined to large certificates, it seems likely that the market will continue limited and that a large proportion of holders and prospective purchasers will be subject to similar seasonal and cyclical forces.

EFFECTS ON FINANCIAL FLOWS

The issuance of time certificates of deposit, together with a monetary policy which has maintained short-term rates at relatively high levels throughout the cycle and the failure of corporate investment to pick up as it has in other periods of cyclical expansion, has modified sharply financial flows of the most recent cycle compared with those of earlier cycles.

Differences from earlier cycles

In past cycles, banks have increased holdings of U.S. Government securities, State and local government securities, and real estate loans in periods of recession, with much of the increase in the early stages concentrated in short-term U.S. Government securities. During the subsequent expansion, as loan demand built up, bank holdings of U.S. Government securities were reduced and holdings of State and local government securities tended to stabilize. These adjustments were particularly large on the part of money market banks, which have generally reduced holdings of State and local government securities and real estate loans as well as showing a very sharp reduction in holdings of U.S. Government securities.

Corporations, on the other hand, have tended to sell Government securities and build up demand deposits during periods of recession as declines in interest rates accompanied reductions in their profits. Early in a period of expansion they increased their holdings of U.S. Government securities substantially as interest rates rose, and subsequently reduced their holdings as their own needs for funds increased. Holdings of finance company paper by corporations have reflected the demand for funds on the part of finance companies as well as corporate needs for funds. Such holdings have generally increased early in a period of recession, when reductions in market rates of interest made a shift from bank financing particularly attractive for finance companies, declined as the recession progressed and finance company needs for funds declined, risen in the early stages of an expansion, and then stabilized as increased market rates caused finance companies to resort more to bank borrowings.

In the recession of 1960–61, the maintenance of short-term rates moderated the usual cyclical reduction in corporate holdings of Government securities and the increase in their demand deposits. During the early stages of the expansion, bank holdings of U.S. Government securities continued to increase, while those of corporations showed little change; to a significant degree corporations were making it possible for banks to hold on to Government securities by supplying funds in the form of time deposits rather than purchasing such securities themselves. Holdings of U.S. Government securities by city banks did decline moderately in 1962 and more sharply since then, but in contrast to other cyclical expansions State and local government securities and real estate loans have continued to expand at a rapid pace. Corporations with a large volume of internal funds available and with limited investment expenditures have continued to expand holdings of time deposits and finance company paper.

Sources of funds

Directly, most of the funds placed by corporations in time certificates of deposit have probably come from current operations. With profits and depreciation allowances high and current investment modest for a period of cyclical expansion, corporations have been in a position to add to their liquid asset holdings. Holdings of Government securities declined and demand deposits increased in 1960–61, but less than might have been expected on the basis of earlier cyclical experience. Since then, holdings of U.S. Government securities have shown mainly seasonal changes and demand deposits have declined somewhat. Holdings of finance company paper increased in 1960, showed little change in 1961 despite the reduced volume of automobile financing, and have risen sharply further in 1962–63, although much less sharply than time certificates of deposit.

Thus, from the standpoint of the corporations, the sharp increase in time certificates of deposit reflects the large volume of internal funds together with their choice of this form of investment on the basis of prevailing interest returns. It seems unlikely that corporations have borrowed for the explicit purpose of holding such certificates. On the other hand, the availability of short-term investments at attractive yields reduced pressures to use available funds to reduce bank and long-term indebtedness and may have them more willing at times to borrow in anticipation of their needs.

From the standpoint of the banks, the increase reflects the limited demand for additional checking accounts at prevailing levels of incomes and interest rates, the willingness of banks to compete for short-term funds and invest at a relatively small rate spread, and the willingness of the Federal Reserve to make reserves available to meet this expansion. In some cases there were direct transfers from demand to time deposits; more frequently, recipients of demand deposits in the normal courses of business converted them into time deposits, thus freeing reserves for credit expansion. In any case the Federal Reserve supplied sufficient reserves to meet required reserves behind the time deposits while permitting a modest expansion in demand deposits.

Flows in absence of time deposits

The ways in which financial flows would have differed if banks had not competed for time deposits would have depended on the type of monetary and debt management policies being followed as well as on elasticities of demand and supply of the various lending and borrowing groups. If time deposits had not been available, corporate demand would have impinged heavily on existing short-term paper, and a major element in the demand for long-term securities and real estate loans would have been absent or substantially weaker.

If rates on short-term securities had been permitted to decline in reflection of this demand, corporations would have increased holdings of short-term Treasury securities and, as rates declined, demand deposits as well. The lower rates might have induced finance companies to borrow an even larger share of their funds through directly placed paper, thus increasing supplies of these assets. Commercial banks, with more limited funds to lend, would not have been in a position to place the same pressure on long-term yields, particularly of State and local government securities, and might even have had to liquidate State and local government securities as well as longer term U.S. Government securities before this time. Higher rates would have induced purchases by individuals and miscellaneous investors. Thus, the net result would have been lower short-term rates and higher long-term rates, increased holdings of short-term securities by nonfinancial corporations, increased holdings of longer term securities by individuals and miscellaneous investors, and reduced commercial bank holdings of each and a shift of demand deposits from individuals to corporations. Lower short-term and higher long-term rates might have brought forth on their own an increased supply of short-term assets and a reduced supply of long-term assets. It also seems likely that a somewhat increased volume of demand deposits would have been compatible with the desired degree of monetary ease.

If, however, as seems likely, the Treasury had combated the pressures on short-term rates by even further issues of short-term securities, rather than permitting rates to fall, the reduced growth of time deposits would have been accompanied by larger corporate holdings of short-term securities, smaller bank holdings of longer term securities, and increased holdings of State and local government securities by individuals. Presumably, the Treasury in issuing short-term securities would have reduced its longer term debt by a corresponding amount, thus offsetting or more than offsetting the upward pressure due to reduced bank demand, but it seems likely that higher yields on State and local government securities would have been necessary to induce individuals and miscellaneous investors to purchase them.

PROBLEMS FOR BANK OPERATIONS AND MONETARY POLICY

The nature and extent of problems that are likely to be associated with the large volume of time deposits of corporations, State and local governments and foreign accounts depends, of course, in large measure on the type of economy one expects as well as the extent of further growth of time certificates of deposit. If one assumes that the threat of excessive demand and of domestic inflation is largely a thing of the past and that the major problem will continue to be that of keeping up short-term interest rates with the minimum discouragement to real investment, then there would seem to be no reason to expect pressures for liquidation of time certificates of deposit. Problems might well arise from the standpoint of bank earnings, the soundness of investments, or individual bank liquidity needs. If, however, the major financial problem should become again, as it has so often in the past, that of curbing excessive demand, then these problems might be swamped by that of making monetary policy effective without causing serious dislocations in the securities markets and/or serious problems from the standpoint of bank capital positions.

Bank earnings and credit quality

Even though corporations continue to accumulate liquid assets and have only a modest demand for bank credit and monetary policy continues to encourage business expansion, it seems likely that some banks are experiencing pressures on earnings as a result of the high rates paid on time deposits or, to alleviate such pressures, are acquiring sufficient long-term or low-quality assets as to lead to possibilities of future difficulties even in the absence of corporate liquidations of liquid assets and more restrictive monetary policies.

At the time that expansion into time certificates of deposit began, short-term interest rates were at cyclical lows, although well above lows in other recent cycles, and long-term rates were down only slightly from previous highs. The 3-percent maximum rate on time deposits was almost 1 percentage point below yields on long-term U.S. Government securities and one-half of 1 percent below yields on 3- to 5-year maturities and one-fourth of 1 percent to 1 percent below yields on the top four classes of State and local government securities. Increases in short-term rates, together with modest increases in yields on long-term U.S. Government securities and further declines in yields on State and local government securities, have brought yields on both groups of U.S. Government securities to about the levels now being paid on time certificates of deposit, while yields on State and local government securities are substantially below these rates. Net mortgage yields remain 5–5½ percent.

Administrative costs of issuing time certificates of deposit are negligible and costs of investment are not great at the margin. Hence, investment in almost any type of long-term asset appeared profitable at the time that the expansion of time certificates of deposit became significant. Investment in U.S. Government securities is no longer profitable, but mortgage loans continue profitable. Before-tax yields on high-grade State and local government securities are well below rates being paid on time certificates of deposit. Since increases in such securities do not increase taxable income, however, but increases in time deposits do increase tax-deductible costs, raising of funds through time deposits to invest in such securities continues to be profitable as long as banks are subject to income taxes.

It should be noted that banks in a position to profit from the tax exemption privilege could generally have increased total profits after taxes in any case by shifting from other assets, particularly U.S. Government securities, to State and local government securities. They took advantage of the increase in total funds and the presumed long-run character of these funds to effect a shift in portfolio composition without reducing the level of customer loans, or until recently, U.S. Government securities.

To the extent that after-tax income is increased by purchasing State and local government securities at a negative yield-differential, banks may be enabled to build up capital accounts to meet future losses. On the other hand, if any substantial part of bank funds are invested in assets with a before-tax return below the costs of attracting and investing the funds, problems would be compounded for any future period of losses or sharply reduced profits when the tax-exemption privilege would lose its value.

To maintain yields, it is reported that many banks have been purchasing lower grade or longer term assets and that some that had maintained staggered maturies on municipal securities in the past are no longer doing so. No satisfactory data are available to measure quality of bank credit or any recent deterioration that may have taken place. Data newly available from examination reports, however, show that among Federal Reserve member banks examined from mid-February through June, more than 25 percent of State and local government security holdings had maturities of 10 years or more, and among banks with total deposits of $500 million or more the proportion exceeded 35 percent.

Problems of liquidity

While problems for bank earnings and soundness may exist in the absence of liquidations of corporate financial assets or further increases in interest rates, the biggest problems from the standpoint of monetary policy and from the standpoint of bank adjustment would arise in the event of a strong increase in demand, corporate use of liquid assets for investment purposes, and inflationary pressures. Unless one believes that such developments are a thing of the past, consideration should be given to the nature of such problems.

Stabilty of time deposits.—It has been claimed that ime certificates of deposit, and time deposits of corporations generally, are unlikely to present any problems of drains from the standpoint of bank liquidity. As evidence, it is pointed out that savings deposits historically have continued to increase even in periods of sharp increases in economic demand and inflationary pressures, and it is inferred that because of the similarity in form time deposits should be expected to perform in a similar manner.

Many bankers admit that corporations may at times be pressed for funds but believe that they are in a position to compete to retain time deposits without difficulty. Experience thus far has given no evidence of what will happen if corporations have strong needs of funds in their own operations, although recent experience has shown that banks believe that it is necessary, and that under current circumstances they will act accordingly, to raise rates to hold funds when market rates of interest rise.

It is unrealistic to contend that because savings deposits have been maintained and even increased in periods of rising consumer expenditures, attractive investment opportunities, and restrictive monetary policy, a similar performance should be expected of corporate time deposits. The form of an asset or the characteristics of the issuer have little relevance for the stability of demand over a period extending beyond its maturity. Rather, the nature of the holder and the purpose for which it is held are all-important, and in this respect there are substantial differences between savings deposits held by the bulk of consumers and time deposits held by corporations.

Savings deposits and shares have indeed shown remarkable growth even in periods of strong consumer demand, inflationary pressures, and restrictive monetary policies. This reflects the fact that they are an important form of saving in a high-saving economy, that for many savers there are few alternative means of holding savings, and that the bulk of large-ticket consumer items are purchased on credit rather than by drawing on assets. For many holders, savings deposits are an integral and permanent part of their portfolios. Even where consumers accumulate such deposits and draw them down to make specific expenditures, they frequently intend to begin accumulating anew to meet other needs. In the past, when deposits have been drawn down by some holders, the reductions have been marginal and have been more than offset by increases on the part of other holders building up their deposits either as a permanent part of their portfolios or to meet planned expenditures. Thus, on balance, savings deposits and shares have increased even in periods of heavy demand.

The nature of operations of nonfinancial corporations and the purpose for which they hold financial assets is, however, quite different. Nonfinancial corporations are by their nature interested primarily in the operation of their businesses. Financial assets are held for the purpose of facilitating such operations and are drawn down readily when profitable investment opportunities present themselves. Large corporations and increasingly even smaller ones, have become quite interest-sensitive as between alternative forms of financial investment, and the total volume of financial assets that they hold is undoubtedly influenced at the margin by the relationship between the cost of borrowing and the return on idle funds. Nevertheless, it seems unrealistic to expect small changes in returns on financial assets held to have great influence on the willingness of corporations to take advantage of profitable investment opportunities in their own businesses.

While the present situation is a completely new and untested one in many respects, and while there are few statistics on breakdowns of bank time deposits in the past, nevertheless developments during earlier cycles give some evidence of the differences existing even then between time deposits at commercial banks and the deposits of small savers. While savings deposits and shares at savings and loan associations, mutual savings banks, and credit unions have shown steady growth over the postwar period, total time and savings deposits at commercial banks have shown definite cyclical movements, with sharp increases in periods of recession and a leveling out in periods of cyclical expansion. These tendencies were especially marked at city banks, while at country banks the expansion was much more regular. While the cyclical movements at city banks may have been heightened by inadequate adjustments of rates to market conditions, in some cases reflecting legal limitations under regulation Q, they show clearly that large commercial banks have always had among their time deposit customers a significant number—whether corporations, foreign accounts, or wealthy individuals—who drew down time deposits in periods of cyclical expansion to make other financial or real investments.

Ability of banks to compete.—Bankers have argued that, even though corporations may reduce the total volume of their liquid assets in order to make investments in their businesses, such assets would never approach the zero level, and commercial banks would be able to compete successfully with other forms of assets for such funds as were available. This would undoubtedly be true within limits, but the limits may be more restricted than many bankers believe and the price might be far more than the bankers have bargained for.

Increases in short-term interest rates in periods of cyclical expansion have always been relatively great, and it seems likely that increases in rates on time certificates of deposit would have to be greater than on many market instruments. Despite the recent increase, the market remains relatively narrow. As of December 5, 1962, about 70 percent of all outstanding negotiable time certificates had been issued to corporations, and more than two-thirds of the remainder to State and local governments or foreign accounts. It is to be expected that corporations, particularly the large corporations that hold the bulk of the negotiable certificates, would be subject to similar cyclical influences on the demand for funds and that State and local governments and foreign accounts would absorb considerably larger amounts only at substantial increases in relative rates.

The market for short-term Treasury securities is a far wider market, with substantial amounts going to miscellaneous investors in periods of tight money. Moreover, the Treasury has considerable flexibility in varying maturities and types of debt to fit the economic and financial conditions in which it is operating—with, of course, due regard for the requirements of monetary policy—and in a period of economic expansion it might well expect to have a cash operating surplus in the absence of tax reductions or sharp increases in expenditures.

Finance company paper is largely confined to the same market as time certificates of deposit, although finance companies have been willing to make it available in considerably lower denominations. It may be mentioned that in the past increasing corporate demands for funds have been accompanied by merely a leveling off and not an actual decline in their holdings of finance company paper, and that this has been accomplished without a disproportionately large increase in rates. It should be noted, however, that despite the sharp postwar increases, such paper was generally no more than 10 percent as large as corporate holdings of U.S. Government securities. At the present time, corporate time deposits at commercial banks are estimated to be about half as large as their holdings of U.S. Government securities, and it seems unlikely that corporations could be induced to make all their cyclical adjustments through Treasury securities without considerable changes in relative rates. Large finance companies have always had the option of avoiding disproportionately large increases in rates paid by shifting to borrowing from banks or in the capital market. These alternatives are, of course, not available in the same way for bank issues of time certificates.

Even if banks should be willing to compete sufficiently strongly to retain time certificates of deposit under such circumstances, it is by no means certain that their net retention of funds would be so great as their retention of time certificates of deposit. To the extent that they succeeded only in driving finance companies to the banking system to prevent paying higher rates on finance company paper, or causing the nonfinancial corporations holding time certificates of deposit to borrow more than otherwise, they would only be substituting one form of drain for another. Bank lending rates have historically risen less than market rates in periods of expansion, and banks could find themselves paying high rates on time certificates of deposit in effect to raise funds to make loans to finance companies or nonfinancial corporations at lower rates.

Ability of banks to meet drains.—In view of the substantial volume of funds going into State and local government securities, it seems unlikely that banks would be able to meet a drain due to a reduction of time certificates of deposit without liquidating a considerable volume of such securities; and it seems unlikely that they could do so without experiencing substantial loss. Prices of State and local government securities have been subject to wider swings than prices of U.S. Government securities, reflecting changes in the tax status of the marginal investor as well as changes in market conditions generally, and bank demand in recent years has resulted in a greater increase in prices of State and local government securities than of other securities. Moreover, as noted, many of the State and local government securities held are long term and hence particularly vulnerable to capital loss. The market for such securities is distinctly limited, and it seems unlikely that savings institutions and individuals

could be induced to take over substantial amounts without a considerable price reduction.

Many banks have referred to regular inflows of funds from mortgage and consumer installment loans as available to meet any liquidations of time certificates of deposit. Effectuating reductions in flows of funds to such areas has not been easy in the past, however, once departments have been set up and staffed to deal with direct loans and contacts have been established with sellers of paper.

It should also be noted that the banks that would seem to be most vulnerable from the standpoint of liquidations of time certificates of deposit are those that have always been subject to the strongest drains from other sources because they have the greatest proportion of their funds in cyclically sensitive loans such as business loans and loans to nonbank financial institutions, because even within these categories loans tend to show larger cyclical movements at money market banks, and because there tend to be shifts of deposits in favor of non-money-market banks in periods of cyclical expansion. In both the 1955–57 and 1959–60 expansion periods, for example, New York banks reduced their holdings of U.S. Government securities by 40 percent or more and reduced holdings of State and local government securities moderately in order to meet their various needs for funds.

It is true, of course, that some of these needs might be moderated by the existence of time certificates of deposit, and that drains due to time certificates of deposit would be to some extent a substitute for loan demand. It seems unlikely that the offset would be anywhere close to complete, however. Cyclical increases in business loan demands in the past have always been in addition to substantial liquidations of Treasury securities, and, as noted below, there is no reason why a corporation should feel constrained to refrain from borrowing simply because it had liquidated time deposits.

The overall extent of drains for commercial banks in a period of increasing demands would also depend, of course, upon the extent to which banks continue to attract savings deposits from individuals. While banks, particularly city banks, have definitely improved their competitive position in this area, it seems unlikely that recent rates of expansion would be repeated in a period of strong demand for funds. Moreover, the close competition for funds between savings deposits and other types of time deposits suggests that substantial interest rate increases might be required on these deposits as well.

Influence of monetary policy on corporations.—The basic question from the standpoint of monetary policy is, of course, the effect of the changes that have taken place in the institutional environment on the amenability of corporations and banks to the types of restraints applied in periods of restrictive credit policy.

The major ways in which corporations can raise funds to meet their own needs besides liquidating time deposits are drawing on demand deposits, borrowing from banks, borrowing in the security markets, liquidating Treasury bills, and liquidating finance company paper. Drawing on demand deposits is subject to least direct control, since presumably for these funds the corporations are not subject at all to market forces. Borrowing is subject to the greatest degree of control. At the least, corporations must consider the cost of borrowed funds. In addition, funds may not be made available by banks or other lenders and, if they are, corporations will be subject to some measure of discipline with respect to amounts and uses. Moreover, most corporations scrutinize closely the volume of their indebtedness and the wisdom of borrowing.

Liquidation of interest-bearing financial assets falls between these extremes with respect to susceptibility to control. Funds held in the form of financial assets are presumably interest sensitive, but use of them does not involve businesses going further into debt or subjecting themselves to lender scrutiny. The level of indebtedness may have been maintained at a higher level than otherwise to permit holding a large amount of liquid assets in a period of slack. Nevertheless, it seems likely that corporations would consider quite differently maintaining a given level of indebtedness while liquidating financial assets, on the one hand, and increasing indebtedness on the other. Certainly outstanding long-term indebtedness is unlikely to present problems, and lenders are likely to scrutinize more closely requests for increases in financing than for mere renewals.

Influence of monetary policy on banks.—A liquidation of time certificates of deposit would, of course, from the standpoint of the banking system show up as a shift from time to demand deposits and a related increase in required reserves. The Federal Reserve would have to make a decision as to the extent to which these requirements would be met.

Meeting the increased reserve requirements might well lead to an increase in the money supply of considerably greater magnitude than was warranted by

economic conditions. On the other hand, failing to meet such requirements would place the Federal Reserve in a position of demanding credit contraction from banks in a way that it has never done in the recent past.

In order to limit shifts from time to demand deposits, it would be necessary to force banks as a group actually to contract credit, rather than merely to moderate the expansion that would otherwise have taken place, as has been done in the past. In past periods of expansion, banks as a group have had to liquidate securities to meet a substantial part of their loan demands, and individual banks have undoubtedly had to reduce total loans and investments. Nevertheless, total loans and investments at all commercial banks have continued to show small increases and even at New York banks have generally merely leveled off.

During past expansions banks have undoubtedly suffered undesired capital losses on security sales to meet loan demand of established customers. Nevertheless, some element of choice is always involved between liquidating securities and refusing to lend. If banks cannot meet loan demands without serious impairment of their positions, they can use considerable moral pressure on customers to scrutinize demands closely or to seek other sources, or can refuse to lend if circumstances warrant. This is a far cry from a situation in which banks might be forced to reduce total assets on a large scale to meet liquidations of time deposits, accepting whatever price they could get for securities with limited markets.

Since the banking system has created liquidity in the process of borrowing short and lending long, reduction of time deposits and accompanying liquidation of long-term investments by banks would involve a reduction in the public's liquidity. Rather than a transfer of U.S. Government securities from corporations to individuals and miscellaneous investors, there would be extinguishing of time deposits and a transfer of long-term assets, particularly State and local government securities, to the latter groups. As noted above, such transfers might well require very substantial price reductions which could impair bank capital positions. Assuming that the transfer were effected, it would also make the purchasers feel substantially less liquid.

Under such circumstances, the desired degree of tightness might well involve some increase in checking accounts but a reduction in total deposits. It may be difficult to locate this position, however, and there could well be even more rapid shifts in desires for liquidity than in the past.

The conditions in which monetary control has been least effective in the past have been conditions in which the public held a large volume of inactive demand deposits which could be activated without difficulty. Under such circumstances, the monetary authorities have never been willing to bring about the reduction in the money supply which would be necessary to restrain total spending sufficiently to curb inflations. A large volume of volatile time deposits in the banking system might present the monetary authorities with a similar dilemma.

Relation to discount policy.—The rapid increase of a type of deposit which is quite sensitive to market rates but which is offset in large part by long-term investments may well present serious problems from the standpoint of the administration of System discount policy whether or not corporations draw down total interest-earning assets. At present rate relationships, banks would find it more profitable to raise funds through the discount window rather than competing to maintain time deposits, and it is to be expected that similar relationships would prevail in any period of tightening credit. In the past, deposit drains not associated with seasonal or other foreseeable needs have been considered justification for discounting with Reserve banks beyond periods normally considered appropriate. Are such privileges to be extended to drains of time certificates of deposit if banks have issued an excessive amount, have made no provisions for meeting liquidations, and are unable or unwilling to compete to retain them? Or, alternatively, are banks to be forced to sell securities at whatever price can be obtained or to compete even more aggressively to maintain time deposits?

Appendix A

Changes in Bank Assets and Liabilities, May 1961–May 1963

All weekly reporting banks.—In the 2 years ending May 29, 1963, time and savings deposits at weekly reporting banks increased from $39.2 to $54.5 billion and accounted for 88 percent of the $17.5 billion total growth in deposits. Savings accounts increased $7.8 billion and other time deposits $7.5 billion, of which indi-

viduals, partnerships, and corporations accounted for $5.2 billion, foreign accounts for $900 million, domestic governmental units for $1.2 billion, and domestic banks for $100 million. At the end of the period, savings accounts were 25 percent of total deposits at weekly reporting banks and other time deposits 13 percent, compared with 22 percent and 9 percent, respectively, at the beginning of the period.

During the same period, holdings of securities other than U.S. Government securities increased $6.8 billion and accounted for 36 percent of the total expansion in loans and investments. Holdings of U.S. Government securities maturing in more than 5 years increased $2.6 billion and real estate loans $3.7 billion, while holdings of shorter term U.S. Government securities declined substantially. Other securities increased from 9 to 13 percent of total loans and investments, and long-term U.S. Government securities and real estate loans also increased as a proportion of the total. On the other hand, U.S. Government securities maturing in less than 1 year declined from 9 to 6 percent of total loans and investments.

Time and savings deposits at New York City banks were a smaller proportion of total deposits than for all weekly reporting banks in the spring of 1961—21 percent, compared with 31 percent, but they accounted for an even larger percent of the expansion—92 percent, compared with 88 percent. Similarly, State and local government securities, long-term U.S. Government securities, and real estate loans were a smaller proportion of total loans and investments at New York banks at the beginning of the period but accounted for a larger proportion of the asset increase, and reductions in holdings of shorter term U.S. Government securities were particularly large. Securities other than U.S. Government securities accounted for 55 percent of the total expansion and rose from 9 to 15 percent of total loans and investments.

The 2-year period covered does not include the initial expansion of time certificates of deposit at New York City banks early in 1961 nor the even earlier expansion at 11th district banks. On the other hand, it does include a period of rapid expansion early in 1963 by a number of late starters which had only small amounts of negotiable time certificates of deposit outstanding at the time of the December 5, 1962, survey—for example, in the Boston and Cleveland Federal Reserve districts. Unfortunately, we do not have information on the proportion of the increase in other time deposits this year that is accounted for by negotiable time certificates of deposit except at selected banks in leading cities. For banks in most districts during 1962, however, and for New York and Chicago banks this year, changes in negotiable certificates and in total time deposits other than savings deposits have been close, although in most districts the expansion of negotiable certificates of deposit was somewhat smaller. Since May other time deposits have increased rapidly, as have holdings of other securities and real estate loans, but recently there has been some liquidation of long-term U.S. Government securities.

It is, of course, impossible to relate increases in specific assets to specific sources of funds. Banks were obtaining funds from savings deposits, from other time deposits, to a limited extent from demand deposits, and from the liquidation of short-term U.S. Government securities, and they were increasing holdings of long-term U.S. Government securities, State and local government securities, and most types of loans. For weekly reporting banks as a whole, and for most groups of banks, the increase in deposits was larger than the loan demand of the customers, and found its way into long-term investments.

The closest relationship between the other time deposit category and an asset group appears to be with the "other" security group, which consists largely of State and local government securities. Movements in the totals for all weekly reporting banks were similar. Moreover, increases during the period are fairly closely related for individual Federal Reserve districts and for individual New York banks, and in general those districts or banks with high ratios of other time deposits to total deposits have a high ratio of "other" securities to total loans and investments, and vice versa. There is some relationship between increases in other time deposits and increases in real estate loans and in long-term U.S. Government securities, but the relationship is far less close, and the level of real estate loans in particular depends on a number of factors of varying importance.

To some extent, the relationship between other time deposits and holdings of State and local government securities reflects merely the fact that banks increasing such deposits generally had relatively large increases in total available funds. Since most banks had large increases in savings deposits, those also having large increases in other time deposits were most likely to have funds available in excess of customer loan demands. Districts with small increases in

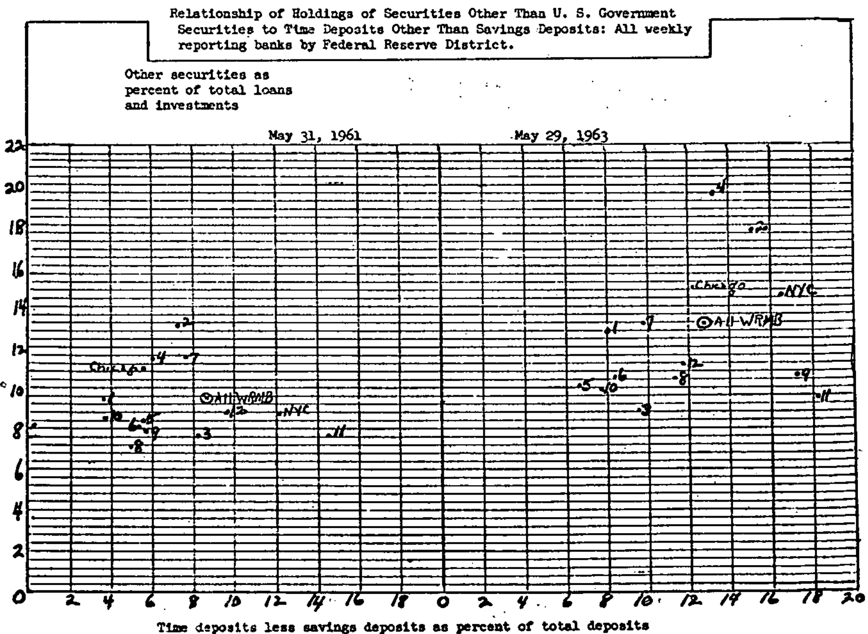
savings deposits showed a much less close relationship between inflows of other time deposits and investments in other securities, as did districts that were faced with particularly large loan demands.

However, the relationship seems to be somewhat closer than one based simply on supply of funds. Districts with relatively large expansions in the form of savings deposits were less likely to have large increases in other securities than those with large increases in the form of other time deposits. Moreover, large expansions in other time deposits were not accompanied by smaller liquidations of total U.S. Government securities or of short-term securities.

The scatter diagram plots the ratio of other time deposits to total deposits against the ratio of other securites to total loans and investments by Federal Reserve districts for May 1961 and May 1963. For this purpose, New York City and Chicago are shown separately from the rest of the second and seventh districts, respectively. This treatment permits the major groups of money market banks to be shown separately. It leaves the second and seventh Reserve districts without their major cities, however; and remaining banks in these districts have typically had relatively large savings deposits and relatively large holdings of real estate loans and State and local government securities for weekly reporting banks.

In 1961, security holdings clustered rather closely around the 9 percent average for all weekly reporting banks. The highest ratio of security holdings to loans and investments was on the part of second district banks outside New York City, which were not among the highest in ratios of other time deposits to total deposits. The highest ratios of other time deposits to total deposits were on the part of New York City and 11th district banks, neither of which had a particularly high ratio of other securities to total loans and investments. The high ratio of other time deposits for New York banks reflected the importance of foreign deposits as well as the expansion that had already taken place in corporate time certificates of deposit.

As has been noted, New York banks showed especially large increases in other securities in the ensuing 2-year period, and banks in most other districts that were increasing other time deposits rapidly also increased such securities sharply. At the end of the period, large holdings of other securities tended to be associated with relatively high liabilities in the form of other time deposits, and vice versa.



The major exceptions were banks in the 9th and 11th Federal Reserve districts, which along with New York City had the highest ratios of other time deposits but had relatively low ratios of other securities. These two districts had two of the three highest ratios of long-term U.S. Government securities to total loans and investments, however, and each increased total holdings of U.S. Government securities over the 2-year period. Both districts also had higher than average ratios of business and consumer loans to total loans and investments, and 11th district banks used an unusually large proportion of total available funds in expanding these items.

A major factor in the small increase in State and local government securities relative to other time deposits in the ninth Federal Reserve district was the fact that deposit expansion was confined entirely to such deposits. A small decline in demand deposits was barely offset by a small rise in savings deposits, and all asset expansion had to be met from other time deposits. Banks in the ninth district had generally maintained rates on savings deposits at uncompetitively low rates while raising rates on time deposits, and it seems likely that a considerable part of the expansion in time deposits consisted of funds that would have gone into savings deposits in other districts.

Banks outside leading cities.—Banks other than weekly reporting banks have also shown rather substantial increases in time and savings deposits over the period since early 1961. These increases have been accompanied by substantially less change in the structure of assets and liabilities than for weekly reporting banks, however.

Nonreporting banks held more time and savings deposits in relation to total deposits than weekly reporting banks at the beginning of the period—42 percent, as compared with 31 percent. They also held substantially larger proportions of U.S. Government securities, other securities, and real estate loans and smaller proportions of commercial and industrial loans, security loans, and loans to nonbank financial institutions.

During the 2 years following May 1961, total deposits of nonweekly reporting banks expanded at a somewhat faster rate than those of reporting banks. A substantially larger percentage of the increase was in the form of demand deposits, however—about one-third, compared with one-eighth. Time and savings deposits increased at a slower rate than for weekly reporting banks and rose only from 42 to 46 percent of the total. As in the case of weekly reporting banks, about one-half of the expansion in time and savings deposits was in the form of time deposits other than savings accounts.

The distribution of newly acquired assets and existing portfolio among types of assets differed considerably less for for these banks than for weekly reporting banks. Other securities increased $3 billion but rose only from 13 to 14 percent of total loans and investments. Holdings of U.S. Government securities also showed a sizable increase although declining as a proportion of total assets. The expansion in loans was widely distributed among types, with real estate loans showing proportionately less increase than business loans.

The net effect of the changes of the past few years has been to bring the asset structure of city banks and outside banks closer together. The liability structure is also becoming more similar in terms of types of deposits, but it seems unlikely that the change has alleviated the types of drains to which city banks are peculiarly subject nearly so much as the relationships between time and demand deposits might suggest.

APPENDIX B

TIME CERTIFICATES OF DEPOSIT AND BANK INVESTMENTS, 1962

As of December 5, 1962, all but 1 of the 22 weekly reporting banks with total deposits of $1 billion or more and all but 1 of the 39 banks with deposits of $500 million to $1 billion had some negotiable time certificates of deposit outstanding. By contrast, only about two-thirds of the weekly reporting banks with deposits of $100 to $500 million and one-half of those with deposits of less than $100 million were issuers of such certificates. Very few nonweekly reporting banks had any negotiable certificates outstanding, and only in the Atlanta and Boston Federal Reserve Districts were certificates of nonweekly reporting banks estimated to account for as much as 10 percent of the total.

Ratio of time certificates to total deposits.—In each size group, only about one-third of all banks issuing time certificates of deposit had outstanding certificates totaling 5 percent or more of total deposits. Two of the 21 banks with

deposits of $1 billion or more had ratios of 10 percent or more, as did from 10 to 20 percent of banks in the other three size groups. The extreme ratios—both the ratios in excess of 20 percent and the ratios of 1 percent or less—were found on the part of nonmoney market banks.

It is known that the ratios of time certificates of deposit to total deposits have increased at least at the large banks since the end of 1962. The table below compares the ratios on December 5, 1962, and October 16, 1963, for 36 banks in 6 Federal Reserve districts which currently report weekly data.

TABLE 1.—*Distribution of weekly reporting banks by ratio of negotiable time certificates of deposit to total deposits for 36 large weekly reporting banks*

Ratio of certificates of deposit to total deposits	Number of banks	
	Dec. 5, 1962	Oct. 16, 1963
Under 5 percent	16	10
5 to 10 percent	10	11
10 to 15 percent	8	9
15 percent or more	2	6
Total	36	36

TABLE 2.—*Distribution of weekly reporting banks by total deposits and by ratios of negotiable time certificates of deposit to total deposits*

[Dollar amounts in millions]

Outstanding certificates of deposits as a percentage of total deposits	Total	Total deposits of bank			
		$0 to $100	$100 to $500	$500 to $1,000	$1,000 and over
	Number of banks				
No certificates	116	61	53	1	1
Total, some certificates	228	56	113	38	21
Less than 2.5	80	20	40	15	5
2.5 to 5	64	13	33	8	10
5 to 7.5	27	8	15	3	1
7.5 to 10	26	4	13	6	3
10 to 12.5	13	5	5	2	1
12.5 to 15	9	3	3	3	
15 and greater	9	3	4	1	1
Total	344	117	166	39	22
	Percentage distribution within deposit class				
No certificates	34	52	32	3	5
Total, some certificates	66	48	68	97	95
Less than 2.5	23	17	24	38	23
2.5 to 5	19	11	20	21	45
5 to 7.5	8	7	9	8	5
7.5 to 10	8	3	8	15	14
10 to 12.5	4	4	3	5	5
12.5 to 15	3	3	2	8	
15 and greater	3	3	2	3	5
Total	100	100	100	100	100
Average total deposits	$429	$51	$235	$716	$3,398

NOTE.—For the 344 weekly reporting member banks, details may not add to totals because of rounding

These banks were all banks with a substantial dollar volume of time certificates of deposit outstanding at the end of 1962, and the ratios to total deposits were also higher than for banks in any of the size groups covered. For these banks, total time certificates of deposit increased by 42 percent from December 5, 1962, to October 16, 1963. The percentage of these banks with time certificates of deposit equal to 5 percent or more of total deposits increased from 56 to 72

percent, and the proportion with ratios of 10 percent or more rose from 28 to 42 percent.

Relationship of time certificates of deposit to other magnitudes.—Table 3 shows the breakdown of deposits and of earning assets for weekly reporting banks, by size of bank and ratio of time certificates of deposit to total deposits, as of December 1962, and table 4 shows the change in the various deposit and earning asset items for the same group of banks during the period December 1960 to December 1962.

As would be expected, those banks having relatively high ratios of time certificates of deposit to total deposits also had relatively high ratios of "other" time deposits of individuals, partnerships, and corporations to total deposits as of the end of 1962. They also showed relatively large increases both in total deposits and in time and savings deposits of individuals, partnerships, and corporations. The relationship was least close on the part of the smallest size class—those banks with deposits of less than $100 million. For banks in this size group, other time deposits were about as large a percentage of total deposits as in other size groups. The growth in total deposits and in time and savings deposits of individuals, partnerships, and corporations was as large for those banks without negotiable time certificates of deposit as for banks with such deposits, but for banks having such certificates the relationship among the different ratio groupings was similar to that in the larger size groups. Apparently among banks of this size group competition for funds of corporations and miscellaneous investors is not greatly affected by whether or not they make available negotiable certificates, and the decision to issue such certificates reflects local custom and other factors.

Although the larger banks have issued a considerable volume of time certificates of deposit to foreign accounts and the smaller banks have issued a considerable volume to State and local government accounts, neither the importance of time deposits other than those of individuals, partnerships, and corporations nor their change over the 2-year period bore any consistent relationship to the ratio of time certificates of deposit to total deposits. Demand deposits tended to show smaller increases for banks with a relatively high percentage of time certificates of deposit to the total, suggesting that even for the individual bank there may have been some substitution of these deposits for demand deposits.

State and local government securities were a larger proportion of total loans and investments for banks with a relatively large percentage of time certificates of deposit, but this relationship was not close except in the largest size group. In all size groups, however, the increase in holdings of these securities was greatest for banks with large amounts of time certificates of deposit outstanding. There was little relationship between time certificates of deposit and the percentage of total loans and investments accounted for by real estate loans or long-term U.S. Government securities, but in the larger size classes these items showed relatively large increases over the 2-year period for banks with large volumes of time certificates of deposit.

In some size classes the expansion in loans to security dealers and brokers and in short-term U.S. Government securities was greatest for banks with large amounts of time certificates of deposit. It is known, however, that some of these banks have shifted from such assets to State and local government securities since that time, and for the 36 banks reporting data currently, ratios of U.S. Government securities maturing within 1 year to total loans and investments were lower for banks with a large proportion of time certificates of deposit outstanding.

Within the limits of the system of classification available, there were not great differences among the asset structures of banks with differing volumes of time certificates of deposit outstanding at the end of 1962. Some of the largest differences among banks, such as that in the proportion of real estate loans, reflected structural differences which had been in effect for some time. On the other hand, there were growing differences in holdings of long-term investments, particularly State and local government securities, as well as some differences in liquid investments, in part at least temporary, reflecting the investments of funds obtained from time certificates of deposit.

TABLE 3.—*Composition of deposits and earning assets of weekly reporting banks by ratio of negotiable time certificates of deposit to total deposits, December 1962*

Item	All reporting banks—Ratio of time CD's to total deposits (percent) [1]					
	Total	0	Under 2.5	2.5 to 5.0	5.0 to 10.0	10.0 and over
	Percent of total deposits					
Deposits	100.0	100.0	100.0	100.0	100.0	100.0
Demand	66.5	70.2	60.2	70.6	68.0	63.7
Time and savings	33.5	29.8	39.8	29.4	32.0	36.3
Savings IPC	23.2	22.7	32.1	19.6	15.7	15.7
Other time IPC	6.1	5.2	3.5	5.2	8.4	14.7
All other	4.2	1.9	4.2	4.6	7.9	5.9
	Percent of total loans and investments [2]					
Loans and investments [2]	100.0	100.0	100.0	100.0	100.0	100.0
Loans:						
Commercial and industrial	27.1	20.8	22.9	30.3	29.3	30.8
Nonbank financial	5.3	4.4	4.6	5.5	6.5	5.5
Security dealers and brokers	3.6	2.2	1.3	5.2	3.4	6.5
Real estate	11.9	12.0	18.1	9.4	8.2	8.3
Other [3]	16.4	22.3	17.9	15.2	15.8	13.6
U.S. Government securities	24.9	29.5	25.1	23.2	24.2	24.5
Within 1 year	9.1	10.0	7.9	9.7	8.2	11.2
1 to 5 years	11.2	14.5	12.1	9.4	11.0	9.1
5 years and over	4.6	5.0	5.1	4.1	5.0	4.2
State and local government securities	10.8	8.8	10.1	11.2	12.6	10.8
	Number of banks					
Reporting banks	344	116	80	64	53	31

[1] Banks issuing CD's were ranked according to amounts of outstanding certificates in denominations of $100,000 or more expressed as a percentage of total deposits.

[2] Total loans plus investments in U.S. Government securities and State and local government securities. Does not include corporate stocks or other bonds, notes, and debentures.

[3] Includes loans to domestic commercial and foreign banks; security loans, excluding those to brokers and dealers; agricultural loans; consumer loans; and all other loans to nonprofit organizations, not secured by real estate.

TABLE 4.—*Change in deposits and earning assets of weekly reporting banks by ratio of negotiable time certificates of deposit to total deposits, December 1962*

Item	All reporting banks—Ratio of time CD's to total deposits (percent)[1]					
	Total	0	Under 2.5	2.5 to 5.0	5.0 to 10.0	10.0 and over
	Percentage change, 1960–62					
Deposits	+15.2	+11.4	+13.3	+15.6	+18.2	+19.3
Demand	+4.8	+4.7	+6.0	+5.6	+3.7	+3.4
Time and savings	+43.6	+31.2	+26.5	+50.0	+68.2	+78.2
Time and savings IPC	+41.9	+29.2	+26.2	+48.5	+62.8	+79.5
All other	+57.3	+70.3	+29.3	+58.7	+123.3	+71.7
Loans and investments[2]	+30.6	+27.1	+25.7	+32.1	+35.2	+37.6
Loans:						
Commercial and industrial	+11.5	+8.8	+10.9	+14.7	+8.4	+9.0
Nonbank financial	+18.7	+13.9	+15.3	+16.7	+26.0	+25.3
Security dealers and brokers	+64.1	+36.9	+12.5	+75.3	+56.6	+11.8
Real estate	+23.3	+26.0	+16.9	+30.6	+29.3	+26.4
Other[3]	+25.1	+28.4	+24.3	+25.4	+33.0	+8.1
U.S. Government securities	+8.7	+8.5	+4.8	+3.9	+13.5	+37.6
Within 5 years	+2.7	+1.7	−1.7	−2.7	+3.2	+29.8
5 years and over	+55.0	+45.9	+40.7	+52.2	+83.4	+94.8
State and local government securities	+61.9	+35.6	+45.7	+59.5	+92.2	+111.1
	Number of banks					
Reporting banks	344	116	80	64	53	31

[1] Banks issuing CD's were ranked according to amounts of outstanding certificates in denominations of $100,000 or more expressed as a percentage of total deposits.
[2] Total loans plus investments in U.S. Government securities and State and local government securities. Does not include corporate stocks or other bonds, notes, and debentures.
[3] Includes loans to domestic commerical and foreign banks; security loans, excluding those to brokers and dealers; agricultural loans; consumer loans; and all other loans to nonprofit organizations, not secured by real estate.

MATURITY DISTRIBUTION OF NEGOTIABLE TIME CERTIFICATES OF DEPOSIT

This memorandum summarizes the results of a recent survey of the maturity distribution of outstanding negotiable certificates of deposit at major issuing banks in the New York and Chicago Federal Reserve districts. The survey covered 21 banks (14 in New York City, 5 in Chicago, and 2 in Detroit) which account for about 45 percent of the more than $10.5 billion of CD's outstanding at present. Respondents used the new reporting form which is scheduled for quarterly distribution to weekly reporting banks beginning in May. As a result, more detail was obtained in the current survey than in those of last September and December.

A total of $850 million of CD's, nearly one-fifth of the amount outstanding at the 21 banks as of the February 19 survey date, will mature during March. Of these, more than 40 percent, or about $350 million, will mature on the March 16 tax date. On the tax date last December, maturities at the 12 banks surveyed amounted to $224 million, about 55 percent of the estimated total for the month; and, on the September tax date, they amounted to $320 million, about 65 percent of the estimated total.

Relative to an estimated $6.6 billion corporate tax liability, considerably larger than the payments of $3⅝ billion in September and December, the March tax date maturities appear moderate. Total maturities for the month, however, are much larger than in September and December, even after allowance for the difference in bank coverage. The wider dispersion of March maturities may be attributable to the efforts of issuing banks to avoid tax date concentration, possibly effected through rate incentives as well as other means. On the other hand, it is possible that some maturities related to the tax date may have been omitted in obtaining data only for March 16 and not for other days bracketing the tax date. However, in September and December the bulge in maturities was confined to the tax date itself.

At five large Chicago banks, CD's maturing on March 30 and 31 amount to about $50 million, or almost one-fifth of their total maturities for the month. This probably reflects the efforts of corporations and individuals to avoid the April 1 tax on personal property in the State of Illinois (Revenue Act of 1939). Maturities on the March 10 corporate dividend date at the 21 banks are reported at $23 million, somewhat lower than figures of $27 and $37 million for the 10th of September and December 1963.

Since the December 1962 survey of CD's at weekly reporting banks, the maturity structure of outstanding CD's appears to have shortened significantly. The major part of this change probably has occurred since the amendment of regulation Q last July. At present, more than 80 percent of the CD's outstanding at the 21 banks mature within 6 months, with most of the remainder distributed over the 6- to 12-month range and only 1 percent maturing after February 1965. Although information on time to maturity was not obtained in December 1962, only 1 percent of the CD's then outstanding at these same banks had original maturities of less than 6 months. About 89 percent fell in the 6- to 12-month range and the remaining 10 percent had original maturities of more than 1 year.

A breakdown of outstanding certificates by maturity category is presented in the attached table.

Maturity distribution of outstanding negotiable certificates of deposit at major issuing banks[1] in New York and Chicago districts as of Feb. 19, 1964

[Amounts in millions of dollars]

Period of maturity	New York		Chicago		Total		Cumulative	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	Maturities by months							
1964								
Feb. 20-29	174	4.8	67	5.9	241	5.0	241	5.0
March	594	16.3	256	22.5	850	17.7	1,091	22.8
April	654	17.9	266	23.4	920	19.2	2,011	41.9
May	420	11.5	97	8.5	517	10.8	2,528	52.7
June	483	13.2	119	10.4	602	12.6	3,130	65.3
July	408	11.2	100	8.8	508	10.6	3,638	75.9
August	239	6.5	51	4.5	290	6.0	3,928	81.9
September	180	4.9	34	3.0	214	4.5	4,142	86.4
October	108	3.0	58	5.1	166	3.5	4,308	89.9
November	77	2.1	15	1.3	92	1.9	4,400	91.8
December	133	3.6	23	2.0	156	3.3	4,556	95.0
1965								
January	111	3.0	17	1.5	128	2.7	4,684	97.7
February	48	1.3	8	.7	56	1.2	4,740	98.9
March or later	26	.7	28	2.5	54	1.1	4,794	100.0
	Maturities by 3-month periods							
Within 3 months[2]	1,842	50.4	686	60.2	2,528	52.7	2,528	52.7
3 to 6 months	1,130	30.9	270	23.7	1,400	29.2	3,928	81.9
6 to 9 months	365	10.0	107	9.4	472	9.9	4,400	91.8
9 months or more	318	8.7	76	6.7	394	8.2	4,794	100.0
Total	3,655	100.0	1,139	100.0	4,794	100.0	----------	----------

[1] Coverage included 14 banks in New York City, 5 in Chicago and 2 in Detroit.
[2] 3 calendar months plus last 10 days in February.

Results of the First Quarterly Survey of Certificate of Deposit Maturities

This memorandum summarizes the results of the first of a series of quarterly surveys of the maturity structure of negotiable time certificates of deposit in denominations of $100,000 or more outstanding at weekly reporting member banks. Of the 349 banks surveyed, 244 reported outstanding negotiable CD's totaling $11,736 million on the May 20 survey date.

The survey shows that the bulk of the CD's outstanding have relatively short maturities, with nearly $8.5 billion, or about 72 percent, maturing during the 5 months ending in October, as shown in table 1. Within this period, the maturities are fairly evenly distributed, but thereafter, they decline with

each successive month, except for a small bulge in March 1965. Less than 2 percent of the CD's currently outstanding will mature after May 1965.

The relatively uniform distribution of CD maturities during the 5 months ending in October presumably reflects the efforts of individual banks to avoid concentration of deposit drains from maturing CD's. Banks have done this by use of aggressive selling techniques and rate incentives, and in some instances, they have avoided issuing CD's of certain maturities by making terms unattractive.

Relative to developments during the March tax period, maturities of $600 million on the June 15 tax date appear moderate and consistent with bank efforts to avoid excessive maturities during such periods. At large banks in New York City and Chicago, maturities were about $300 million, somewhat less than the $350 million on the March tax date, as shown in table 2. Maturities on the June 10 dividend date at all reporting banks totaled about $100 million.

Since the pilot survey at banks in New York and Chicago in February, the maturity structure of CD's outstanding at these banks has become less concentrated in the under-3-month area and heavier in the 3–9-month range, as shown in table 3. This presumably reflects the improved ability of banks to compete for longer maturities under the 4-percent ceiling in view of the decline in Treasury bill yields since late February.

Some shifting toward longer maturities also may have occurred at prime banks outside New York and Chicago, but information on their maturities is not available for February. Among smaller banks, one effect of the recent decline in bill yields was to enable some of the banks that had encountered difficulties in rolling over CD maturities earlier this year when market rates advanced, to increase their outstandings again.

At present, the maturity distribution at banks outside New York City and Chicago is somewhat shorter than at banks within the two cities, as shown in table 4. For example, almost 48 percent of the CD's outside banks mature by the end of August compared with 40 percent at New York and Chicago banks. This difference probably reflects in part the necessity for nonprime banks to offer shorter maturities in order to compete with the prime banks at the 4-percent ceiling.

As shown in tables 5a and 5b, maturities are distributed in roughly the same manner within each Federal Reserve district. Although the amount of CD's maturing after May 1965 in the Cleveland district is substantially larger than in other districts, this is accounted for by one bank, and is not representative of the maturity pattern throughout the district.

TABLE 1.—*Outstanding negotiable time certificates of deposit, all weekly reporting member banks, May 20, 1964*

Period of maturity	Certificates of deposit in millions of dollars	Percentage distribution	Cumulative percentage
1964			
May 21-31	338	2.9	2.9
June [1]	1,787	15.2	18.1
July	1,792	15.3	33.4
August	1,288	11.0	44.4
September	1,739	14.8	59.2
October	1,532	13.1	72.2
November	943	8.0	80.3
December	748	6.4	86.6
1965			
January	429	3.7	90.3
February	277	2.4	92.6
March	314	2.7	95.3
April	228	1.9	97.3
May	94	.8	98.1
June or later	226	1.9	100.0
Total	11,736	100.0	

[1] Includes $100,000,000 maturing on June 10 and $600,000,000 on June 15.

TABLE 2.—*Tax and dividend date maturities of negotiable time certificates of deposit, March–June 1964*

[Amounts in millions of dollars]

Weekly reporting member banks	Mar. 10	June 10	Mar. 16	June 15
All weekly reporting member banks	(1)	97	(1)	596
Banks in New York City and Chicago	23	29	350	303

[1] Not available.

TABLE 3.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City and Chicago banks, February–May, 1964*

1964–65	Percentage distribution		Cumulative percentage	
	February	May	February	May
Feb. 20–29 to May 21–31	5.0	2.5	5.0	2.5
March to June	17.7	14.5	22.8	17.0
April to July	19.2	13.6	41.9	30.6
May to August	10.8	9.6	52.7	40.2
June to September	12.6	15.1	65.3	55.3
July to October	10.6	13.9	75.9	69.2
August to November	6.0	9.8	81.9	78.9
September to December	4.5	8.4	86.4	87.3
October to January	3.5	4.9	89.9	92.2
November to February	1.9	2.5	91.8	94.8
December to March	3.3	2.7	95.0	97.5
January to April	2.7	1.8	97.7	99.3
February to May	1.2	.5	98.9	99.7
March or June	1.1	.3	100.0	100.0

TABLE 4.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks*

[Amounts in millions of dollars, as of May 20, 1964]

Period of maturity	New York City and Chicago		Other		New York City and Chicago, cumulative	Other, percentage, cumulative
	Amount	Percent	Amount	Percent		
1964						
May 21–31	126	2.5	212	3.2	2.5	3.2
June	737	14.5	1,050	15.8	17.0	19.0
July	693	13.6	1,098	16.5	30.6	35.4
August	485	9.6	803	12.1	40.2	47.5
September	766	15.1	973	14.6	55.3	62.1
October	705	13.9	827	12.4	69.2	74.5
November	496	9.8	448	6.7	78.9	81.3
December	426	8.4	322	4.8	87.3	86.1
1965						
January	249	4.9	180	2.7	92.2	88.8
February	129	2.5	148	2.2	94.8	91.0
March	138	2.7	176	2.6	97.5	93.7
April	89	1.8	140	2.1	99.3	95.8
May	23	.5	71	1.1	99.7	96.8
June or later	15	.3	211	3.2	100.0	100.0
Total	5,077	100.0	6,659	100.0		

TABLE 5a.—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve district, as of May 20, 1964*

[Amounts in millions of dollars]

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
1964													
May 21-31	338	18	104	8	38	4	6	65	9	10	8	30	38
June	1,787	72	780	54	117	44	49	229	38	36	55	162	151
July	1,792	64	742	51	106	41	47	251	56	34	62	185	153
August	1,288	41	474	23	88	23	44	173	44	29	43	119	187
September	1,739	99	694	59	137	46	40	221	70	31	41	117	184
October	1,532	100	570	80	100	28	25	248	28	40	30	82	201
November	943	43	494	35	54	6	20	75	23	23	21	49	100
December	748	23	418	32	42	6	13	73	14	5	16	44	62
1965													
January	429	14	237	5	19	4	6	48	14	8	8	38	28
February	277	4	129	6	12	3	10	29	5	9	6	28	36
March	314	8	139	8	15	6	8	51	14	7	9	22	27
April	228	13	83	1	27	2	4	33	2	10	6	19	28
May	94	13	19	----------	21	1	3	14	2	3	2	8	8
June or later	226	3	14	5	131	----------	12	24	3	7	2	14	11
Total	11,736	515	4,897	367	907	214	287	1,534	322	253	309	917	1,214
June 10	97	4	47	1	6	2	1	12	----------	2	1	5	16
June 15	596	23	302	16	30	1	9	82	9	12	17	57	38

TABLE 5b.—*Distribution of maturities of outstanding negotiable time certificates of deposit by Federal Reserve district, as of May 20, 1964*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
	Percentage distribution												
1964													
May 21-31	2.9	3.5	2.1	2.2	4.2	1.9	2.1	4.2	2.8	4.0	2.6	3.3	3.1
June	15.2	14.0	15.9	14.7	12.9	20.6	17.1	14.9	11.8	14.2	17.8	17.7	12.4
July	15.3	12.4	15.2	13.9	11.7	19.2	16.4	16.4	17.4	13.4	20.1	20.2	12.6
August	11.0	8.0	9.7	6.2	9.7	10.7	15.3	11.3	13.7	11.5	13.9	13.0	15.4
September	14.8	19.2	14.2	16.1	15.1	21.5	13.9	14.4	21.7	12.3	13.3	12.8	15.2
October	13.1	19.4	11.7	21.8	11.0	13.1	8.7	16.2	8.7	15.8	9.7	8.9	16.6
November	8.0	8.3	10.1	9.5	6.0	2.8	7.0	4.9	7.1	9.1	6.8	5.3	8.2
December	6.4	4.5	8.5	8.7	4.6	2.8	4.5	4.6	4.3	2.0	5.2	4.8	5.1
1965													
January	2.7	2.7	4.8	1.4	2.1	1.9	2.1	3.1	4.3	3.2	2.6	4.1	2.3
February	2.4	.8	2.6	1.6	1.3	1.4	3.5	1.9	1.6	3.6	1.9	3.1	3.0
March	2.7	1.6	2.8	2.2	1.7	2.8	2.8	3.3	4.3	2.8	2.9	2.4	2.2
April	1.9	2.5	1.7	.3	3.0	.9	1.4	2.2	.6	4.0	1.9	2.1	2.3
May	.8	2.5	.4	----------	2.3	.5	1.0	.9	.6	1.2	.6	.9	.7
June or later	1.9	.6	.3	1.4	14.4	----------	4.2	1.6	.9	2.8	.6	1.5	.9
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1964													
May 21-31	2.9	3.5	2.1	2.2	4.2	1.9	2.1	4.2	2.8	4.0	2.6	3.3	3.1
June	18.1	17.5	18.0	16.9	17.1	22.5	19.2	19.2	14.6	18.2	20.4	21.0	15.5
July	33.4	29.9	33.2	30.8	28.8	41.7	35.6	35.5	32.0	31.6	40.5	41.2	28.1
August	44.4	37.9	42.9	37.0	38.5	52.4	50.9	46.8	45.7	43.1	54.4	54.2	43.5
September	59.2	57.1	57.1	53.1	53.6	73.9	64.8	61.2	67.4	55.3	67.7	67.0	58.7
October	72.2	76.5	68.8	74.9	64.6	87.0	73.5	77.4	76.1	71.7	77.4	75.9	75.3
November	80.3	84.8	78.9	84.4	70.6	89.8	80.5	82.3	83.2	80.2	84.2	81.2	83.5
December	86.6	89.3	87.4	93.1	75.2	92.6	85.0	87.0	87.5	82.2	89.4	86.0	88.6
1965													
January	90.3	92.0	92.2	94.5	77.3	94.5	87.1	90.2	91.8	85.4	92.0	90.1	90.9
February	92.6	92.8	94.8	96.1	78.6	95.9	90.6	92.0	93.4	88.9	93.9	93.2	93.9
March	95.3	94.4	97.6	98.3	80.3	98.7	93.4	95.4	97.7	91.7	96.8	95.6	96.1
April	97.3	96.9	99.3	98.6	83.3	99.6	94.8	97.5	89.3	95.7	98.7	97.7	98.4
May	98.1	99.4	99.7	98.6	85.6	100.0	95.8	98.4	98.9	96.8	99.3	98.6	99.1
June or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

RESULTS OF THE AUGUST 19 SURVEY OF CD MATURITIES

This memorandum summarizes the results of the second quarterly survey of the maturity structure of outstanding negotiable time certificates of deposit in denominations of $100,000 or more. Of the 347 weekly reporting banks surveyed, 249 reported outstanding CD's totaling $12.2 billion on the August 19 survey date.

The bulk of the CD's outstanding continue to have relatively short maturities. About $6.1 billion or one-half of outstandings will mature within the 3 months ending in November and about $9.4 billion or more than three-fourths within the 5 months ending in January, a somewhat shorter maturity distribtuion than that reported in the first survey in May.

As shown in table 1, maturities are fairly uniformly distributed within the 5 months ending in January, presumably reflecting the continued efforts of individual banks to avoid excessive deposit drains from large concentrations of CD maturities. After January, maturities decline with each successive month except for small increases in June and in the final period which includes all maturities after August 1965. These maturities amount to about 2 percent of outstanding CD's.

The largest monthly maturities, about $2.2 billion, will occur during June, reflecting business needs for funds for tax and dividend purposes. As shown in table 2, maturities on the September 15 tax date are $708 million, about $110 million higher than on the June tax date despite an estimated decline in corporate income tax payments of nearly 45 percent from the June level. However, there is no tax anticipation bill maturing in September as there was in June. On the September 10 dividend date, maturities amounted to about $110 million, only $10 million more than on June 10.

The average maturity of outstanding CD's shortened somewhat from about 4.1 months at the time of the May survey to about 3.8 months as of August 19. This shortening of maturities reflects in part a slower rate of growth of outstanding CD's in recent months. From the first of the year until the May 20 survey, outstanding CD's grew at an annual rate of nearly 60 percent. But over the following 13 weeks ending August 19, the rate of increase in outstanding was only 16 percent, lowering the annual rate of growth for the year to 43 percent.

Maturity distributions and related figures for banks in New York City and Chicago and for other banks are presented in table 4. Maturities at banks in New York and Chicago, compared with those at other banks, tend to be lighter within 3 months, heavier from 3 to 8 months, and lighter again after 8 months. The average maturity in August at both groups of banks was the same, but was shorter than in May.

Maturity distributions for CD's at banks classified according to amount of total deposits are presented in table 5. Average maturity is shorter by one-half month at banks with total deposits of $500 million to $1 billion than at banks with total deposits of $1 billion or more. Below $500 million in deposits, however, average maturity tends to be longer as size of bank decreases. This pattern suggests that as bank size decreases, the available supply of CD funds may be less sensitive to interest rate spreads and credit rating considerations than at larger banks, especially at banks with total deposits of less than $500 million. Smaller banks may also pursue a more conservative approach than larger banks in the issuance of negotiable certificates of deposit.

A review of maturity by Federal Reserve district, shown in table 6, reveals that the shortest average maturities, slightly over 3 months, were found in the lower midwestern area comprising the St. Louis and Kansas City Federal Reserve districts. The longest maturities of 5.2 months and 4.5 months were found in the Cleveland and Atlanta districts respectively.

The shorter average maturities in the St. Louis and Kansas City Federal Reserve districts are mainly due to heavy bulges of CD's maturing at the end of August and in the current month. Within the St. Louis district the bulge may be partially due to needs for funds around the tax period. Maturities on September 15 amount to $38 million, about 12 percent of CD's outstanding in that district as of the survey data.

The relatively long average maturity in the Cleveland district continues to be accounted for by one bank and is not representative of the average maturity for the rest of the district. Excluding the figures for this bank, the average mautrity of outstanding CD's in the Cleveland district is about 3.9 months, only slightly longer than the national average.

TABLE 1.—*Outstanding negotiable time certificates of deposit, all weekly reporting member banks, Aug. 19, 1964*

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage
1964			
Aug. 20-31	414.1	3.4	3.4
September [1]	2,156.7	17.7	21.1
October	2,008.8	16.5	37.6
November	1,522.1	12.5	50.0
December	1,859.2	15.2	65.3
1965			
January	1,459.7	12.0	77.3
February	755.7	6.2	83.5
March	649.9	5.3	88.8
April	339.4	2.8	91.6
May	201.5	1.6	93.2
June	269.9	2.2	95.4
July	190.7	1.6	97.0
August	104.2	.9	97.9
September or later	260.5	2.1	100.0
Total	12,193.4	100.0	

[1] Includes $109 million maturing on Sept. 10 and $708 on Sept. 15.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposit—March–June–September 1964*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in— New York City	Banks in— Chicago	Other banks
	Tax-date maturities			
1964				
Mar. 16	(1)	243	87	(1)
June 15	596	230	73	293
Sept. 15	708	253	86	369
	Dividend-date maturities			
Mar. 10	(1)	16	4	(1)
June 10	97	23	6	68
Sept. 10	110	33	8	69

[1] Not available.

TABLE 3.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City and Chicago banks, February–May–August 1964*

Period of maturity	Percentage distribution—date of survey			Cumulative percentage—date of survey		
	Feb. 19	May 20	Aug. 19	Feb. 19	May 20	Aug. 19
1 to 12 days [1]	5.0	2.5	2.3	5.0	2.5	2.3
Additional months:						
1	17.7	14.5	16.0	22.8	17.0	18.3
2	19.2	13.6	15.1	41.9	30.6	33.5
3	10.8	9.6	12.8	52.7	40.2	46.2
4	12.6	15.1	17.1	65.3	55.3	63.3
5	10.6	13.9	14.9	75.9	69.2	78.2
6	6.0	9.8	6.2	81.9	78.9	84.4
7	4.5	8.4	7.0	86.4	87.3	91.4
8	3.5	4.9	2.9	89.9	92.2	94.3
9	1.9	2.5	1.5	91.8	94.8	95.7
10	3.3	2.7	2.1	95.0	97.5	97.9
11	2.7	1.8	1.1	97.7	99.3	99.0
12	1.2	.5	.5	98.9	99.7	99.5
More than 12	1.1	.3	.5	100.0	100.0	100.0

[1] Number of days of the survey month following the survey: February, 9; May, 11; August, 12.

TABLE 4.—*Maturity distribution of outstanding negotiable time certificates of deposit—New York City and Chicago versus other reporting banks as of Aug. 19, 1964*

[Dollars in millions]

Period of maturity	New York City and Chicago		Other		Cumulative percentage	
	Amount	Percent	Amount	Percent	New York City and Chicago	Other
1964						
Aug. 20-31	$125.2	2.3	$288.9	4.2	2.3	4.2
September	859.8	16.0	1,296.9	19.0	18.3	23.3
October	813.5	15.1	1,195.3	17.5	33.5	40.8
November	685.2	12.8	837.9	12.3	46.2	53.1
December	921.3	17.1	937.9	13.8	63.3	66.8
1965						
January	800.7	14.9	659.0	9.7	78.2	76.5
February	332.0	6.2	423.7	6.2	84.4	82.7
March	376.4	7.0	273.5	4.0	91.4	86.7
April	153.8	2.9	185.6	2.7	94.3	89.5
May	79.1	1.5	122.4	1.8	95.7	91.3
June	114.6	2.1	155.3	2.3	97.9	93.5
July	60.9	1.1	129.8	1.9	99.0	95.4
August	25.3	.5	78.9	1.2	99.5	96.6
September or later	28.2	.5	232.3	3.4	100.0	100.0
Total	5,376.0	100.0	6,817.4	100.0		
Average maturity (months)	3.8		3.8			
Number of banks reporting	25		224			

TABLE 5.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of bank as of Aug. 19, 1964* [1]

[Dollars in millions]

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		
1964							
Aug. 20–31	$4.6	$13.2	$77.9	$78.7	$239.7	$414.1	$414.1
September	31.7	56.5	346.4	418.5	1,303.6	2,156.7	2,570.8
October	28.3	54.9	225.8	371.9	1,327.9	2,008.8	4,579.6
November	20.0	44.1	226.0	237.6	995.4	1,523.1	6,102.7
December	19.0	29.7	198.3	325.7	1,286.5	1,859.2	7,961.9
1965							
January	15.0	35.7	146.9	214.7	1,047.4	1,459.7	9,421.6
February	13.4	20.6	96.4	123.7	501.6	755.7	10,177.3
March	9.7	5.7	77.2	91.7	465.6	649.9	10,827.2
April	7.9	8.7	43.8	51.0	228.0	339.4	11,166.6
May	4.5	6.1	35.1	28.6	127.2	201.5	11,368.1
June	8.3	7.4	59.3	33.3	161.6	269.9	11,638.0
July	4.8	15.1	39.0	14.5	117.3	190.7	11,828.7
August	2.9	5.1	31.2	11.7	53.3	104.2	11,932.9
September or later	3.4	9.5	30.4	24.5	192.7	260.5	12,193.4
Total	173.5	312.3	1,633.7	2,026.1	8,047.8	12,193.4	
Sept. 10	3.6	2.0	11.3	27.6	65.0	109.5	
Sept. 15	1.5	6.0	71.9	168.9	460.1	708.4	
Average maturity (months)	4.3	4.0	3.9	3.4	3.9	3.8	
Number of banks reporting	56	55	69	39	30	249	

[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 on June 30, 1964.

Source: Banking Section, Sept. 18, 1964.

TABLE 6a.—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve district as of Aug. 19, 1964*

[Dollars in millions]

Period of maturity	All districts	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1964													
Aug. 20-31	$414.1	$12.4	$135.7	$7.8	$44.4	$5.5	$13.2	$41.0	$22.5	$8.9	$18.2	$41.5	$63.0
September	2,156.7	115.0	857.7	82.4	148.1	59.9	50.8	263.8	93.5	34.1	69.5	162.6	219.3
October	2,008.8	127.9	752.2	94.1	114.7	40.0	38.4	319.8	43.8	50.3	50.9	141.3	235.4
November	1,523.1	83.3	730.6	46.5	74.6	19.9	36.7	149.9	38.4	30.9	44.4	113.0	154.9
December	1,859.2	92.3	908.0	60.3	111.9	23.8	37.2	198.7	37.6	17.9	47.8	115.4	208.3
1965													
January	1,459.7	62.0	759.7	29.3	59.0	12.9	24.9	163.6	29.4	16.7	21.9	132.0	148.3
February	755.7	26.7	318.7	22.8	48.8	6.3	23.8	71.0	24.0	22.8	14.8	65.6	110.4
March	649.9	22.2	359.4	16.2	26.2	8.1	22.3	88.3	21.7	8.9	9.6	35.6	31.4
April	339.4	18.8	154.0	8.4	36.1	2.1	6.4	40.0	2.2	11.6	8.7	24.1	27.0
May	201.5	18.7	72.8	1.3	25.5	1.8	5.7	22.6	2.5	6.5	3.8	19.2	21.1
June	269.9	6.9	108.4	16.3	9.4	24.0	15.2	29.2	6.6	3.8	6.4	22.4	21.3
July	190.7	8.8	57.3	6.5	11.3	7.4	9.2	16.4	3.1	1.7	5.3	41.9	21.8
August	104.2	4.2	26.9	2.5	9.6	6.9	8.1	9.6	2.7	5.0	2.8	8.0	17.9
September or later	260.5	3.9	32.2	16.9	151.4	----------	11.6	26.9	0.8	1.7	1.2	4.0	9.9
Total	12,193.4	603.1	5,273.6	411.3	871.0	218.6	303.5	1,440.8	328.8	220.8	305.3	926.6	1,290.0
Sept. 10	109.5	4.2	44.4	5.0	9.3	.6	----------	13.5	7.0	1.4	1.9	7.2	15.0
Sept. 15	708.4	27.9	299.1	40.5	58.1	20.7	9.5	104.1	38.2	4.0	13.3	54.8	38.2
Average maturity (months)	3.8	3.5	3.8	3.8	5.2	3.9	4.5	3.6	3.1	3.8	3.2	3.9	3.6
Number of reporting banks	249	16	37	9	15	15	16	28	12	13	34	31	23

TABLE 6b.—*Distribution of maturities of outstanding negotiable time certificates of deposit by Federal Reserve district, as of Aug. 19, 1964*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
	Percentage distribution												
1964													
Aug. 20-31	3.4	2.1	2.6	1.9	5.1	2.5	4.4	2.8	6.9	4.0	6.0	4.5	4.9
September	17.7	19.1	16.3	20.0	17.0	27.4	16.7	18.3	28.4	15.4	22.8	17.5	17.0
October	16.5	21.2	14.3	22.9	13.2	18.3	12.7	22.2	13.3	22.8	16.7	15.3	18.2
November	12.5	13.8	13.8	11.3	8.6	9.1	12.1	10.4	11.7	14.0	14.5	12.2	12.0
December	15.2	15.3	17.2	14.7	12.8	10.9	12.3	13.8	11.4	8.1	15.7	12.5	16.1
1965													
January	12.0	10.3	14.4	7.1	6.8	5.9	8.2	11.4	8.9	7.6	7.2	14.2	11.5
February	6.2	4.4	6.0	5.6	5.6	2.9	7.8	4.9	7.3	10.3	4.8	7.1	8.6
March	5.3	3.7	6.8	3.9	3.0	3.7	7.3	6.1	6.6	4.0	3.1	3.8	2.4
April	2.8	3.1	2.9	2.0	4.1	1.0	2.1	2.8	.7	5.3	2.9	2.6	2.1
May	1.6	3.1	1.4	.3	2.9	.8	1.9	1.6	.8	2.9	1.2	2.1	1.6
June	2.2	1.1	2.1	4.0	1.1	11.0	5.0	2.0	2.0	1.7	2.1	2.4	1.7
July	1.6	1.5	1.1	1.6	1.3	3.4	3.0	1.1	.9	.8	1.7	4.5	1.7
August	.9	.7	.5	.6	1.1	3.1	2.7	.7	.8	2.3	.9	.9	1.4
September or later	2.1	.6	.6	4.1	17.4	----------	3.8	1.9	.3	.8	.4	.4	.8
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1964													
Aug. 20-31	3.4	2.1	2.6	1.9	5.1	2.5	4.4	2.8	6.9	4.0	6.0	4.5	4.9
September	21.1	21.1	18.8	21.9	22.1	29.9	21.1	21.2	35.3	19.5	28.7	22.0	21.9
October	37.6	42.3	33.1	44.8	35.3	48.2	33.7	43.4	48.6	42.3	45.4	37.3	40.1
November	50.0	56.1	47.0	56.1	43.8	57.3	45.8	53.8	60.3	56.3	59.9	49.5	52.1
December	65.3	71.4	64.2	70.8	56.7	68.2	58.1	67.5	71.7	64.4	75.6	61.9	68.3
1965													
January	77.3	81.7	78.6	77.9	63.5	74.1	66.3	78.9	80.7	71.9	82.8	76.2	79.8
February	83.5	86.2	84.6	83.4	69.1	77.0	74.1	83.8	88.0	82.2	87.6	83.3	88.3
March	88.8	89.8	91.4	87.4	72.1	80.7	81.5	90.0	94.6	86.3	90.8	87.1	90.8
April	91.6	93.0	94.4	89.4	76.2	81.7	83.6	92.7	95.2	91.5	93.6	89.7	92.9
May	93.2	96.1	95.7	89.7	79.1	82.5	85.5	94.3	96.0	94.5	94.9	91.8	94.5
June	95.4	97.2	97.8	93.7	80.2	93.5	90.5	96.3	98.0	96.2	97.0	94.2	96.2
July	97.0	98.7	98.9	95.3	81.5	96.8	93.5	97.5	98.9	97.0	98.7	98.7	97.8
August	97.9	99.4	99.4	95.9	82.6	100.0	96.2	98.1	99.8	99.2	99.6	99.6	99.2
September or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

RESULTS OF THE NOVEMBER 18, 1964, SURVEY OF CD MATURITIES

In the November 18 survey of maturities of outstanding negotiable time certificates of deposit of $100,000 or more at weekly reporting member banks, 253 banks reported $12,740 million outstandings. This was an increase of $547 million from the August 19 survey. The annual growth rate of CD's between August 19 and November 18 was 17.9 percent, substantially lower than the 43.7-percent growth rate earlier in the year.

On the survey date, 73.6 percent of all outstandings matured in the first 4 full months including the December and March tax and dividend periods. As shown in table 1, the largest percentage of maturities occurs in the months of December, January, and March. The distribution in these months is heavier and less even than that reported for the corresponding months in the August 19 survey (table 3), with the March maturities being particularly heavy.

One factor which contributed to this distribution of maturities was that banks encountered increasing difficulty in issuing longer term CD's over the late summer and fall, as short-term market rates rose relative to regulation Q ceilings. Another factor was the pattern of corporate tax payments under existing tax laws. Estimated corporate tax liabilities for March 1965 are $7.2 billion as compared with about $4 billion paid this September and December. The maturities on the dividend date in December are heavier relative to the tax date in that month than they were on comparable September dates as shown in table 2. This probably reflects the heavier dividend and bonus payments at year-end and is particularly pronounced at banks in New York City.

Table 4 shows that the average maturity of CD's at banks in New York City and Chicago in November was 3.1 months; considerably below the 3.8 month average reported in August. The average maturity at other banks remained at 3.8 months. The heavy concentration of March maturities appears mainly at banks in New York City and Chicago, suggesting that CD's of these banks are more extensively purchased for tax reserve purposes than are those of banks in smaller financial centers. In addition, yield considerations relative to other money market instruments probably are a more important factor in CD demand at these banks. Induced by higher market rates, most often quoted rate on CD's with maturities of 6 months and over at New York City banks was at the 4-percent ceiling from September 30 until the revision of regulation Q on November 24, and some banks were paying that rate on 90-day maturities over most of this period.

The volume of CD's with maturities of a year or more was relatively much greater at banks outside New York City and Chicago than at banks in these two cities. This suggests that demand for CD's at outside banks is less interest sensitive and that the customer relationship may be a more important consideration in the issuance of CD's than at the New York and Chicago banks.

Annual rates of change in outstanding CD's between August 19 and November 18 differed by size class of bank with the largest banks showing the greatest change, as shown in table 5. Maturities at banks in the largest size class are heavy through March and then fall off sharply while those at smaller banks taper off gradually. Thus the average maturity is somewhat longer at the small banks than at the larger banks. Compared with the August 19 survey the maturities have shortened in all but the $100 to $200 million deposit class with the largest decrease being in the $1 billion or more size class—from 3.9 to 3.4 months.

Tables 6a and 6b present the data by district. Average maturities are shortest in the St. Louis and New York districts and longest in the Cleveland district. The change since the August 19 survey is most marked in New York where average maturities declined from 3.8 to 3.1 months, and in Richmond where average maturities increased from 3.9 to 4.7 months. Average maturities declined in all but the Richmond, Philadelphia, Cleveland, and Kansas City districts. The percentage distributions show that banks in the Kansas City, St. Louis, and Boston districts have the highest percentage of immediate maturities while Minneapolis banks have the fewest. Banks in the Richmond district had heavy immediate maturities at the time of the August survey but had substantially fewer in November. In both surveys banks in the Cleveland, Philadelphia, and Atlanta districts had the largest percentage of maturities of 1 year or more.

TABLE 1.—*Outstanding negotiable time certificates of deposit, weekly reporting member banks, Nov. 18, 1964*

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage
1964			
Nov. 19–30	614.7	4.8	4.8
December [1]	2,416.9	19.0	23.8
1965			
January	2,313.6	18.2	42.0
February	1,752.7	13.8	55.7
March	2,276.9	17.9	73.6
April	1,268.5	10.0	83.5
May	598.7	4.7	88.2
June	388.5	3.0	91.3
July	249.2	1.9	93.2
August	154.9	1.2	94.5
September	187.4	1.5	95.9
October	120.3	.9	96.9
November	48.5	.4	97.3
December or later	349.6	2.7	100.0
Total	12,740.4	100.0	

[1] Includes $156,000,000 maturing on Dec. 10 and $694,000,000 on Dec. 15.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposits, March, June, September, December 1964*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in—		Other banks
		New York City	Chicago	
TAX-DATE MATURITIES				
1964				
Mar. 16 [1]	(2)	243	87	(2)
June 15 [3]	596	230	73	293
Sept. 15 [4]	708	253	86	369
Dec. 15 [5]	694	272	67	355
DIVIDEND-DATE MATURITIES				
1964				
Mar. 10 [1]	(1)	16	4	(2)
June 10 [3]	97	23	6	68
Sept. 10 [4]	110	33	8	69
Dec. 10 [5]	156	63	4	89

[1] As reported on Feb. 19.
[2] Not available.
[3] As reported on May 20.
[4] As reported on Aug. 19.
[5] As reported on Nov. 18.

TABLE 3.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City and Chicago banks, February, May, August, November 1964*

Period of maturity	Percentage distribution—Date of survey				Cumulative percentage—Date of survey			
	Feb. 19	May 20	Aug. 19	Nov. 18	Feb. 19	May 20	Aug. 19	Nov. 18
1 to 12 days [1]	5.0	2.5	2.3	4.8	5.0	2.5	2.3	4.8
Additional months:								
1	17.7	14.5	16.0	17.5	22.8	17.0	18.3	22.3
2	19.2	13.6	15.1	19.9	41.9	30.6	33.5	42.2
3	10.8	9.6	12.8	15.1	52.7	40.2	46.2	57.3
4	12.6	15.1	17.1	22.7	65.3	55.3	63.3	80.0
5	10.6	13.9	14.9	9.1	75.9	69.2	78.2	89.1
6	6.0	9.8	6.2	4.1	81.9	78.9	84.4	93.3
7	4.5	8.4	7.0	2.9	86.4	87.3	91.4	96.2
8	3.5	4.9	2.9	1.2	89.9	92.2	94.3	97.4
9	1.9	2.5	1.5	.7	91.8	94.8	95.7	98.0
10	3.3	2.7	2.1	1.1	95.0	97.5	97.9	99.1
11	2.7	1.8	1.1	.5	97.7	99.3	99.0	99.5
12	1.2	.5	.5	(2)	98.9	99.7	99.5	99.6
More than 12	1.1	.3	.5	.4	100.0	100.0	100.0	100.0

[1] Number of days of the survey month following the survey: Feb. 10; May 11; Aug. 12; Nov. 12.
[2] Less than 0.05 percent.

TABLE 4.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks as of Nov. 18, 1964*

[Dollars in millions]

Period of maturity	New York City and Chicago		Other		New York City and Chicago	Other
	Amount	Percent	Amount	Percent	Cumulative percentage	
1964						
Nov. 19-30	$287.5	4.8	$327.2	4.9	4.8	4.9
December	1,056.7	17.5	1,360.2	20.3	22.3	25.1
1965						
January	1,198.6	19.9	1,115.0	16.6	42.2	41.7
February	909.4	15.1	843.3	12.6	57.3	54.3
March	1,369.1	22.7	907.8	13.5	80.0	67.8
April	549.4	9.1	719.1	10.7	89.1	78.5
May	248.6	4.1	350.1	5.2	93.3	83.7
June	174.4	2.9	214.1	3.2	96.2	86.9
July	72.3	1.2	176.9	2.6	97.4	89.6
August	39.7	0.7	115.2	1.7	98.0	91.3
September	63.5	1.1	123.9	1.8	99.1	93.1
October	28.4	0.5	91.9	1.4	99.5	94.5
November	2.4	(1)	46.1	0.7	99.6	95.2
December or later	25.4	.4	324.2	4.8	100.0	100.0
Total	6,025.4	100.0	6,715.0	100.0		
Average maturity (months)	3.1		3.8			
Number banks reporting	25		228			

[1] Less than 0.05 percent.

TABLE 5.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of bank,*[1] *as of Nov. 18, 1964*

[Amounts in millions of dollars]

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		
1964							
Nov. 19-30	9.0	11.0	101.0	86.0	407.7	614.7	614.7
December	23.8	53.1	340.0	466.6	1,533.4	2,416.9	3,031.6
1965							
January	17.9	54.9	232.0	369.2	1,639.6	2,313.6	5,345.2
February	18.2	28.7	184.5	260.7	1,260.6	1,752.7	7,097.9
March	27.1	31.6	210.2	314.5	1,693.5	2,276.9	9,374.8
April	16.6	42.5	152.1	222.5	834.8	1,268.5	10,643.3
May	10.9	24.4	81.6	104.5	377.3	598.7	11,242.0
June	7.7	9.8	77.6	56.0	237.4	388.5	11,630.5
July	4.4	15.7	52.1	42.6	134.4	249.2	11,879.7
August	4.4	9.5	41.0	20.7	79.3	154.9	12,034.6
September	5.0	6.4	43.2	31.0	101.8	187.4	12,222.0
October	4.1	4.7	30.6	23.6	57.3	120.3	12,342.3
November	1.3	3.6	14.8	8.5	20.3	48.5	12,390.8
December or later	3.1	17.9	38.9	45.1	244.6	349.6	12,740.4
Total	153.5	313.8	1,599.6	2,051.5	8,622.0	12,740.4	
Annual rate of growth since Aug. 19 (percent)	−46.2	+19.1	−8.3	+5.0	+28.5	+17.9	
Dec. 10	1.6	1.1	20.2	36.6	96.8	156.3	
Dec. 15	2.0	4.2	70.4	140.3	477.3	694.2	
Average maturity (months)	4.1	4.3	3.7	3.3	3.4	3.4	
Number banks reporting	58	56	69	40	30	253	

[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.

TABLE 6a.—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve District, as of Nov. 18, 1964*

[Amounts in millions of dollars to 1 decimal]

Period of maturity	All districts	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
1964													
Nov. 19-30	614.7	27.9	306.4	13.8	29.2	10.2	14.9	71.4	9.6	7.0	27.3	38.7	58.3
December	2,416.9	123.2	1,076.8	72.7	132.8	33.4	63.4	264.4	86.2	24.2	83.8	184.1	271.9
1965													
January	1,313.6	94.3	1,058.9	46.3	129.2	19.1	45.2	401.6	41.2	37.6	33.6	203.2	203.4
February	1,752.7	66.3	828.3	43.0	90.8	20.0	42.3	225.5	48.9	33.0	30.3	138.4	185.9
March	2,276.9	75.3	1,181.1	87.1	89.7	25.4	46.7	351.7	62.8	36.1	34.3	100.8	185.9
April	1,268.5	67.7	518.6	39.2	101.7	21.6	22.6	136.0	20.8	47.2	35.9	66.7	190.5
May	598.7	39.1	248.8	13.9	45.4	9.4	15.8	49.3	19.0	15.0	7.5	49.1	86.4
June	388.5	17.5	167.2	16.9	17.3	25.6	20.6	43.5	10.1	4.2	9.3	26.3	30.0
July	249.2	11.3	87.4	7.2	14.6	8.9	11.6	23.6	3.3	1.9	7.3	45.5	26.6
August	154.9	9.0	37.3	6.9	17.0	8.9	9.9	16.9	3.4	7.2	3.8	11.8	22.8
September	187.4	9.9	49.0	11.6	5.6	11.7	12.7	34.8	3.3	2.6	3.5	11.3	31.4
October	120.3	5.6	33.9	1.1	11.2	12.4	5.5	16.9	3.8	1.8	4.7	7.4	16.0
November	48.5	1.4	7.6	1.1	8.5	1.6	3.1	4.0	0.7	0.8	5.7	3.5	10.5
December or later	349.6	2.8	31.8	26.5	185.6	---------	14.1	39.8	0.4	2.2	8.2	8.8	29.4
Total	12,740.4	551.3	5,633.1	387.3	878.6	208.2	328.4	1,679.4	313.5	220.8	295.2	895.6	1,349.0
Dec. 10	156.3	12.5	84.1	3.3	16.0	3.0	3.3	7.9	3.1	1.8	3.8	5.4	12.1
Dec. 15	694.2	34.0	331.0	25.7	39.6	1.4	19.6	78.2	22.7	8.9	15.1	53.0	65.0
Average maturity (months)	3.4	3.3	3.1	4.1	5.4	4.7	4.1	3.5	3.0	3.7	3.3	3.3	3.6
Number banks reporting	253	16	37	9	15	15	17	29	13	14	34	31	23

TABLE 6b.—*Distribution of maturities of outstanding negotiable time certificates of deposit by Federal Reserve district, as of Nov. 18, 1964*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
	Percentage distribution												
1964													
Nov. 19-30	4.8	5.1	5.4	3.6	3.3	4.9	4.5	4.3	3.1	3.2	9.2	4.3	4.3
December	19.0	22.3	19.1	18.8	15.1	16.0	19.3	15.8	27.5	11.0	28.4	20.6	20.1
1965													
January	18.2	17.1	18.8	11.9	14.7	9.2	13.8	23.9	13.1	17.1	11.4	22.7	15.1
February	13.8	12.0	14.7	11.1	10.3	9.6	12.9	13.4	15.6	15.0	10.3	15.4	13.8
March	17.9	13.7	21.0	22.5	10.2	12.2	14.2	20.9	20.0	16.4	11.6	11.3	13.8
April	10.0	12.3	9.2	10.1	11.6	10.4	6.9	8.1	6.6	21.4	12.2	7.4	14.1
May	4.7	7.1	4.4	3.6	5.2	4.5	4.8	2.9	6.1	6.6	2.5	5.5	6.4
June	3.0	3.2	3.0	4.4	2.0	12.3	6.3	2.6	3.2	1.9	3.1	2.9	2.2
July	1.9	2.0	1.5	1.8	1.7	4.3	3.5	1.4	1.1	.8	2.5	5.1	2.0
August	1.2	1.6	.7	1.8	1.9	4.3	3.0	1.0	1.1	3.3	1.3	1.3	1.7
September	1.5	1.8	.9	3.0	.6	5.6	3.9	2.1	1.1	1.2	1.2	1.3	2.3
October	.9	1.0	.6	.3	1.3	5.9	1.7	1.0	1.2	.8	1.6	.8	1.2
November	.4	.3	.1	.3	1.0	.8	.9	.2	.2	.3	1.9	.4	.8
December or later	2.7	.5	.6	6.8	21.1	----------	4.3	2.4	.1	1.0	2.8	1.0	2.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1964													
Nov. 19-30	4.8	5.1	5.4	3.6	3.3	4.9	4.5	4.3	3.1	3.2	9.2	4.3	4.3
December	23.8	27.4	24.6	22.3	18.4	20.9	23.8	20.0	30.6	14.1	37.6	24.9	24.5
1965													
January	42.0	44.5	43.4	34.3	33.1	30.1	37.6	43.9	43.7	31.2	49.0	47.6	39.6
February	55.7	56.5	58.1	45.4	43.5	39.7	50.5	57.3	59.3	46.1	59.3	63.0	53.3
March	73.6	70.2	79.0	67.9	53.7	51.9	64.7	78.3	79.3	62.5	70.9	74.3	67.1
April	83.5	82.5	88.2	78.0	65.3	62.3	71.6	86.4	86.0	83.8	83.1	81.7	81.2
May	88.2	89.6	92.6	81.6	70.4	66.8	76.4	89.3	92.0	90.6	85.6	87.2	87.6
June	91.3	92.7	95.6	86.0	72.4	79.1	82.7	91.9	95.2	92.5	88.8	90.1	89.9
July	93.2	94.8	97.2	87.8	74.1	83.4	86.2	93.3	96.3	93.4	91.2	95.2	91.8
August	94.5	96.4	97.8	98.6	76.0	87.7	89.2	94.3	97.4	96.6	92.5	96.5	93.5
September	95.9	98.2	98.7	92.6	76.6	93.3	93.1	96.4	98.4	97.8	93.7	97.8	95.9
October	96.9	99.2	99.3	92.9	77.9	99.2	94.8	97.4	99.6	98.6	95.3	98.6	97.0
November	97.3	99.5	99.4	93.2	78.9	100.0	95.7	97.6	99.9	99.0	97.2	99.0	97.8
December or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

RESULTS OF THE FEBRUARY 17, 1965, SURVEY OF CERTIFICATES OF DEPOSIT MATURITIES

This memorandum summarizes the results of the February 17, 1965, survey of the maturity structure of outstanding time certificates of deposit of $100,000 or more at weekly reporting member banks. The 256 responding banks reported a total of $13,747 million outstanding, an increase at an annual rate of more than 30 percent since the November 18, 1964, survey, and greater than the 18 percent rate of increase in the 3 months prior to that.

In the 4 full months covering the March and June tax and dividend dates and the new April 15 date for corporation payments of the first installment on their current year's tax liabilities, almost 70 percent of the outstandings will mature, somewhat less than the amount maturing in the similar period of the last survey. As shown in table 1, the largest concentration of maturities is in March and April, when they total about 46 percent of oustandings, the largest volume for the comparable 2 months since the survey was undertaken. After July, maturities taper off sharply.

In June, when corporate tax payments are expected to be larger than in March, maturities amount to only about half the March total. Corporate demand for CD's with a June maturity may be dampened, to some extent, by the availability of a $3.3 billion tax bill maturing in June, the largest since May of 1962.

The major factor contributing to this maturity structure, however, was the relationship between market rates of interest and regulation Q ceilings, both immediately before and since the revision in these ceilings in late November. For some weeks prior to the revision, prime banks had been unable to attract any appreciable amounts of funds with maturities beyond 6 months, and most of the maturities were reported to have fallen in the 4–5 months range. After the revision, banks were reluctant to pay the higher rates necessary to draw longer term funds, and instead took advantage of the new authority to obtain funds in the 30–89 day range. Earlier this year, however, short-term market rates advanced further and funds in these short maturities again became generally unavailable. Thus, for some weeks prior to the February survey, prime banks had been seeking funds in the 4–6 months maturity range or longer. These developments have kept maturities relatively short and resulted in the concentration in March and April as well as some recent rise in maturities in the summer and early autumn.

The average maturity of CD's remains at 3.1 months at New York City and Chicago banks and at 3.8 months at other banks. At both groups of banks the increased concentration of 1- and 2-month maturities, compared with November, has been about offset by the higher proportion of those at 5 months and over.

Tables 6a and 6b present the data by district. Average maturities are shortest in Minneapolis and longest in Cleveland. Richmond and Minneapolis show the most marked change on the downside since the last survey, shortening the average maturity of outstandings from 4.7 to 3.6 months and from 3.7 to 2.8 months, respectively. St. Louis led the others on the upside, lengthening the average of its maturities from 3 to 3.5 months. The percentage distribution show that banks in Kansas City and St. Louis continue to have the highest percentage of immediate maturities, while banks in the Cleveland district have the fewest. As in earlier surveys, banks in Philadelphia, Cleveland, and Atlanta continue to show the greatest percentage of maturities of 1 year or more.

TABLE 1.—*Outstanding negotiable time certificates of deposit, weekly reporting member banks, Feb. 17, 1965*

Period of maturity	Amount (in millions of dollars)	Percentage distribution	Cumulative percentage
1965			
Feb. 18–28	649.7	4.7	4.7
March [1]	3,289.5	23.9	28.7
April	2,333.4	17.0	45.6
May	1,493.2	10.9	56.5
June	1,656.6	12.1	68.5
July	1,562.8	11.4	79.9
August	829.7	6.0	85.9
September	604.0	4.4	90.3
October	264.0	1.9	92.3
November	145.9	1.1	93.3
December	278.4	2.0	95.3
1966			
January	244.9	1.8	97.1
February	86.1	.6	97.8
March or later	309.0	2.2	100.0
Total	13,747.2	100.0	----------

[1] Includes $234,000,000 maturing on Mar. 10 and $865,000,000 on Mar. 15.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposits, March, June, September, and December 1964, and February 1965*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in— New York City	Banks in— Chicago	Other banks
TAX-DATE MATURITIES				
1964				
Mar. 16 [1]	(2)	243	87	(2)
June 15 [3]	596	230	73	293
Sept. 15 [4]	708	253	86	369
Dec. 15 [5]	694	272	67	355
1965				
Mar. 15	865	454	103	308
DIVIDEND-DATE MATURITIES				
1964				
Mar. 10 [1]	(2)	16	4	(2)
June 10 [3]	97	23	6	68
Sept. 10 [4]	110	33	8	69
Dec. 10 [5]	156	63	4	89
1965				
Mar. 10	234	110	40	84

[1] As reported on Feb. 19.
[2] Not available.
[3] As reported on May 20.
[4] As reported on Aug. 19.
[5] As reported on Nov. 18.

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TABLE 3.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City and Chicago banks May, August, and November, 1964, and February 1965*

Period of maturity	Percentage distribution—date of survey				Cumulative percentage—Date of survey			
	May 20	Aug. 19	Nov. 18	Feb. 17	May 20	Aug. 19	Nov. 18	Feb. 17
1 to 12 days [1]	2.5	2.3	4.8	5.0	2.5	2.3	4.8	5.0
Additional months:								
1	14.5	16.0	17.5	27.0	17.0	18.3	22.3	31.9
2	13.6	15.1	19.9	16.4	30.6	33.5	42.2	48.4
3	9.6	12.8	15.1	11.1	40.2	46.2	57.3	59.5
4	15.1	17.1	22.7	12.3	55.3	63.3	80.0	71.8
5	13.9	14.9	9.1	11.6	69.2	78.2	89.1	83.4
6	9.8	6.2	4.1	5.3	78.9	84.4	93.3	88.7
7	8.4	7.0	2.9	5.5	87.3	91.4	96.2	94.2
8	4.9	2.9	1.2	2.0	92.2	94.3	97.4	96.2
9	2.5	1.5	.7	.8	94.8	95.7	98.0	97.0
10	2.7	2.1	1.1	1.2	97.5	97.9	99.1	98.3
11	1.8	1.1	.5	.9	99.3	99.0	99.5	99.1
12	.5	.5	(2)	.3	99.7	99.5	99.6	99.4
More than 12 months	.3	.5	.4	.6	100.0	100.0	100.0	100.0

[1] Number of days of the survey month following the survey: May, 11; August, 12; November, 12; February, 11.
[2] Less than 0.05 percent.

TABLE 4.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks as of Feb. 17, 1965*

[Dollars in millions]

Period of maturity	New York City and Chicago		Other		Cumulative percentage	
	Amount	Percent	Amount	Percent	New York City and Chicago	Other
1965						
Feb. 18–28	$311.2	5.0	$338.5	4.5	5.0	4.5
March	1,686.8	27.0	1,602.7	21.4	31.9	25.9
April	1,029.0	16.4	1,304.4	17.4	48.4	43.3
May	694.8	11.1	798.4	10.7	59.5	54.0
June	772.6	12.3	884.0	11.8	71.8	65.8
July	725.0	11.6	837.8	11.2	83.4	77.0
August	329.0	5.3	500.7	6.7	88.7	83.7
September	345.3	5.5	258.7	3.4	94.2	87.1
October	126.2	2.0	137.8	1.8	96.2	89.0
November	50.7	.8	95.2	1.3	97.0	90.2
December	77.0	1.2	201.4	2.7	98.3	92.9
1966						
January	53.2	.9	191.7	2.6	99.1	95.5
February	18.1	.3	68.0	.9	99.4	96.4
March or later	38.0	.6	271.0	3.6	100.0	100.0
Total	6,256.9	100.0	7,490.3	100.0		
Average maturity (months)	3.1		3.8			
Number of banks reporting	25		231			

TABLE 5.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of bank,*[1] *as of Feb. 17, 1965*

[Dollar amounts in millions]

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							
Feb. 18–28	9.7	11.2	80.8	92.9	455.1	649.7	469.7
March	44.3	56.8	385.6	552.1	2,250.7	3,289.5	3,939.2
April	26.1	79.8	288.9	395.0	1,543.6	2,333.4	6,272.6
May	17.6	42.0	183.7	234.2	1,015.7	1,493.2	7,765.8
June	15.4	29.2	259.3	258.6	1,094.1	1,656.6	9,422.4
July	12.9	33.2	188.0	215.5	1,113.2	1,562.8	10,985.2
August	10.8	20.9	111.8	101.8	584.4	829.7	11,814.9
September	6.0	8.8	76.0	69.3	443.9	604.0	12,418.9
October	5.2	10.2	37.9	45.0	165.7	264.0	12,682.9
November	2.4	6.1	22.7	22.8	91.9	145.9	12,828.8
December	8.4	17.5	53.1	58.9	140.5	278.4	13,107.2
1966							
January	4.5	14.3	46.0	52.3	127.8	244.9	13,352.1
February	2.0	5.8	21.2	14.7	42.4	86.1	13,438.2
March or later	3.7	18.1	39.8	26.2	221.2	309.0	13,747.2
Total	169.0	353.9	1,794.8	2,139.3	9,290.2	13,747.2	
Annual rate of growth since Nov. 18, 1964 (percent)—	+40.4	+51.1	+48.8	+17.1	+31.0	+31.6	
Mar. 10, 1965	.4	2.5	17.1	23.7	190.0	233.7	
Mar. 15, 1965	2.7	4.0	83.0	100.0	675.1	864.8	
Average maturity (months)	3.7	4.3	3.8	3.4	3.4	3.5	
Number of banks reporting	61	55	69	41	30	256	

[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.

TABLE 6a.—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve district, as of Feb. 17, 1965*

[Dollar amounts in millions]

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
1965													
Feb. 18–28	649.7	19.0	284.4	32.4	30.9	12.5	20.7	74.3	17.7	12.4	12.9	56.9	75.6
March	3,289.5	128.1	1,547.3	126.3	137.0	50.3	80.5	487.0	92.8	66.5	94.9	207.7	271.1
April	2,333.4	105.3	1,012.3	63.4	158.7	36.6	52.8	273.7	46.6	65.8	71.3	161.4	285.5
May	1,493.2	84.1	687.1	30.0	87.4	20.2	28.5	166.6	35.4	27.7	21.9	108.5	195.8
June	1,656.6	76.2	765.8	53.8	104.1	41.3	60.1	196.0	33.3	25.8	38.8	115.0	146.4
July	1,562.8	74.2	731.6	46.9	95.7	17.5	31.2	163.2	31.5	24.2	26.0	144.6	176.2
August	829.7	33.6	280.8	32.1	78.1	12.6	24.1	114.0	15.9	14.6	16.9	63.5	143.5
September	604.0	19.1	273.1	17.5	35.2	13.7	22.0	131.9	8.8	2.7	7.1	32.0	40.9
October	264.0	17.3	125.4	1.7	14.3	13.6	8.2	35.1	6.4	2.0	5.7	13.3	21.0
November	145.9	5.2	57.8	3.4	17.5	3.4	6.5	13.7	2.2	1.3	5.9	8.0	21.0
December	278.4	13.5	80.7	10.2	24.7	6.7	9.6	34.9	22.4	4.4	6.7	19.6	43.0
1966													
January	244.9	4.3	53.7	10.2	26.2	1.7	15.3	36.6	8.1	4.3	7.5	25.6	49.4
February	86.1	0.8	27.8	2.7	9.6	1.5	5.6	3.5	3.0	1.0	4.1	7.4	18.1
March or later	309.0	2.9	38.2	21.1	160.3	1.8	24.7	24.1	1.4	1.0	5.4	7.3	20.8
Total	13,747.2	583.6	5,966.0	451.7	979.7	233.4	389.8	1,759.6	325.5	253.7	325.1	970.8	1,508.3
Mar. 10, 1965	233.8	5.1	125.2	3.9	10.1	1.1	3.2	41.5	3.0	1.1	3.5	12.2	23.9
Mar. 15, 1965	864.8	38.7	491.2	17.1	29.8	3.0	15.8	110.7	24.3	4.1	20.3	48.0	61.8
Average maturity (months)	3.5	3.3	3.2	3.6	5.3	3.6	4.3	3.4	3.5	2.8	3.3	3.4	3.7
Number of banks reporting	256	16	36	9	17	16	18	27	13	15	34	31	24

TABLE 6(b).—*Distribution of maturities of outstanding negotiable time certificate of deposit by Federal Reserve district, as of Feb. 17, 1965*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
	Percentage distribution												
1965													
Feb. 18–28	4.7	3.3	4.8	7.2	3.1	5.4	5.3	4.2	5.4	4.9	4.0	5.9	5.0
March	23.9	21.9	25.9	28.0	14.0	21.6	20.7	27.7	28.5	26.2	29.2	21.4	18.0
April	17.0	18.0	17.0	14.0	16.2	15.7	13.6	15.5	14.3	25.9	21.9	16.6	18.9
May	10.9	14.4	11.5	6.6	8.9	8.7	7.3	9.5	10.9	10.9	6.7	11.2	13.0
June	12.1	13.1	12.8	11.9	10.6	17.7	15.4	11.1	10.2	10.2	11.9	11.8	9.7
July	11.4	12.7	12.3	10.4	9.8	7.5	8.0	9.3	9.7	9.5	8.0	14.9	11.7
August	6.0	5.8	4.7	7.1	8.0	5.4	6.2	6.5	4.9	5.8	5.2	6.5	9.5
September	4.4	3.3	4.6	3.9	3.6	5.8	5.6	7.5	2.7	1.1	2.2	3.3	2.7
October	1.9	3.0	2.1	.4	1.4	5.8	2.1	2.0	2.0	.8	1.7	1.4	1.4
November	1.1	.9	1.0	.7	1.8	1.4	1.7	.8	.7	.5	1.8	.8	1.4
December	2.0	2.3	1.4	2.5	2.5	2.9	2.5	2.1	6.9	1.7	2.1	2.0	2.8
1966													
January	1.8	.7	.9	2.3	2.7	.7	3.9	2.2	2.5	1.7	2.3	2.6	3.3
February	.6	.1	.4	.6	1.0	.6	1.4	.2	.9	.4	1.3	.8	1.2
March or later	2.2	.5	.6	4.7	16.4	.8	6.3	1.4	.4	.1	1.7	.8	1.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1965													
Feb. 18–28	4.7	3.3	4.8	7.2	3.1	5.4	5.3	4.2	5.4	4.9	4.0	5.9	5.0
March	28.7	25.2	30.7	35.1	17.1	26.9	26.0	31.9	33.9	31.1	33.2	27.3	23.0
April	45.6	43.2	47.7	49.2	33.3	42.6	39.5	47.5	48.3	57.0	55.1	43.9	43.9
May	56.5	57.7	59.2	55.8	42.3	51.2	46.8	56.9	59.1	68.0	61.8	55.1	54.9
June	68.5	70.7	72.0	67.7	52.9	68.9	62.2	68.1	69.4	78.1	73.8	66.9	64.6
July	79.9	83.4	84.3	78.1	62.7	76.4	70.2	77.3	79.0	87.7	81.8	81.8	76.3
August	85.9	89.2	89.0	85.2	70.6	81.8	76.4	83.8	83.9	93.4	87.0	88.3	85.8
September	90.3	92.5	93.6	89.1	74.2	87.7	82.1	91.3	86.6	94.5	89.1	91.6	88.5
October	92.3	95.4	95.7	89.5	75.7	93.5	84.2	93.3	88.6	95.3	90.9	93.0	89.9
November	93.3	96.3	96.6	90.2	77.5	95.0	85.8	94.1	89.3	95.8	92.7	93.8	91.3
December	95.3	98.6	98.0	92.5	80.0	97.9	88.3	96.2	96.2	97.5	94.8	95.8	94.1
1966													
January	97.1	99.4	98.9	94.7	82.7	98.6	92.2	98.4	98.6	99.2	97.1	98.5	97.4
February	99.5	99.5	99.4	95.3	83.6	99.2	93.7	98.6	99.6	99.6	98.3	99.2	98.6
March or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

MATURITY DISTRIBUTION OF NEGOTIABLE TIME CERTIFICATES OF DEPOSIT FROM MAY 19, 1965, SURVEY

This memorandum summarizes the results of the May 19, 1965, survey of the maturity structure of outstanding negotiable time certificates of deposit of $100,000 or more at weekly reporting member banks. The 248 responding banks reported $15,058 million outstanding, an annual rate of increase of 38 percent since the February survey, a larger increase than shown in either the February 1965 or November 1964 surveys.

About two-thirds of outstanding certificates of deposit will mature by the end of September, a period which includes the June and September tax and dividend date (table 1). This compares to virtually the same proportion of outstandings that were to mature in the similar period as of the February 1965 survey and three-fourths at the November 1964 survey—which was taken prior to the last change in regulation Q. As of May of last year, a little less than 60 percent of outstanding certificates of deposit matured by the end of September. This year a considerably greater proportion of the outstandings mature in June than in the survey a year ago—21.5 percent versus 15.2 percent—even though this June the maturing tax bill is the largest since 1962.

At the May survey date, the average maturity of certificates of deposit outstanding at New York City and Chicago banks had increased to 3.7 months, from the 3.1 months at the November 1964 and February 1965 survey dates, while the average maturity of certificates of deposit at respondent banks in other cities declined from 3.8 months at the earlier dates to 3.6 months in May (table 4). This latter maturity is the shortest since the survey has been kept, while the average maturity of certificates of deposit outstanding at New York City and Chicago banks has risen back toward the previous high of 3.8 months. The lengthening of maturities at New York City and Chicago banks, relative to previous surveys, is indicated in table 3. As of the current survey, about three-fourths of the certificates of deposit at New York and Chicago banks mature 5 months after the survey month, the smallest proportionate amount maturing in that period since the previous May survey. The maturities in the sixth month after the survey date (November), 11.4 percent of outstandings, are the heaviest since the survey began.

Nearly all of the increase in outstanding certificates of deposit since the February survey has occurred at New York City banks; banks in cities other than New York and Chicago have reduced their outstandings by $100 million since that time. Indeed, as of the current survey, New York City and Chicago banks had more certificates of deposit outstanding than all other banks combined for the first time since these surveys have been taken.

At least two factors have been at work. First, rate ceilings under regulation Q—and perhaps some unwillingness to pay higher rates—have limited the ability of smaller banks to attract certificates of deposit money. As in the November 1964 survey—taken before the increase in regulations Q—smaller banks have reduced their outstandings (table 5). However, unlike the November survey, banks in the $500 million to $1 billion deposit category also reduced their outstandings, while banks with deposits over $1 billion—mainly the New York City banks—increased their outstandings more than during any other period. Moreover, the smaller banks reduced the average maturity of their outstanding certificates of deposit, while the larger banks increased the average maturity of their certificates of deposit. On the other hand, longer maturities (in excess of 7 months) remain more important absolutely and proportionally at banks outside of New York City and Chicago (table 4). This may indicate less interest sensitivity among the customers of outside banks, although the shortening of maturities indicates that there is not complete insensitivity on the part of these banks and/or their customers.

Second, New York City banks reduced their liquidity in the first quarter of the year in order to meet unusually heavy loan demands. In order to rebuild that liquidity, and possibly in anticipation of further loan demand and their relatively heavy June certificate of deposit maturities, they became aggressive seekers of funds in the certificate of deposit market. They chose and were able to garner these funds, evidently, by issuing somewhat longer maturities than earlier in the year. Concurrently with their increase in outstanding certificates of deposit in April–May, they reduced their Federal funds purchases and borrowings from the Federal Reserve.

Tables 6a and 6b present the data by Federal Reserve district. The longest average maturity continues to be in the Cleveland district, while Richmond now has the shortest average maturity. New York and Chicago were the only districts to show an increase in average maturities from the last survey. The largest increase (from 3.2 to 3.7 months) occurred in the New York district and the largest decline occurred in the Richmond and Minneapolis districts (from 3.6 to 3 months and 3.4 to 2.8 months, respectively). The Richmond and Kansas City districts have the greatest proportion of their outstandings maturing by the end of June, while Cleveland has the least. The Cleveland, Philadelphia, and Atlanta districts continue to have the largest percentage of maturities of 1 year or more.

TABLE 1.—*Outstanding negotiable time certificates of deposit, weekly reporting member banks, May 19, 1965*

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage
1965			
May 20-31	645.0	4.3	4.3
June [1]	3,244.4	21.5	25.8
July	2,584.3	17.2	43.0
August	1,738.5	11.5	54.5
September	1,944.9	12.9	67.5
October	1,264.1	8.4	75.9
November	1,229.7	8.2	84.0
December	635.2	5.5	89.6
1966			
January	431.3	2.9	92.4
February	222.7	1.5	93.9
March	218.3	1.4	95.4
April	137.7	.9	96.3
May	85.1	.6	96.8
June or later	476.3	3.2	100.0
Total	15,057.5	100.0	------------

[1] Includes $245,000,000 maturing on June 10 and $684,000,000 on June 15.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposit, June–September–December 1964, March–June 1965*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in— New York City	Banks in— Chicago	Other banks
TAX-DATE MATURITIES				
1964				
June 15 [1]	596	230	000	293
Sept. 15 [2]	708	253	86	369
Dec. 15 [3]	694	272	67	355
1965				
Mar. 15 [4]	865	454	103	308
June 15 [5]	684	332	125	227
DIVIDEND-DATE MATURITIES				
1964				
June 10 [1]	97	23	6	68
Sept. 10 [2]	110	33	8	69
Dec. 10 [3]	156	63	4	89
1965				
Mar. 10 [4]	234	110	40	84
June 10 [5]	245	137	12	96

[1] As reported on May 20, 1964.
[2] As reported on Aug. 19, 1964.
[3] As reported on Nov. 18, 1964.
[4] As reported on Feb. 17, 1965.
[5] As reported on May 20, 1965.

TABLE 3.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City and Chicago banks, August to November 1964; February to May 1965*

Period of maturity	Percentage distribution—Date of survey				Cumulative percentage—Date of survey			
	Aug. 19	Nov. 18	Feb. 17	May 19	Aug. 19	Nov. 18	Feb. 17	May 19
1 to 12 days [1]	2.3	4.8	5.0	4.3	2.3	4.8	5.0	4.3
Additional months:								
1	16.0	17.5	27.0	21.7	18.3	22.3	31.9	26.1
2	15.1	19.9	16.4	14.7	33.5	42.2	48.4	40.7
3	12.8	15.1	11.1	8.9	46.2	57.3	59.5	49.6
4	17.1	22.7	12.3	14.3	63.3	80.0	71.8	63.9
5	14.9	9.1	11.6	10.1	78.2	89.1	83.4	74.1
6	6.2	4.1	5.3	11.4	84.4	93.3	88.7	85.5
7	7.0	2.9	5.5	6.5	91.4	96.2	94.2	91.9
8	2.9	1.2	2.0	2.2	94.3	97.4	96.2	94.2
9	1.5	.7	.8	1.4	95.0	98.0	97.0	95.6
10	2.1	1.1	1.2	1.1	97.9	99.1	98.3	96.7
11	1.1	.5	.9	.4	99.0	99.5	99.1	97.1
12	.5	(2)	.3	.3	99.5	99.6	99.4	97.3
More than 12	.5	.4	.6	2.7	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: Aug. 12, Nov. 12, Feb. 11, and May 12.
[2] Less than 0.05 percent.

TABLE 4.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks as of May 19, 1965*

[Dollars in millions]

Period of maturity	New York City and Chicago		Other		New York City and Chicago	Other
	Amount	Percent	Amount	Percent	Cumulative percentage	
1965						
May 20-31	$330.6	4.3	$314.4	4.3	4.3	4.3
June	1,667.1	21.7	1,577.3	21.3	26.1	25.6
July	1,125.6	14.7	1,458.7	19.7	40.7	45.3
August	680.1	8.9	1,058.4	14.3	49.6	59.7
September	1,097.5	14.3	847.4	11.5	63.9	71.1
October	777.0	10.1	487.1	6.6	74.1	77.7
November	874.5	11.4	355.2	4.8	85.5	82.5
December	496.1	6.5	339.1	4.6	91.9	87.1
1966						
January	171.5	2.2	259.8	3.5	94.2	90.6
February	108.4	1.4	114.3	1.6	95.6	92.2
March	83.2	1.1	135.1	1.8	96.7	94.0
April	29.2	0.4	108.5	1.5	97.1	95.5
May	19.3	0.3	65.8	0.9	97.3	96.4
June or later	206.8	2.7	269.5	3.6	100.0	100.0
Total	7,666.9	100.0	7,390.6	100.0		
Average maturity (months)	3.7		3.6			
Number banks reporting	23		225			

TABLE 5.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of bank* [1]

[Amounts in millions of dollars, as of May 19, 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							
May 20-31	8.3	12.0	75.0	91.0	458.7	645.0	645.0
June	40.4	52.8	421.2	512.9	2,217.1	3,244.4	3,889.4
Due on June 10	2.7	4.2	27.3	29.2	181.3	244.7	
Due on June 15	7.9	5.2	51.7	67.4	552.0	684.2	
July	21.0	59.6	315.2	412.3	1,776.2	2,584.3	6,473.7
August	18.9	43.9	234.1	260.7	1,180.9	1,738.5	8,212.2
September	18.1	23.9	203.9	222.4	1,476.6	1,944.9	10,157.1
October	10.7	25.0	94.8	161.5	972.1	1,264.1	11,421.2
November	9.0	13.5	76.0	110.5	1,020.7	1,229.7	12,650.9
December	8.6	22.4	87.0	128.4	588.8	835.2	13,486.1
1966							
January	4.7	20.1	57.6	76.4	272.5	431.3	13,917.4
February	3.4	6.9	29.1	30.7	152.6	222.7	14,140.1
March	4.6	4.5	45.1	33.0	131.1	218.3	14,358.4
April	3.7	9.7	28.6	27.6	68.1	137.7	14,496.1
May	1.0	5.1	23.0	10.6	45.4	85.1	14,581.2
June or later	3.5	12.6	28.4	32.2	399.6	476.3	15,057.5
Total	155.9	312.0	1,719.0	2,110.2	10,760.4	15,057.5	
Annual percentage rate of growth since Feb. 17, 1965	−21.5	−47.4	−16.9	−5.4	+63.3	+38.1	
Average maturity (months)	3.6	4.2	3.5	3.4	3.7	3.7	
Number banks reporting	55	53	69	41	30	248	

[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.

TABLE 6a.—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve district, as of May 19, 1965*

[Amounts in millions of dollars to 1 decimal]

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
1965													
May 20-31	645.0	17.5	305.4	14.0	37.7	13.2	14.8	82.5	16.3	6.2	16.1	45.8	75.5
June	3,244.4	137.1	1,603.0	105.5	158.4	60.9	95.4	411.1	67.3	50.6	80.8	227.2	248.0
July	2,584.3	172.8	1,149.6	84.7	147.5	27.6	70.5	263.6	47.4	51.0	57.6	217.7	294.3
August	1,738.5	98.9	666.1	54.8	145.9	20.8	52.8	196.8	42.6	25.6	38.4	116.7	279.1
September	1,944.9	40.8	1,014.4	49.1	128.6	26.2	35.6	250.4	36.2	27.5	44.4	132.9	158.8
October	1,264.1	50.3	707.4	18.7	62.6	23.6	22.0	146.4	21.1	21.0	17.1	57.9	116.0
November	1,229.7	33.7	796.4	29.7	50.4	9.9	16.6	134.3	12.3	14.8	14.6	30.1	86.9
December	835.2	25.9	425.1	17.5	44.1	7.9	23.1	140.7	35.3	6.1	11.7	28.5	69.3
1966													
January	431.3	11.9	159.5	11.3	36.7	3.2	20.4	60.1	11.2	6.7	10.3	31.2	68.8
February	222.7	2.2	116.0	7.6	14.8	1.5	10.4	12.1	5.5	2.7	5.5	13.9	30.5
March	218.3	8.3	94.0	2.8	10.1	1.9	10.9	30.6	3.4	.5	9.2	22.7	23.9
April	137.7	6.9	34.3	1.7	10.7	2.5	15.2	19.1	1.6	7.9	4.0	11.4	22.4
May	85.1	10.5	21.4	.7	7.8	.7	4.7	7.5	4.8	4.7	1.3	11.1	9.9
June or later	476.3	8.9	204.2	27.0	174.2	1.7	15.8	19.8	1.2	.2	5.4	9.7	8.2
Total	15,057.5	625.7	7,296.8	425.1	1,029.5	201.6	407.3	1,775.0	306.2	225.5	316.4	956.8	1,491.6
June 10	244.7	7.6	150.5	2.8	19.1	3.9	....	17.0	5.0	7.2	5.1	14.1	12.4
June 15	684.2	18.9	378.4	15.0	32.8	.5	13.0	131.8	15.1	4.3	13.1	34.8	27.0
Average maturity (months)	3.7	3.2	3.7	3.6	5.0	3.0	4.0	3.5	3.5	3.4	3.3	3.2	3.5
Number of banks reporting	248	16	34	9	17	16	18	25	13	13	31	32	24

TABLE 6b.—*Distribution of maturities of outstanding negotiable time certificates of deposit by Federal Reserve district, as of May 19, 1965*

Period of maturity	All districts	Boston	New York	Philadelphia	Cleveland	Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
	Percentage distribution												
1965													
May 20-31	4.3	2.8	4.2	3.3	3.7	6.6	3.6	4.6	5.3	2.7	5.1	4.8	5.1
June	21.5	21.9	22.0	24.8	15.4	30.2	23.2	23.2	22.0	22.4	25.5	23.7	16.6
July	17.2	27.6	15.8	19.9	14.3	13.7	17.3	14.9	15.5	22.6	18.2	22.7	19.7
August	11.5	15.8	9.1	12.9	14.2	10.3	13.0	11.1	13.9	11.4	12.1	12.2	18.7
September	12.9	6.5	13.9	11.5	12.5	13.0	8.7	14.1	11.8	12.2	14.0	13.9	10.7
October	8.4	8.0	9.7	4.4	6.1	11.7	5.4	8.2	6.9	9.3	5.4	6.0	7.8
November	8.2	5.4	10.9	7.0	4.9	4.9	4.1	7.6	4.0	6.6	4.6	3.1	5.8
December	5.5	4.2	5.8	4.1	4.3	3.9	5.7	7.9	11.5	2.7	3.7	3.0	4.6
1966													
January	2.9	1.9	2.2	2.7	3.6	1.6	5.0	3.4	3.7	3.0	3.3	3.3	4.6
February	1.5	.4	1.6	1.8	1.4	.8	2.5	.7	1.8	1.2	1.8	1.5	2.0
March	1.4	1.3	1.3	.7	1.0	1.0	2.7	1.7	1.1	.2	2.9	2.4	1.6
April	.9	1.1	.4	.4	1.0	1.2	3.7	1.1	.5	3.5	1.3	1.2	1.5
May	.6	1.7	.3	.2	.7	.3	1.2	.4	1.6	2.1	.4	1.2	.7
June or later	3.2	1.4	2.8	6.3	16.9	.8	3.9	1.1	.4	.1	1.7	1.0	.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1965													
May 20-31	4.3	2.8	4.2	3.3	3.7	6.6	3.6	4.6	5.3	2.7	5.1	4.8	5.1
June	25.8	24.7	26.2	28.1	19.0	36.8	26.8	27.8	27.3	25.2	30.6	28.5	21.7
July	43.0	52.3	41.9	48.0	33.4	50.4	44.1	42.7	42.8	47.8	48.8	51.3	41.4
August	54.5	68.1	51.0	60.9	47.5	60.8	57.1	53.7	56.7	59.2	61.0	63.5	60.1
September	67.5	74.7	64.9	72.5	60.0	73.8	65.8	67.9	68.5	71.4	75.0	77.4	70.8
October	75.9	82.7	74.6	76.9	66.1	85.5	71.2	76.1	75.4	80.7	80.4	83.4	78.6
November	84.0	88.1	85.5	83.9	71.0	90.4	75.3	83.7	79.4	87.2	85.0	86.6	84.4
December	89.6	92.2	91.4	88.0	75.3	94.3	81.0	91.6	91.0	89.9	88.7	89.5	89.0
1966													
January	92.4	94.1	93.6	90.6	78.9	95.9	86.0	95.0	94.6	92.9	92.0	92.8	93.6
February	93.9	94.5	95.1	92.4	80.3	96.6	88.6	95.7	96.4	94.1	93.7	94.3	95.7
March	95.4	95.8	96.4	93.1	81.3	97.6	91.2	97.4	97.5	94.3	96.6	96.6	97.3
April	96.3	96.9	96.9	93.5	82.3	98.8	95.0	98.5	98.0	97.8	97.9	97.8	98.8
May	96.8	98.6	97.2	93.7	83.1	99.2	96.1	98.9	99.6	99.9	98.3	99.0	99.4
June or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

MATURITY DISTRIBUTION OF NEGOTIABLE TIME CERTIFICATES OF DEPOSIT FROM AUGUST 18, 1965, SURVEY

This memorandum summarizes the results of the August 18, 1965, survey of the maturity structure of outstanding negotiable time certificates of deposit of $100,000 or more at weekly reporting member banks. The 249 responding banks reported $16,009 million outstanding, indicating an annual rate of increase of about 25 percent over the 3 months since the May survey. While this was less than the very large rate of increase shown in the previous 3 months, the distribution of the increase in the more recent period was more uniform than in the spring of the year.

About two-thirds of outstanding CD's will mature by the end of the year, a period which includes the September and December tax and dividend dates (table 1). This proportion is virtually the same as shown in the survey last August, and for a comparable period as of the May survey. A somewhat larger proportion of CD's matures this September than last year—19.3 percent versus 17.7 percent. This involves a year-over-year increase of $940 million, or nearly 50 percent, in the amount of September maturities. Corporate tax payments expected this September, however, are estimated to be only about $150 million higher than a year ago, with no maturing tax anticipation bills outstanding in either year. As can be seen in table 2, the year-to-year rise in maturing CD's at the September tax and dividend dates is concentrated entirely at banks in New York City.

Nevertheless, banks in New York City appear to have been quite successful this year in avoiding tax-month concentrations of maturities. This is suggested particularly by the heavy volume of November maturities, which exceed the December total by over $100 million, as shown in table 3. At Chicago banks, in contrast, December maturities are nearly $100 million higher than those in November, and account for 21 percent of their outstandings (table 4b).

New York City banks also have added substantially over the past 6 months to the amount of CD's maturing in more than 1 year, and, to a lesser degree, so have those outside New York and Chicago. At Chicago banks, such maturities in August as in other recent months were small.

The average maturity of all CD's outstanding on August 18 rose further to 3.9 months from 3.7 months in May, as shown in table 5. The increase reflected appreciable maturity lengthening at banks outside New York and Chicago and a moderate further rise in average maturity at New York City banks. At Chicago banks, the average fell during this period from 3.4 to 3.1 months.

Nearly all of the increase in CD's between February and May occurred at banks in New York City. Between May and August, somewhat more than half of the increase in CD's outstanding was accounted for by banks outside of New York. The reasons for this reversal appear to be twofold.

First, an increase in loan demand in the June-August period added pressure on banks outside of New York to raise funds in this market. This increased loan demand may help to explain their willingness to extend maturities. Second, and perhaps more important, the market for CD sales by nonprime banks was more favorable. Rates on short-term Treasury bills were somewhat lower, and from mid-June to mid-July, the New York banks largely withdrew from this market—perhaps in response to reduced loan demand and a liquidity buildup in earlier months. This provided room for increased issuance of CD's by other banks. Since mid-July, as New York banks once again entered the market, there has been considerable slowdown of net CD sales at outside banks.

As might be expected, these developments at banks in New York and elsewhere influenced the maturity distribution of outstanding CD's by size of bank, shown in table 6. In the February–May period, all but the largest size banks reduced their CD's. From May to August, the smaller banks have not only shown the greatest relative growth in outstanding CD's, but also a substantial rise in average maturities. In August, average maturities at smaller banks exceeded those at the largest size banks, a reversal of the May relationship.

Tables 7a and 7b present the data by Federal Reserve district. Cleveland, which consistently has had the longest average maturity, was joined by Atlanta; in August both had an average maturity of 5 months. The shortest maturity was for Chicago, the only district to show a decline in average maturity since May. Richmond, the district with the shortest maturity on the last survey, tied

with Atlanta for the district showing the largest increase in average maturity. Kansas City has the largest proportion of its outstandings maturing by the end of September, while Boston has the least. Cleveland, Atlanta, Minneapolis, and New York have the largest proportions of CD's maturing in excess of 1 year.

TABLE 1.—*Outstanding negotiable time certificates of deposit, weekly reporting member banks, Aug. 18, 1965*

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage
1965—Aug. 19-31	809.5	5.1	5.1
September [1]	3,095.6	19.3	24.4
October	2,143.1	13.4	37.8
November	2,143.9	13.4	51.2
December	2,453.7	15.3	66.5
1966—January	1,952.2	12.2	78.7
February	908.6	5.7	84.4
March	525.5	3.3	87.7
April	349.9	2.2	89.8
May	200.7	1.3	91.1
June	241.5	1.5	92.6
July	280.6	1.7	94.4
August	177.6	1.1	95.5
September or later	726.2	4.5	100.0
Total	16,008.6	100.0	

[1] Includes $206,000 000 maturing on Sept. 10 and $989, on Sept. 15.

Source: Financial Statistics Section, Division of Data Processing, Board of Governors of the Federal Reserve System.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposit, September–December 1964, and March–June–August 1965*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in— New York City	Banks in— Chicago	Other banks
Tax date maturities:				
1964—Sept. 15 [1]	708	253	86	369
Dec. 15 [2]	694	272	67	355
1965—Mar. 15 [3]	865	454	103	308
June 15 [4]	684	332	125	227
Sept. 15 [5]	989	591	96	302
Dividend date maturities:				
1964—Sept. 10 [1]	110	33	8	69
Dec. 10 [2]	156	63	4	89
1965—Mar. 10 [3]	234	110	40	84
June 10 [4]	245	137	12	96
Sept. 10 [5]	206	103	9	94

[1] As reported on Aug. 19, 1964.
[2] As reported on Nov. 18, 1964.
[3] As reported on Feb. 17, 1965.
[4] As reported on May 20, 1965.
[5] As reported on Aug. 19, 1965.

TABLE 3.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks as of Aug. 18, 1965*

[Dollars in millions]

Period of maturity	New York City amount	Chicago amount	Other		
			Amount	Percent	Cumulative percentage
1965					
Aug. 19-31	$237.8	$48.1	$523.6	6.6	6.6
September	1,291.1	302.0	1,502.5	19.0	25.6
October	895.6	205.9	1,041.6	13.2	38.8
November	1,128.0	185.3	830.6	10.5	49.3
December	1,002.3	279.0	1,172.4	14.8	64.1
1966					
January	803.4	175.0	973.8	12.3	76.4
February	386.8	59.9	461.9	5.8	82.2
March	207.6	23.9	294.0	3.7	85.9
April	154.2	12.3	183.4	2.3	88.3
May	62.8	2.0	135.9	1.7	90.0
June	44.4	16.7	180.4	2.3	92.3
July	137.4	9.7	133.5	1.7	93.9
August	75.7	9.5	92.4	1.2	95.1
September or later	339.1	.5	386.6	4.9	100.0
Total	6,766.2	1,329.8	7,912.6	100.0	
Average maturity (months)	3.9	3.1	4.0		
Number of banks reporting	12	10	227		

TABLE 4a.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City banks, November 1964, and February, May, August 1965*

Period of maturity	Percentage distribution—Date of survey				Cumulative percentage—Date of survey			
	Nov. 18	Feb. 17	May 19	Aug. 18	Nov. 18	Feb. 17	May 19	Aug. 18
1 to 12 days [1]	5.1	5.1	4.2	3.5	5.1	5.1	4.2	3.5
Additional months:								
1	18.1	26.1	21.3	19.1	23.2	31.3	25.5	22.6
2	18.3	16.9	14.8	13.2	41.5	48.2	40.3	35.8
3	15.3	11.7	8.4	16.7	56.8	59.9	48.8	52.5
4	22.2	12.6	14.3	14.8	79.0	72.5	63.0	67.3
5	9.7	12.0	10.4	11.9	88.7	84.6	73.4	79.2
6	4.5	4.8	12.0	5.7	93.2	89.3	85.4	84.9
7	3.1	4.9	6.0	3.1	96.3	94.2	91.4	88.0
8	1.2	2.2	2.2	2.3	97.6	96.4	93.6	90.3
9	.7	.9	1.6	.9	98.3	97.3	95.2	91.2
10	.9	1.1	1.0	.7	99.1	98.3	96.2	91.8
11	.5	.8	.4	2.0	99.6	99.1	96.6	93.9
12	(2)	.3	.3	1.1	99.6	99.4	96.9	95.0
More than 12 days	.4	.6	3.1	5.0	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: November, 12; February, 11; May, 12; and August, 13.
[2] Less than 0.05 percent.

TABLE 4b.—*Maturity distribution of negotiable time certificates of deposit outstanding at Chicago banks, November 1964, and February, May, August 1965*

Period of maturity	Percentage distribution—Date of survey				Cumulative percentage—Date of survey			
	Nov. 18	Feb. 17	May 19	Aug. 18	Nov. 18	Feb. 17	May 19	Aug. 18
1 to 12 days [1]	3.4	4.3	4.6	3.6	3.4	4.3	4.6	3.6
Additional months:								
1	15.2	30.2	23.9	22.7	18.6	34.4	28.6	26.3
2	26.2	14.8	14.1	15.5	44.8	49.3	42.6	41.8
3	14.3	8.5	11.0	13.9	59.1	57.8	53.6	55.7
4	24.8	11.2	14.6	21.0	83.9	69.0	68.2	76.7
5	7.0	9.9	8.9	13.2	90.9	78.9	77.1	89.9
6	2.4	7.2	8.4	4.5	93.3	86.0	85.6	94.4
7	2.2	8.0	8.9	1.8	95.5	94.0	94.5	96.2
8	1.0	1.5	2.5	.9	96.4	95.5	97.0	97.1
9	.6	.6	.6	.2	97.0	96.1	97.6	97.3
10	1.8	1.8	1.3	1.3	98.8	97.9	98.9	98.5
11	.4	1.2	.5	.7	99.3	99.2	99.3	99.2
12	.1	.2	.1	.7	99.4	99.4	99.4	99.3
More than 12 days	.6	.6	.6	[2]	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: November, 12; February, 11; May, 12; and August, 13.
[2] Less than 0.05 percent.

TABLE 4c.—*Maturity distribution of negotiable time certificates of deposit outstanding at other banks, November 1964, and February, May, August 1965*

Period of maturity	Percentage distribution—Date of survey				Cumulative percentage—Date of survey			
	Nov. 18	Feb. 17	May 19	Aug. 18	Nov. 18	Feb. 17	May 19	Aug. 18
1 to 12 days [1]	4.9	4.5	4.3	6.6	4.9	4.5	4.3	6.6
Additional months:								
1	20.3	21.4	21.3	19.0	25.1	25.9	25.6	25.6
2	16.6	17.4	19.7	13.2	41.7	43.3	45.3	38.8
3	12.6	10.7	14.3	10.5	54.3	54.0	59.7	49.3
4	13.5	11.8	11.5	14.8	67.8	65.8	71.1	64.1
5	10.7	11.2	6.6	12.3	78.5	77.0	77.7	76.4
6	5.2	6.7	4.8	5.8	83.7	83.7	82.5	82.2
7	3.2	3.4	4.6	3.7	86.9	87.1	87.1	85.9
8	2.6	1.8	3.5	2.3	89.6	89.0	90.6	88.3
9	1.7	1.3	1.6	1.7	91.3	90.2	92.2	90.0
10	1.8	2.7	1.8	2.3	93.1	92.9	94.0	92.3
11	1.4	2.6	1.5	1.7	94.5	95.5	95.5	93.9
12	.7	.9	.9	1.2	95.2	96.4	96.4	95.1
More than 12 days	4.8	3.6	3.6	4.9	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: November, 12; February, 11; May, 12; and August, 13.

TABLE 5.—*Average length of maturity on survey date negotiable time certificates of deposit, November 1964, and February, May, August 1965*

[In months]

Bank classification	Date of survey			
	Nov. 18	Feb. 17	May 19	Aug. 18
New York City	3.1	3.1	3.7	3.9
Chicago	3.0	3.2	3.4	3.1
Other	3.8	3.8	3.6	4.0
All reporting banks	3.4	3.5	3.7	3.9

TABLE 6.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of bank,[1] as of Aug. 18, 1965*

(Millions of dollars)

Period of maturity	Total deposits of bank [2]					Total	Cumulative total
	Under 100,000,000,000	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							
Aug. 19–31	11.7	18.1	133.5	137.4	508.8	809.5	809.5
September	36.7	64.7	359.4	430.1	2,204.7	3,095.6	3,905.1
Due on Sept. 10	1.8	5.8	15.5	26.8	156.0	205.9	
Due on Sept. 15	6.1	15.0	57.3	93.7	816.4	988.5	
October	23.3	42.7	244.5	337.6	1,495.0	2,143.1	6,048.2
November	18.7	34.2	187.7	213.1	1,690.2	2,143.9	8,192.1
December	20.7	42.1	237.8	354.1	1,799.0	2,453.7	10,645.8
1966							
January	17.3	37.9	186.8	292.3	1,417.9	1,952.2	12,598.0
February	11.9	24.7	95.1	137.5	639.4	908.6	13,506.6
March	5.0	8.5	78.9	74.4	358.7	525.5	14,032.1
April	5.3	11.6	41.0	65.4	226.6	349.9	14,382.0
May	3.1	8.7	32.7	32.7	123.5	200.7	14,582.7
June	6.4	14.7	79.8	44.6	96.0	241.5	14,824.2
July	3.7	15.9	42.6	38.6	179.8	280.6	15,104.8
August	2.4	4.0	19.6	25.1	126.5	177.6	15,282.4
September or later	10.8	21.4	69.2	86.8	538.0	726.2	16,008.6
Total	177.0	349.2	1,808.6	2,269.7	11,404.1	16,008.6	
Annual rate of growth since May 20, 1965 (percent)	+54.1	+47.7	+20.8	+30.2	+23.9	+25.3	
Average maturity (months)	4.1	4.5	4.0	3.9	3.7	3.9	
Number of banks reporting	57	53	68	41	30	249	

[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.

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TABLE 7(a).—*Maturity distribution of outstanding negotiable time certificates of deposit by Federal Reserve district, as of Aug. 18, 1965*

[Amounts in millions of dollars to 1 decimal]

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
1965													
Aug. 19–31	809.5	35.5	301.7	21.1	110.6	13.7	19.0	76.8	22.7	10.3	21.5	71.1	105.5
September	3,095.6	98.7	1,503.4	107.1	179.4	38.6	60.3	393.1	67.0	55.3	87.9	226.9	277.9
Sept. 10	205.9	6.0	121.9	5.0	22.5	1.3	1.7	10.6	2.7	.8	5.1	15.4	12.9
Sept. 15	988.5	23.9	644.4	21.6	54.9	3.6	7.9	103.2	11.8	4.8	6.7	61.5	44.2
October	2,143.1	114.6	1,017.1	39.0	96.3	54.2	54.0	264.1	41.5	40.1	50.7	153.2	218.3
November	2,143.9	86.5	1,236.6	47.8	102.2	19.0	38.4	237.5	24.4	26.4	42.1	123.8	159.2
December	2,453.7	177.6	1,117.8	88.2	163.3	35.6	59.5	332.2	75.1	27.0	42.6	131.3	203.5
1966													
January	1,952.2	121.1	906.3	79.3	135.6	14.6	35.9	223.1	39.2	21.0	25.0	128.8	222.8
February	908.6	52.6	428.7	30.1	45.0	9.8	20.0	91.8	22.5	19.2	15.9	53.2	119.8
March	525.5	16.8	274.6	13.9	55.2	2.7	20.9	46.1	10.2	4.1	12.0	26.5	42.5
April	349.9	17.6	171.3	6.9	24.2	4.1	18.7	27.7	2.2	11.3	8.8	20.9	36.2
May	200.7	20.1	71.7	11.4	18.6	.7	10.4	6.6	5.0	5.9	3.7	25.6	21.0
June	241.5	32.4	55.7	14.1	13.3	21.4	25.2	23.2	12.3	8.7	7.9	14.3	13.0
July	280.6	5.7	163.3	3.2	9.6	7.8	12.5	13.7	6.1	7.3	9.0	20.7	21.7
August	177.6	1.6	82.5	3.6	15.3	9.4	10.1	13.5	.3	5.3	3.1	16.5	16.4
September or later	726.2	4.5	353.8	18.7	191.2	.5	32.9	17.6	2.0	13.8	1.3	40.5	49.4
Total	16,008.6	785.3	7,684.5	484.4	1,159.8	232.1	417.8	1,767.0	330.5	255.7	331.5	1,053.3	1,506.7
Average maturity (months)	3.9	3.8	3.8	3.9	5.0	4.0	5.0	3.2	3.5	4.2	3.3	3.7	3.7
Number of banks reporting	249	16	32	9	16	16	18	27	12	15	32	32	24

TABLE 7(b).—*Distribution of maturities of outstanding negotiable time certificates of deposit by Federal Reserve district, as of Aug. 18, 1965*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Francisco
	Percentage distribution												
1965													
Aug. 19-31	5.1	4.5	3.9	4.3	9.5	5.9	4.6	4.3	6.9	4.0	6.5	6.7	7.0
September	19.3	12.6	19.6	22.1	15.5	16.6	14.4	22.3	20.3	21.6	26.5	21.5	18.4
October	13.4	14.6	13.2	8.0	8.3	23.4	12.9	14.9	12.6	15.7	15.3	14.5	14.5
November	13.4	11.0	16.1	9.9	8.8	8.2	9.2	13.4	7.4	10.3	12.7	11.8	10.6
December	15.3	22.6	14.6	18.2	14.1	15.3	14.2	18.8	22.7	10.6	12.9	12.5	13.5
1966													
January	12.2	15.4	11.8	16.4	11.7	6.3	8.6	12.6	11.8	8.2	7.5	12.2	14.8
February	5.7	6.7	5.6	6.2	3.9	4.2	4.8	5.2	6.8	7.5	4.8	5.1	7.9
March	3.3	2.1	3.6	2.9	4.8	1.2	5.0	2.6	3.1	1.6	3.6	2.5	2.8
April	2.2	2.3	2.2	1.4	2.1	1.8	4.5	1.6	.7	4.4	2.7	2.0	2.4
May	1.3	2.6	.9	2.4	1.6	.3	2.5	.4	1.5	2.3	1.1	2.4	1.4
June	1.5	4.1	.7	2.9	1.1	9.2	6.0	1.3	3.7	3.4	2.4	1.4	.9
July	1.7	.7	2.1	.7	.8	3.4	3.0	.8	1.8	2.9	2.7	2.0	1.4
August	1.1	.2	1.1	.7	1.3	4.0	2.4	.8	.1	2.1	.9	1.6	1.1
September or later	4.5	.6	4.6	3.9	16.5	.2	7.9	1.0	.6	5.4	.4	3.8	3.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1965													
Aug. 19-31	5.1	4.5	3.9	4.3	9.5	5.9	4.6	4.3	6.9	4.0	6.5	6.7	7.0
September	24.4	17.1	23.5	26.5	25.0	22.5	19.0	26.6	27.1	25.7	33.0	28.3	25.4
October	37.8	31.7	36.7	34.5	33.3	45.9	31.9	41.5	39.7	41.3	48.3	42.8	39.9
November	51.2	42.7	52.8	44.4	42.1	54.1	41.1	55.0	47.1	51.7	61.0	54.6	50.5
December	66.5	65.3	67.4	62.6	56.2	69.4	55.3	73.8	69.8	62.2	73.8	67.1	64.0
1966													
January	78.7	80.7	79.2	79.0	67.9	75.7	63.9	86.4	81.7	70.4	81.4	79.3	78.8
February	84.4	87.4	84.7	85.2	71.8	79.9	68.7	91.6	88.5	77.9	86.2	84.3	86.7
March	87.7	89.6	88.3	88.0	76.5	81.1	73.7	94.2	91.6	79.5	89.8	86.9	89.5
April	89.8	91.8	90.5	89.5	78.6	82.9	78.2	95.8	92.2	84.0	92.5	88.8	91.9
May	91.1	94.4	91.5	91.8	80.2	83.2	80.7	96.2	93.7	86.3	93.6	91.3	93.3
June	92.6	98.5	92.2	94.7	81.4	92.4	86.7	97.5	97.5	89.7	96.0	92.6	94.2
July	94.4	99.2	94.3	95.4	82.2	95.7	89.7	98.2	99.3	92.5	98.7	94.6	95.6
August	95.5	99.4	95.4	96.1	83.5	99.8	92.1	99.0	99.4	94.6	99.6	96.2	96.7
September or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

MATURITY DISTRIBUTION OF NEGOTIABLE TIME CERTIFICATES OF DEPOSIT FROM NOVEMBER 17, 1965, SURVEY

This memorandum summarizes the results of the November 17, 1965, survey of the maturity structure of outstanding negotiable time certificates of deposit of $100,000 or more at weekly reporting member banks. The 245 responding banks reported $16,368 million outstanding, indicating an annual rate of increase of about 9 percent over the 3 months since the August survey.

Not only is this the smallest rate of increase since these surveys began in May 1964, but also maturities are more concentrated in the near term than indicated in previous surveys. Over one-fourth will mature by the end of 1965 and almost one-half will mature by the end of January 1966 (table 1). Last November, when Q ceilings also were an impediment to issuance of CD's and maturities were similarly concentrated, only a little over two-fifths of the outstandings matured by the end of January. In the August 1965 survey, 38 percent were indicated to mature over a comparable time period, about the same as in August 1964.

Only about 60 percent of the year-over-year estimated increase in December corporate tax payments is accounted for by the $250 million year-over-year increase in CD's maturing on the tax date (table 2). About three-fourths of that increase is at banks in New York City. The increase in year-to-year December dividend date maturities (December 10) is more evenly distributed. All told, December maturities are over $1 billon larger than last year. New York banks have been relatively successful in avoiding heavy maturities for the month of December as a whole, while other banks, especially in Chicago, have a noticeably larger proportion of their outstandings due that month (tables 4A, 4B, and 4C).

The shortening maturities at all banks—back to the level of last year—are clearly seen in table 5. This table emphasizes the particularly marked shortening at Chicago banks—which always have had the shortest maturities—and also the relative success of banks outside of New York and Chicago in resisting the shortening. New York banks, in fact, actually increased their average maturities from a year earlier.

The banks accounting for this year's growth in CD's have shifted as the year progressed. From February to May, banks with deposits of less than $1 billion reduced their outstandings and most of the increase in CD's occurred in New York where loan demands were heavily;

From May to August, over half of the increase in outstandings occurred outside of New York and banks with deposits below $1 billion showed the most rapid rates of increase in outstandings. This shift was due to relatively increased loan demand outside of New York, the withdrawal of New York banks from the market as their loan demand slowed and as their liquidity position was built up, and the apparently increased emphasis of smaller banks on regional CD markets. In addition, there appears to be some shortrun inelasticity to the size of the CD market: as New York banks issued fewer CD's, more funds could be attracted by other banks.

In the August–November period, during which New York CD rates were at or near regulation Q ceilings over one-half the time, total outstandings rose little. New York City banks accounted for somewhat over one-fourth of the increase in outstandings, but while their net outstandings rose at a very modest annual rate of only about 4.5 percent, they succeeded in turning over large maturities issued in the spring. Only the largest nonprime banks showed a decline in outstandings during this period—although it is not clear if this was the result of their withdrawal from the market or the impact of Q restrictions. It is possible that these banks may have attempted to use national—rather than regional—markets so that regulation Q ceilings affected them more harshly than large prime banks or smaller banks not attempting to compete in national markets. Smaller banks and prime banks outside of New York increased their outstandings at rates considerably above the average (table 6A).

Several factors help to explain developments this fall. To be sure, the regulation Q limit is a partial explanation for the slower growth. But, in addition, it must be recalled that somewhat less demand was being placed on banks during this period, as capital market financing accelerated, so that some banks were less active CD bidders; continued large inflows of other time and savings deposits also reduced the need to tap this market. Moreover, corporations—the major buyers of CD's—were in an increasingly tight liquidity position so that even

though CD yields were at a considerable premium over competing financial assets, corporations did not have available funds to greatly increase their purchases. Finally, smaller banks have evidently continued to emphasize regional markets where rates are less important and customer relationships more important. These banks suffered considerably less shortening of their outstandings than larger banks (table 6B).

The ratio of CD's to total deposits at issuing banks has been extremely stable over time, especially for the smaller banks (table 7A). Moreover, the level of this ratio is directly related to bank size, with smaller banks maintaining lower CD-to-deposit ratios than larger banks. As can be seen in table 7B, the average ratios for each size group are representative of most banks in that group. There are, of course, exceptions, and a few small banks have relatively high CD-to-deposit ratios. What is striking, however, is that only five banks, four of which have deposits in excess of $1 billion, have CD's outstanding that are larger than 20 percent of total deposits.

Three size groups of banks showed modest declines in their average CD-to-deposit ratio—those with deposits of $200 to $500 million, $500 million to $1 billion, and the prime New York City banks. The decline in the ratio among the latter group of banks—the first for this group since data have been available—probably reflects the unusual increase in their outstandings during the spring and summer, as discussed above. No prime bank in New York showed any sharp reduction in outstandings. The nonprime banks with deposits in excess of $1 billion showed no decline in their CD-to-deposit ratio, even though they were the only group to show an absolute decline in their outstanding CD's (table 6A). Thus, it is likely that these banks also lost other deposits.

While the average CD-to-deposit ratio for each size group of banks have been relatively stable, 54 banks—almost one-fourth of all issuing banks—showed declines in CD's in excess of 10 percent; 21 banks, or about 10 percent of the group, suffered declines of 25 percent or more (table 7C). Most of the banks with large declines in CD's had deposits below $500 million. However, since most banks that showed sharp declines in CD's also had low CD-to-deposit ratios, very few banks found this decline in CD's to be large relative to total deposits. Only five banks had declines in CD's greater than 3 percent of their deposits, and only two had declines of 5 percent or more (the largest being 6 percent); four of these banks had deposits below $200 million (table 7D). The number of banks showing declines in excess of 3 percent of deposits this fall was the lowest shown on any survey. Thus, while the factors described above limited the growth in CD's, there is no indication that rate pressures caused ay unusually large CD runoffs at individual banks.

Tables 8A and 8B present the data by Federal Reserve district. The St. Louis, Kansas City, Dallas, Atlanta, and New York districts show declines in outstandings—the first such declines ever shown for Atlanta and New York, although they were quite small. Cleveland again had the longest average maturity—5.1 months—and was the only district to show an increase in average maturity, while St. Louis had the shortest average maturity—2.5 months—and tied with Boston for the largest decline in average maturity. St. Louis, Kansas City, and Boston have the largest proportion of CD's maturing by the end of the year, and St. Louis, Chicago, and Boston have the largest proportion maturing over the next 3 months. Cleveland, Atlanta, and Philadelphia have the largest proportion of CD's maturing in excess of 1 year.

TABLE 1.—*Outstanding negotiable time certificates of deposit, weekly reporting member banks, Nov. 17, 1965*

Period of maturity	In millions of dollars	Percentage distribution	Cumulative percentage	Percentage by quarter [1]
1965				
Nov. 18-30	987.0	6.0	6.0	
December [2]	3, 502.3	21.4	27.4	
1966				
January	3, 430.7	21.0	48.4	
February	2, 297.6	14.0	62.3	56.4
March	1, 983.2	12.1	74.5	
April	1, 214.5	7.4	82.2	
May	662.4	4.1	86.0	23.6
June	458.8	2.8	88.8	
July	403.4	2.5	91.3	
August	240.9	1.5	92.7	6.8
September	350.4	2.1	94.9	
October	172.4	1.1	95.9	
November	120.7	.7	96.7	3.9
December or later	543.3	3.3	100.0	
Total	16, 367.6	100.0		

[1] Aggregated only for the previous 3 full months.
[2] Includes $219,000,000 maturing on Dec. 10 and $945,000,000 on Dec. 15.

Source: Financial Statistics Section, Division of Data Processing, Board of Governors of the Federal Reserve System.

TABLE 2.—*Corporate tax and dividend date maturities of negotiable time certificates of deposit, December 1964, and March, June, September, December 1965*

[Amounts in millions of dollars]

Date of maturity	All weekly reporting banks	Banks in New York City	Banks in Chicago	Other banks
TAX DATE MATURITIES				
1964				
Dec. 15 [1]	694	272	67	355
1965				
Mar. 15 [2]	865	454	103	308
June 15 [3]	684	332	125	227
Sept. 15 [4]	989	591	96	302
Dec. 15 [5]	945	452	110	383
DIVIDEND DATE MATURITIES				
1964				
Dec. 10 [1]	156	63	4	89
1965				
Mar. 10 [2]	234	110	40	84
June 10 [3]	245	137	12	96
Sept. 10 [4]	206	103	9	94
Dec. 10 [5]	216	81	33	102

[1] As reported on Nov. 18, 1964.
[2] As reported on Feb. 17, 1965.
[3] As reported on May 20, 1965.
[4] As reported on Aug. 18, 1965.
[5] As reported on Nov. 17, 1965.

TABLE 3.—*Maturity distribution of outstanding negotiable time certificates of deposit, New York City and Chicago versus other reporting banks as of Nov. 17, 1965*

[In millions of dollars]

Period of maturity	New York City	Chicago	Other
	Amount	Amount	Amount
1965			
Nov. 18-30	363.4	87.5	536.1
December	1,306.7	341.0	1,854.6
1966			
January	1,498.2	427.2	1,505.3
February	1,226.0	190.0	881.6
March	897.7	191.1	894.4
April	488.4	64.7	661.4
May	209.0	25.1	428.3
June	136.0	24.5	298.3
July	196.0	15.7	191.7
August	93.9	22.3	124.7
September	187.3	8.5	154.6
October	58.5	8.0	105.9
November	60.2	1.6	58.9
December or later	141.7	.5	401.1
Total	6,863.0	1,407.7	8,096.9
Number banks reporting	12	10	223

NOTE.—Monthly and cumulative percentage distributions for these 3 classifications appear in tables 4A through 4C.

TABLE 4A.—*Maturity distribution of negotiable time certificates of deposit outstanding at New York City banks, November, August, May, February 1965 and November 1964*

Period of maturity	Percentage distribution—Date of survey					Cumulative percentage—Date of survey				
	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964
1 to 12 days [1]	5.3	3.5	4.2	5.1	5.1	5.3	3.5	4.2	5.1	5.1
Additional months:										
1	19.0	19.1	21.3	26.1	18.1	24.3	22.6	25.5	31.3	23.2
2	21.8	13.2	14.8	16.9	18.3	46.2	35.8	40.3	48.2	41.5
3	17.9 (58.7)	16.7 (49.0)	8.4 (44.5)	11.7 (54.7)	15.3 (51.7)	64.0	52.5	48.8	59.9	56.8
4	13.1	14.8	14.3	12.6	22.2	77.1	67.3	63.0	72.5	79.0
5	7.1	11.9	10.4	12.0	9.7	84.2	79.2	73.4	84.6	88.7
6	3.0 (23.2)	5.7 (32.4)	12.0 (36.7)	4.8 (29.4)	4.5 (36.4)	87.3	84.9	85.4	89.3	93.2
7	2.0	3.1	6.0	4.9	3.1	89.3	88.0	91.4	94.2	96.3
8	2.9	2.3	2.2	2.2	1.2	92.1	90.3	93.6	96.4	97.6
9	1.4 (6.3)	.9 (6.3)	1.6 (9.8)	.9 (8.0)	.7 (5.0)	93.5	91.2	95.2	97.3	98.3
10	2.7	.7	1.0	1.1	.9	96.2	91.8	96.2	98.3	99.1
11	.8	2.0	.4	.8	.5	97.1	93.9	96.6	99.1	99.6
12	.9 (4.4)	1.1 (3.8)	.3 (1.7)	.3 (2.2)	([2]) (1.4)	97.9	95.0	96.9	99.4	99.6
More than 12	2.1	5.0	3.1	.6	.4	100.0	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: 1965: Nov. 13, Aug. 13, May 12, Feb. 11; 1964: Nov. 12.

[2] Less than 0.05 percent.

NOTE.—Figures in parenthesis are percentage aggregates only for the previous 3 full months.

TABLE 4B.—*Maturity distribution of negotiable time certificates of deposit outstanding at Chicago banks, November, August, May, February 1965 and November 1964*

Period of maturity	Percentage distribution—Date of survey					Cumulative percentage—Date of survey				
	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964
1 to 12 days [1]	6.2	3.6	4.6	4.3	3.4	6.2	3.6	4.6	4.3	3.4
Additional months:										
1	24.2	22.7	23.9	30.2	15.2	30.4	26.3	28.6	34.4	18.6
2	30.3	15.5	14.1	14.8	26.2	60.8	41.8	42.6	49.3	44.8
3	13.5 (68.0)	13.9 (52.1)	11.0 (49.0)	8.5 (53.5)	14.3 (55.7)	74.3	55.7	53.6	57.8	59.1
4	13.6	21.0	14.6	11.2	24.8	87.9	76.7	68.2	69.0	83.9
5	4.6	13.2	8.9	9.9	7.0	92.5	89.9	77.1	78.9	90.9
6	1.8 (20.0)	4.5 (38.7)	8.4 (31.9)	7.2 (28.3)	2.4 (34.2)	94.2	94.4	85.6	86.0	93.0
7	1.8	1.8	8.9	8.0	2.2	96.0	96.2	94.5	94.0	95.5
8	1.1	.9	2.5	1.5	1.0	97.1	97.1	97.0	95.5	96.4
9	1.6 (4.5)	.2 (2.9)	.6 (12.0)	.6 (10.1)	.6 (3.8)	98.9	97.3	97.6	96.1	97.0
10	.6	1.3	1.3	1.8	1.8	99.3	98.5	98.9	97.9	98.8
11	.6	.7	.5	1.2	.4	99.9	99.2	99.3	99.2	99.3
12	.1 (1.3)	.7 (2.7)	.1 (1.9)	.2 (3.2)	.1 (2.3)	99.9	99.3	99.4	99.4	99.4
More than 12	[2]	[2]	.6	.6	.6	100.0	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: 1965: Nov. 13, Aug. 13, May 12, Feb. 11; 1964: Nov. 12.
[2] Less than 0.05 percent.

NOTE.—Figures in parentheses are percentage aggregates only for the previous 3 full months.

TABLE 4C.—*Maturity distribution of negotiable time certificates of deposit outstanding at other banks, November, August, May, February 1965 and November 1964*

Period of maturity	Percentage distribution—Date of survey					Cumulative percentage—Date of survey				
	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964
1 to 12 days [1]	6.6	6.6	4.3	4.5	4.9	6.6	6.6	4.3	4.5	4.9
Additional months:										
1	22.9	19.0	21.3	21.4	20.3	29.5	25.6	25.6	25.9	25.1
2	18.6	13.2	19.7	17.4	16.6	48.1	38.8	45.3	43.3	41.7
3	10.9 (52.4)	10.5 (42.7)	14.3 (55.3)	10.7 (49.5)	12.6 (49.5)	59.0	49.3	59.7	54.0	54.3
4	11.0	14.8	11.5	11.8	13.5	70.1	64.1	71.1	65.8	67.8
5	8.2	12.3	6.6	11.2	10.7	78.2	76.4	77.7	77.0	78.5
6	5.3 (24.5)	5.8 (32.9)	4.8 (22.9)	6.7 (29.7)	5.2 (29.4)	83.5	82.2	82.5	83.7	83.7
7	3.7	3.7	4.6	3.4	3.2	87.2	85.9	87.1	87.1	86.9
8	2.4	2.3	3.5	1.8	2.6	89.6	88.3	90.6	89.0	89.6
9	1.5 (7.6)	1.7 (7.7)	1.6 (9.7)	1.3 (6.5)	1.7 (7.5)	91.1	90.0	92.2	90.2	91.3
10	1.9	2.3	1.8	2.7	1.8	93.0	92.3	94.0	92.9	93.1
11	1.3	1.7	1.5	2.6	1.4	94.3	93.9	95.5	95.5	94.5
12	.7 (3.9)	1.2 (5.2)	.9 (4.2)	.9 (6.2)	.7 (3.9)	95.0	95.1	96.4	96.4	95.2
More than 12	5.0	4.9	3.6	3.6	4.8	100.0	100.0	100.0	100.0	100.0

[1] Number of days in the survey month following the survey: 1965: Nov. 13, Aug. 13, May 12, Feb. 11; 1964: Nov. 12.

NOTE.—Figures in parentheses are percentage aggregates only for the previous 3 full months.

TABLE 5.—*Average length of maturity on survey date, negotiable time certificates of deposit, November, August, May, February, 1965 and November 1964.*

[In months]

Bank classification	Date of survey				
	Nov. 17, 1965	Aug. 18, 1965	May 19, 1965	Feb. 17, 1965	Nov. 18, 1964
New York City	3.3	3.9	3.7	3.1	3.1
Chicago	2.5	3.1	3.4	3.2	3.0
Other	3.6	4.0	3.6	3.8	3.8
All reporting banks	3.4	3.9	3.7	3.5	3.4

TABLE 6A.—*Maturity distribution of outstanding negotiable time certificates of deposit by size of banks,*[1] *as of Nov. 17, 1965*

[Amounts in millions of dollars]

Period of maturity	Total deposits of banks [2]								
	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				Total
					Nonprime	Prime [3]		Total	
						Outside New York	New York		
1965									
Nov. 18-30	8.7	19.9	126.5	137.7	151.6	200.9	341.7	694.2	987.0
December	38.8	80.0	429.9	560.8	365.0	799.5	1,228.3	2,392.8	3,502.3
Due on Dec. 10	.2	7.5	21.2	36.8	31.5	44.2	77.1	152.8	218.5
Due on Dec. 15	8.3	2.6	51.3	110.1	80.6	240.6	451.6	772.8	945.1
1966									
January	25.3	64.9	318.4	470.3	307.9	817.1	1,426.8	2,551.8	3,430.7
February	17.3	38.8	191.3	258.3	166.2	426.8	1,198.9	1,791.9	2,297.6
March	24.9	31.6	201.1	248.1	201.6	401.5	874.4	1,477.5	1,983.2
April	18.6	36.3	119.5	221.4	104.2	252.6	461.9	818.7	1,214.5
May	12.4	18.9	69.0	135.3	68.2	164.4	194.2	426.8	662.4
June	9.0	17.7	97.0	83.0	30.6	95.7	125.8	252.1	458.8
July	7.0	16.3	49.0	72.5	20.2	52.7	185.7	258.6	403.4
August	3.5	7.3	28.3	38.5	17.4	52.3	93.6	163.3	240.9
September	6.9	6.6	43.1	34.8	20.2	51.9	186.9	259.0	350.4
October	2.5	5.1	35.8	29.8	4.4	36.4	58.4	99.2	172.4
November	2.7	5.8	15.0	17.0	8.9	11.4	59.9	80.2	120.7
December or later	7.8	23.5	86.1	63.5	39.5	192.7	130.2	362.4	543.3
Total	185.4	372.7	1,810.0	2,371.0	1,505.9	3,555.9	6,566.7	11,628.5	16,367.6
Annual rate of growth since Aug. 19, 1965 (percent)	+18.8	+26.8	+0.4	+18.0	−14.4	+24.8	+4.4	8.0	+8.8
Average maturity (months)	4.1	4.0	3.7	3.4	2.9	3.4	3.3	3.3	3.4
Number of banks reporting	55	52	67	41	11	12	7	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.
[3] Prime banks are those whose negotiable certificates of deposits are regarded as being the highest quality and which are reported by dealers to trade within 1 or 2 basis points of each other within the secondary market.

TABLE 6B.—*Maturity percentage distribution of outstanding negotiable time certificates of deposit by size and bank* [1].

Period of maturity	Total deposits of banks [2]								
	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				Total
					Nonprime	Prime [3]		Total	
						Outside New York	New York		
	Percentage distribution								
1965									
Nov. 18-30	4.7	5.3	7.0	5.8	10.1	5.6	5.2	6.0	6.0
December	20.9	21.5	23.7	23.6	24.2	22.5	18.7	20.6	21.4
1966									
January	13.6	17.4	17.6	19.8	20.5	23.0	21.7	21.9	21.0
February	9.3 (43.8)	10.4 (49.3)	10.6 (51.9)	10.9 (54.3)	11.0 (55.7)	12.0 (57.5)	18.3 (58.7)	15.4 (57.9)	14.0 (56.4)
March	13.4	8.5	11.1	10.5	13.4	11.3	13.3	12.7	12.1
April	10.0	9.7	6.6	9.3	6.9	7.1	7.0	7.0	7.4
May	6.7 (30.1)	5.1 (23.3)	3.8 (21.5)	5.7 (25.5)	4.5 (24.8)	4.6 (23.0)	3.0 (23.3)	3.7 (23.4)	4.1 (23.6)
June	4.9	4.7	5.3	3.5	2.0	2.7	1.9	2.2	2.8
July	3.8	4.4	2.7	3.1	1.4	1.5	2.8	2.2	2.5
August	1.9 (10.6)	2.0 (11.1)	1.6 (9.6)	1.6 (8.2)	1.2 (4.6)	1.5 (5.7)	1.4 (6.1)	1.4 (5.8)	1.5 (6.8)
September	3.7	1.8	2.4	1.5	1.3	1.5	2.9	2.2	2.1
October	1.4	1.4	2.0	1.3	.3	1.0	.9	.9	1.1
November	1.5 (6.6)	1.5 (4.7)	.8 (5.2)	.7 (3.5)	.6 (2.2)	.3 (2.8)	.9 (4.7)	.7 (3.8)	.7 (3.9)
December or later	4.2	6.3	4.8	2.7	2.6	5.4	2.0	3.1	3.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

	Cumulative percentage								
1965									
Nov. 18-30	4.7	5.3	7.0	5.8	10.1	5.6	5.2	6.0	6.0
December	25.6	26.8	30.7	29.5	34.3	28.1	23.9	26.5	27.4
1966									
January	39.3	44.2	48.3	49.3	54.8	51.1	45.6	48.5	48.4
February	48.6	54.6	58.9	60.2	65.8	63.1	63.9	63.9	62.4
March	62.0	63.1	70.0	70.7	79.2	74.4	77.2	76.6	74.5
April	72.1	72.8	76.6	80.0	86.1	81.5	84.2	83.6	82.2
May	78.7	77.9	80.4	85.7	90.6	86.1	87.2	87.3	86.0
June	83.6	82.7	85.8	89.2	92.7	88.8	89.1	89.5	88.8
July	87.4	87.0	88.5	92.3	94.0	90.3	91.9	91.7	91.3
August	89.3	89.0	90.1	93.9	95.2	91.8	93.4	93.1	92.7
September	93.0	90.8	92.4	95.3	96.5	93.2	96.2	95.3	94.9
October	94.3	92.1	94.4	96.6	96.8	94.3	97.1	96.2	95.9
November	95.8	93.7	95.2	97.3	97.4	94.6	98.0	96.9	96.7
December or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

[1] Includes only negotiable certificates in denomination of $100,000 or more outstanding at weekly reporting member banks.

[2] As reported in the call report of condition of June 30, 1964.

[3] Prime banks are those whose negotiable certificate of deposits are regarded as being of the highest quality and which are reported by dealers to trade generally within 1 or 2 basis points of each within the secondary market.

NOTE.—Figures in parentheses are precentage aggregates only for the previous 3 full months.

TABLE 7A.—*Ratio of outstanding time certificates of deposit*[1] *to total deposits, various survey dates*

[Percent]

Total deposits [2] (in millions of dollars)	Nov. 17, 1965	Aug. 18, 1965	May 12, 1965 [3]	Feb. 10, 1965 [3]	Nov. 18, 1964
All banks issuing CD's	6.7	6.6	6.4	6.5	6.1
Under 100	4.6	4.6	4.6	4.5	4.4
100 to 200	4.6	4.3	4.0	4.7	4.2
200 to 500	7.4	7.5	7.4	7.6	7.0
500 to 1,000	7.8	8.1	7.8	8.4	7.5
1,000 and over:					
Nonprime	9.4	9.4	9.1	9.9	8.4
Prime [4] outside New York City	9.6	9.2	8.3	8.4	8.2
Prime [4] in New York City	17.2	17.7	15.2	112.8	12.6

[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.
[3] Data for 1 week prior to maturity survey date.
[4] Prime banks are those whose negotiable certificates of deposit are regarded as being the highest quality and which are reported by dealers to trade within 1 or 2 basis points of each other within the secondary market.

TABLE 7B.—*Ratio of outstanding negotiable time certificates of deposit*[1] *to total deposits, Nov. 17, 1965*

[Number of banks]

Total deposits [2] (in millions of dollars)	0 to 5 percent	5 to 10 percent	10 to 15 percent	15 to 20 percent	20 to 25 percent	25 to 30 percent	Average CD-to-deposit ratio
All banks issuing CD's	121	62	41	17	4	1	6.7
Under 100	40	12	8	1			4.6
100 to 200	34	13	2	2	1		4.6
200 to 500	27	16	17	5			7.4
500 to 1,000	15	10	10	3			7.8
1,000 and over:							
Nonprime	2	6	1	1		1	9.4
Prime [3] outside New York City	3	5	1	2	1		9.6
Prime [3] in New York City			2	3	2		17.2

[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.
[3] Prime banks are those whose negotiable certificates of deposit are regarded as being the highest quality and which are reported by dealers to trade within 1 or 2 basis points of each other within the secondary market.

TABLE 7C.—*Percent change in outstanding negotiable time certificates of deposit* [1] *Aug. 18, 1965, to Nov. 17, 1965*

[Number of banks]

Total deposits [2] (in millions of dollars)	Declines of—						No change	Increases of—					
	25 percent or more	20 to 25 percent	15 to 20 percent	10 to 15 percent	5 to 10 percent	0 to 5 percent		0 to 5 percent	5 to 10 percent	10 to 15 percent	15 to 20 percent	20 to 25 percent	25 percent or more
All banks issuing CD's	21	4	14	15	20	29	19	27	22	13	8	10	43
Under 100	5	1	2	4	5	5	11	3	1	1	4	3	15
100 to 200	5	-	4	1	7	6	6	3	3	3	1	1	12
200 to 500	6	3	6	6	2	10	1	4	10	6	2	4	5
500 to 1,000	5	-	1	3	3	3	1	8	5	2	-	1	6
1,000 and over:													
Nonprime	-	-	-	1	-	3	-	3	1	1	-	-	2
Prime [3] outside New York City	-	-	1	-	3	-	-	2	1	-	1	1	3
Prime [3] in New York City	-	-	-	-	-	2	-	4	1	-	-	-	-

[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.

[3] Prime banks are those whose negotiable certificates of deposit are regarded as being the highest quality and which are reported by dealers to trade within 1 or 2 basis points of each other within the secondary market.

TABLE 7D.—*Change in outstanding negotiable time certificates of deposit*[1] *as a percent of total deposits at beginning of period, Aug. 18, 1965, to Nov. 17, 1965*

[Number of banks]

Total deposits[2] (in millions of dollars)	Declines of—						No change	Increases of—					
	5 percent or more	4 to 5 percent	3 to 4 percent	2 to 3 percent	1 to 2 percent	0 to 1 percent		0 to 1 percent	1 to 2 percent	2 to 3 percent	3 to 4 percent	4 to 5 percent	5 percent or more
All banks issuing CD's	2	1	2	9	37	49	28	63	34	14	2	1	3
Under 100	1	1		1	7	10	14	12	11	1		1	1
100 to 200			2		5	16	8	10	6	2	1		2
200 to 500				4	16	12	3	16	10	3	1		
500 to 1,000	1			4	4	6	2	14	4	3			
1,000 and over:													
Nonprime					2	2	1	4	1	1			
Prime[3] outside New York City					2	2		3	1	4			
Prime[3] in New York City					1	1		4	1				

[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.
[3] Prime banks are those whose negotiable certificates of deposit are regarded as being the highest quality and which are reported by dealers to trade within 1 or 2 basis points of each other within the secondary market.

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TABLE 8A.—*Distribution of outstan ing negotiable time certificates of deposit by Federal Reserve district, as of Nov. 17, 1965*

[Amounts in millions of dollars to 1 decimal]

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleve-land	Rich-mond	Atlanta	Chicago	St. Louis	Minne-apolis	Kansas City	Dallas	San Fran-cisco
1965													
Nov. 18–30	987.0	48.3	418.9	22.9	73.3	18.7	19.6	118.0	19.4	13.3	29.6	109.7	95.3
December	3,502.3	249.9	1,506.9	131.2	201.6	52.1	96.7	454.0	111.6	44.2	92.6	232.2	329.3
Due on Dec. 10	218.5	11.0	88.3	10.3	19.0	8.8	3.3	35.4	6.1	3.2	6.1	10.5	16.5
Due on Dec. 15	945.1	77.4	526.0	31.4	57.1	1.4	7.2	121.6	13.9	9.1	12.1	46.9	41.0
1966													
January	3,430.7	172.0	1,678.2	110.3	161.7	31.0	60.8	517.1	56.5	48.8	53.8	205.7	334.8
February	2,297.6	94.5	1,300.6	48.4	117.7	20.2	36.5	266.4	42.0	35.4	22.8	114.1	199.0
March	1,983.2	66.3	1,013.0	65.2	139.0	22.5	42.3	251.9	38.6	28.8	48.0	104.3	163.3
April	1,214.5	58.4	553.7	20.9	86.4	20.3	35.9	114.3	15.3	31.1	30.7	82.2	165.3
May	662.4	48.8	229.4	23.7	92.6	7.3	17.6	63.2	10.3	12.5	13.4	46.7	96.9
June	458.8	42.6	156.2	26.6	42.3	23.6	30.3	43.5	14.8	9.3	9.8	27.1	32.7
July	403.4	13.3	228.4	8.1	17.8	8.1	13.3	24.9	6.7	9.7	9.9	25.2	38.0
August	240.9	6.3	196.2	5.9	9.9	10.6	11.9	30.7	1.3	5.9	4.1	20.9	27.2
September	350.4	6.7	193.3	1.9	43.2	12.9	9.5	24.3	1.6	12.5	5.4	15.6	23.5
October	172.4	3.5	65.3	.4	17.0	14.1	6.2	18.2	.4	3.1	4.0	14.4	25.8
November	120.7	4.0	69.5	3.9	3.1	6.4	3.8	7.8	.4	.9	2.0	8.3	10.6
December or later	543.3	7.9	150.8	27.0	208.5	.2	32.3	19.7	1.0	5.1	1.5	36.4	52.9
Total	16,367.6	822.5	7,670.4	496.4	1,214.1	248.0	416.7	1,954.0	319.9	260.6	327.6	1,042.8	1,594.6
Annual rate of growth since Aug. 19, 1965 (percent)	+8.8	+18.8	−0.8	+10.0	+18.8	+27.6	−1.2	+42.4	−12.8	+7.6	−4.8	−4.0	+23.2
Average maturity (months)	3.4	2.8	3.3	3.3	5.1	4.3	4.3	2.8	2.5	3.8	3.6	3.3	3.5
Number of banks reporting	245	16	32	9	15	16	18	27	12	14	31	31	24

TABLE 8B.—*Distribution of maturities of outstanding negotiabletime certificates of deposit by Federal Reserve district, as of Nov. 17, 1965*

Period of maturity	All districts	Boston	New York	Phila-delphia	Cleveland	Richmond	Atlanta	hicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
	Percentage distribution												
1965													
Nov. 18-30	6.0	5.9	5.5	4.6	6.0	7.5	4.7	6.0	6.1	5.1	9.0	10.5	6.0
December	21.4	30.4	19.6	26.4	16.6	21.0	23.2	23.2	34.9	17.0	28.3	22.3	20.6
1966													
January	21.0	20.9	21.9	22.2	13.3	12.5	14.6	26.5	17.7	18.7	16.4	19.7	21.0
February	14.0 (56.4)	11.5 (62.8)	17.0 (58.5)	9.8 (58.4)	9.7 (39.6)	8.1 (41.6)	8.8 (46.6)	13.6 (63.3)	13.1 (65.7)	13.6 (49.3)	7.0 (51.7)	10.9 (52.9)	12.5 (54.1)
March	12.1	8.0	13.2	13.1	11.4	9.1	10.1	12.9	12.1	11.0	14.7	10.0	10.2
April	7.4	7.1	7.2	4.2	7.1	8.2	8.6	5.9	4.8	11.9	9.4	7.9	10.4
May	4.1 (23.6)	5.9 (21.0)	3.0 (23.4)	4.8 (22.1)	7.6 (26.1)	2.9 (20.2)	4.2 (22.9)	3.2 (22.0)	3.2 (20.1)	4.8 (27.2)	4.1 (28.2)	4.5 (22.4)	6.1 (26.7)
June	2.8	5.2	2.0	5.4	3.5	9.5	7.3	2.2	4.6	3.6	3.0	2.6	2.0
July	2.5	1.6	3.0	1.6	1.5	3.3	3.2	1.3	2.1	3.7	3.0	2.4	2.4
August	1.5 (6.8)	.8 (7.6)	1.4 (6.4)	1.2 (8.2)	.8 (5.8)	4.3 (17.1)	2.8 (13.3)	1.6 (5.1)	.4 (7.1)	2.3 (9.6)	1.2 (7.2)	2.0 (7.0.	1.7 (6.1)
September	2.1	.8	2.5	.4	3.6	5.2	2.3	1.3	.5	4.8	1.6	1.5	1.5
October	1.1	.4	.8	.1	1.4	5.7	1.5	.9	.1	1.2	1.2	1.4	1.6
November	.7 (3.9)	.5 (1.7)	.9 (4.2)	.8 (1.3)	.3 (5.3)	2.6 (13.5)	.9 (4.7)	.4 (2.6)	.1 (.7)	.3 (6.3.	.6 (3.4)	.8 (3.7)	.7 (3.8)
December or later	3.3	1.0	2.0	5.4	17.2	.1	7.8	1.0	.3	2.0	.5	3.5	3.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	Cumulative percentage												
1965													
Nov. 18-30	6.0	5.9	5.5	4.6	6.0	7.5	4.7	6.0	6.1	5.1	9.0	10.5	6.0
December	27.4	36.3	25.1	31.0	14.4	28.5	27.9	29.3	41.0	22.1	37.3	32.8	26.6
1966													
January	48.4	57.2	47.0	53.3	36.0	41.0	42.5	55.7	58.6	40.8	53.7	52.5	47.6
February	62.4	68.7	63.9	63.0	45.6	49.2	51.3	69.4	71.7	54.4	60.7	63.5	60.1
March	74.5	76.7	77.1	76.1	57.1	58.3	61.4	82.3	83.9	65.4	75.3	73.5	70.3
April	82.2	83.8	84.4	80.4	64.2	66.5	70.0	88.1	88.6	77.4	84.7	81.3	80.7
May	86.0	89.8	87.4	85.1	71.8	69.4	74.3	91.3	91.8	83.2	88.8	85.8	86.8
June	88.8	94.9	89.4	90.5	75.3	78.9	81.5	93.6	96.4	85.7	91.8	88.4	88.8
July	91.3	96.5	92.4	92.1	76.8	82.2	84.7	94.8	98.5	89.4	94.8	90.8	91.2
August	92.7	97.3	93.8	93.3	77.6	86.5	87.6	96.4	98.9	91.7	96.1	92.8	92.9
September	94.9	98.1	96.3	93.7	81.2	91.7	89.8	97.7	99.4	96.5	97.7	94.3	94.4
October	95.9	98.6	97.1	93.8	82.6	97.3	91.3	98.6	99.6	97.7	98.9	95.7	96.0
November	96.7	99.0	98.0	94.6	82.8	99.9	92.2	99.0	99.7	98.0	99.5	96.5	96.7
December or later	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

NOTE.—Figures in parentheses are percentage aggregates only for the previous 3 full months.

REPORT OF THE AD HOC SUBCOMMITTEE OF THE FEDERAL RESERVE SYSTEM TO APPRAISE COMMERCIAL BANK ISSUANCE OF SHORT-TERM UNSECURED NEGOTIABLE NOTES,* DECEMBER 3, 1964

I. INTRODUCTION

Up until the past few years, banks regarded the money market primarily as a market in which they bought and sold investments, and not as a major source of funds to supplement deposits. With the development of the marketable certificate of deposit, this situation changed, and large banks became able to bid in a national market for loanable funds to an extent not hitherto possible.[1] This has provided greater flexibility to bank managements, in certain circumstances. For example, formerly when a bank suffered a decline in deposits, the major adjustment it normally would make was to liquidate earning assets (even though borrowing from the Federal Reserve, or purchases of Federal funds, might provide temporary relief). Now, however, a large bank has another alternative, at least to some extent; namely, to raise more money in the CD market by offering a higher rate of interest than before and by seeking such funds more aggressively. At the same time, an element of potential vulnerability has been created in certain other circumstances. The more heavily a bank has become dependent on funds borrowed in the money market, the greater the risk that it may be subjected to a sharp increase in costs or to a substantial drain of funds when the availability of money contracts. In such circumstances, banks might turn to the Federal Reserve's discount facilities on a large scale.

Regulation Q may well have had some salutary effect in restraining reckless issuance of CD's, especially in periods of rising interest rates. Whenever there was a danger that time deposit interest rates might bump the ceilings, banks became very vulnerable to an outflow of funds which they might not be able to check at rates of interest permissible under the regulation. This presumably had a sobering effect on their lending and investing policies. Moreover, the 1-percent ceiling on under-90-day money effectively prevented banks from acquiring funds of a potentially even more volatile sort than over-90-day money.

Having witnessed some of the advantages of large-scale access to the national money market, while at the same time recognizing the dangers of relying exclusively on CD's to tap this market when interest rates on CD's had risen to, or very near, the ceilings established by regulation Q, banks began to think of other ways of achieving the same end. The outcome has been the very recent development of the negotiable unsecured note. The First National Bank of Boston was the pioneer in this development. These notes presently are not subject to regulation Q; moreover, they are not subject to the 4-percent reserve requirement which applies to CD's, nor are they subject to the Federal Deposit Insurance Corporation insurance premium of about one-third of 1 percent, net. However, they are subject to some other restrictions. A national bank by law may not borrow a total amount in excess of 100 percent of its capital plus 50 percent of its unimpaired surplus fund (CD's and borrowing from the Federal Reserve are not included in the limitation). Some State banks are restricted by State regulations. For example, there is a provision in the New York Penal Code that, in effect, bars banks from borrowing through the issuance of any interest-bearing note other than negotiable certificates of deposit[2] (borrowing

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* The memberships of this subcommittee of the Federal Reserve System is as follows: Ansgar R. Berge, Howard D. Crosse, Gerald T. Dunne, Ralph T. Green, Federic Solomon, and David L. Grove, chairman.

[1] The Federal funds market is a national market which predates the market in negotiable CD's, but this market is mainly an interbank market, funds obtained in it ordinarily have not been regarded as a supplement to deposits but rather as a means of making very short-run adjustments in banks' reserve positions. This attitude about the proper use of Federal funds seems to be in the process of changing; however, and the market is coming to be regarded by some banks as a source of loanable funds as well as a reserve adjustment mechanism.

[2] The pertinent part of the code reads as follows:

"§ 298. *Misconduct by banks and bankers.*

"Any banking corporation or private banker authorized to carry on the business of banking under the laws of this state who:

* * * * * * *

"4. Issues or puts in circulation any bank bill or note of any such corporation or banker, unless the same shall be made payable on demand and without interest, except bills of exchange on foreign countries or places beyond the limits or jurisdiction of the United States, and except certificates of deposit payable on presentation, with or without interest, to bearer or to the order of a person named therein, or certificates of deposit payable, with or without interest, to bearer or to the order of a person named therein showing the amount of the deposit, the date of issue and the date when due; but such certificates shall not be issued except as representing money actually on deposit,

"Is guilty of a misdemeanor."

from the Federal Reserve is not debarred, of course). Another State (Pennsylvania) has ruled that unsecured borrowings are subordinate to deposits in the event of liquidation.

The reserve requirement for CD's and the FDIC premium both increase banks' net cost of funds raised by that medium. For example, if a bank issues a $100 1-year CD at 4 percent interest, it must retain $4 as a cash reserve, and thus it obtains only $96 of loanable funds but must pay $4 of interest. This is equivalent to 4.166 percent on the actual amount of funds available for lending. When the FDIC net premium of one-third of 1 percent is added, the bank has paid nearly 4.20 percent for the loanable funds it has acquired, apart from any handling costs. Nevertheless, the force of traditional patterns of thinking in banking has been so great that this consideration, by itself, probably would not have been sufficient to inspire banks to seek new instruments for raising (i.e., borrowing) funds at slightly lower cost.

The principal driving force behind the search for substitutes for CD's, therefore, has been regulation Q. As banks increasingly used CD's to raise funds, the banks became aware that they were becoming more and more vulnerable to a rise in money-market interest rates. In the weeks immediately preceding the November 24 increases in the ceilings, the rate most banks were quoting on CD's with maturities beyond 4 months was the 4-percent maximum. Given the substantial volume of funds derived from issuance of CD's, a rather small further rise in short-term interest rates on Treasury bills might have prompted holders of CD's to shift into bills as their CD's matured, if the Federal Reserve Board had not acted to raise the ceiling. Banks otherwise would not have been able to offer a competitive rate of return, and thus could not have expected their depositors to roll over many of their CD's as they matured.

This fear had an effect on the investment policy of some of the banks. It was not that banks feared that the Federal Reserve Board would not raise the ceiling eventually; rather, it was that the Board would not do so promptly enough to enable the banks to avoid either having to liquidate assets at an undesirable pace or else having to turn down valued customers' requests for loans, with an ensuing rupture of the bank's relationship with such customers.

The most widely held view among large banks that had thought much about borrowing via negotiable unsecured notes, therefore, was that the issuance of such notes would offer a relief valve that would enable them to draw off some of the pressures on their reserves, should interest rates move higher and regulation Q not be modified simultaneously.

Most (but not all) such banks allegedly gave only minor consideration to the use of notes as a device for obtaining funds more cheaply. They pointed out that they expected that holders of CD's would be able to bargain for part of the savings[8] for themselves, by playing one bank off against another. Moreover, if a bank is in need of funds to replace losses from a runoff of CD's, it is not in a very good bargaining position to resist such demands, and the larger the total supply of notes available in the market, the harder it would be for an individual bank to sell notes at a net saving to itself vis-a-vis CD's.

Most banks still would prefer not to show large borrowings on their statements, and this feeling, for many of them, apparently would more than offset any value of a few basic points of lower net cost of borrowing. So long as this feeling persists, it will tend to reduce the volume of notes offered (and at the same time it should help banks to retain the potential savings in costs on such notes as are issued).

Finally, the more a national bank uses its legal maximum potential for issuing notes in order to obtain as much of its resources as cheaply as possible, the less capacity it will have to employ this instrument as an emergency source of funds should regulation Q begin to bind.

Accordingly, the point of view most often expressed by officers of national banks just before the eventful action of the Board on November 24 was that they might like to issue enough notes to accustom the market to this new instrument but not so many as to exhaust the device as a contingency source of funds. Wihin this framework, they seemed to be thinking mainly of notes with maturities ranging from 3 to 12 months; in other words, maturities comparable to those currently prevailing for CD's. On the other hand, one very active New York State-chartered bank expressed particular interest in using notes to raise funds for periods of 1 to 3 months—an area from which banks were then being debarred

[8] See example on p. 3.

by the 1-percent ceiling applicable to CD's in that maturity range. There also has been some mention by both National and State-chartered banks of the possibility of using unsecured notes to raise money for longer periods than has been customary with CD's but for shorter periods than those which have characterized capital debentures.

II. THE SITUATION AT THE TIME OF THE MODIFICATION OF REGULATION Q ON NOVEMBER 24

Present volume.—On the basis of data collected up to November 11, it seems that about $113 million of negotiable short-term notes have been issued by banks and are outstanding. The breakdown by Federal Reserve district is as follows:

District:	*Outstandings (in millions)*
Boston	[1] $36
New York	16
Philadelphia	8
Chicago	20
Kansas City	1
Cleveland	32
	113

[1] A more recent figure of $43,000,000 has been supplied by the Federal Reserve Bank of Boston.

Form.—The notes have been issued in both discount form and simple interest form.[4] The discount version seems to be most widely favored. Possibly there are three reasons for this. (1) By offering them on a bank discount basis (360 days), the quoted yields are directly comparable with those on Treasury bills, which are quoted on the same basis. (2) Banks can offer the same rate on their notes on a discount basis as they are offering on their CD's, but in reality be giving the investor 12 or so basis points more than he obtains on CD's, because the interest is deducted in advance in the former case and thereby reduces the amount of principal the investor has to put up. The longer the maturity, the greater the relative advantage. (3) From the banks' point of view, conceivably they may feel they are in a better position to maintain that these notes are not merely CD's in disguise if the notes are issued in discount form.

Denominations.—There appears to be a prevailing view among the large banks and dealers that the minimum denomination should be $1 million. However, some banks have expressed a willingness to issue notes of $500,000. Notes of any smaller amount could be traded in the secondary market only with difficulty at this stage.

Secondary market.—Several dealers in CD's have expressed a willingness to trade in the new notes. As of the middle of October, perhaps about $10 million may have been traded in the secondary market.

Interest rates.—Banks which have issued notes have attempted to do so at rates equal to those quoted on CD's. However, they have not always been successful, and in some instances have had to quote rates 4 or 5 basis points higher than on CD's. Apparently this is apart from the advantage conferred on the buyer by the use of the discount form, although this is not absolutely certain. Some banks note that corporate treasurers insist on a few basis points more than on CD's on the ground that a CD is a well-established instrument whose sale in the secondary market poses no problems, whereas the scope of the secondary market in notes remains to be seen. Moreover, corporate treasurers are aware of the advantages to the issuing bank of exemption from reserve requirements and regulation Q. For both these reasons, some treasurers will accept notes in lieu of CD's only at some differential in yield.

III. PROSPECTIVE DEVELOPMENTS

How much and how rapidly is the issuance of notes likely to grow? These are questions that cannot be answered with any degree of confidence at the moment; however, some observations can be made.

First of all, the volume of notes cannot become very large unless the hurdles posed by section 298 of the New York Penal Code are overcome. The prevail-

[4] See apps. D, E, and F.

ing view is that this will require action by the New York Legislature since a favorable interpretation of the statute by the superintendent of banks appears unlikely. The New York banks anticipate no substantial opposition to an amendment, but even so they do not see much prospect for completion of such action before March at the earliest. Perhaps more importantly for the long run, the New York banks do not expect that the amendment of section 298 will be accompanied by the imposition of any other restriction, such as the borrowing limits of 100 percent of capital plus 50 percent of surplus to which national banks are subject. If they are correct in this belief, it is clear that one cannot estimate the potential size of their market by using the limits imposed on national banks.

California, another State with some very large State banks, has a statutory provision restricting a bank's borrowing to an amount not exceeding the sum of its capital and surplus; however, a bank may borrow in excess of this limit with the prior written approval of the superintendent. Accordingly much will depend on this official's attitude. This attitude may or may not be very restrictive, because even the authority to borrow up to a total amount equal to a bank's capital and surplus is hedged by a statutory statement concerning the purpose of borrowing, namely, that it be "for temporary purposes." The California superintendent might rule that the issuance of negotiable notes as a persistent and normal source of funds would be contrary to the law. This would then force the State banks to seek relief from the legislature if they wished to participate in the development of this potential source of funds. On the other hand, the California law is sufficiently flexible so that the superintendent could interpret it in a liberal manner that would not place State-chartered banks at a disadvantage vis-a-vis national banks.

In Illinois and Massachusetts, apparently there are no restrictions on borrowing by State banks.

Thus, it is clear from merely these few examples—and many more could be cited—that there are a number of cloudy legal areas that will have to be cleared before a satisfactory estimate of the potential size of the market can be hazarded.[5]

Notwithstanding these qualifications, it seems certain that the present restrictions on national banks alone would prevent the issuance of notes in an amount anywhere near that of negotiable certificates of deposit outstanding (presently around $13 billion) unless State-chartered banks were to be freed of all restraints on borrowing and were aggressively to seek to enlarge their relative share of the market for time money. If we take the 100 largest banks in the country, and use the sum of capital plus 50 prcent of surplus and undivided profits (minus capital debentures outstanding) as a crude yardstick of potential, we obtain a figure of about $8½ billion.[6] Active participation by smaller banks and a substantial revision of current notions about appropriate maximum levels of banks borrowings would have to take place before notes could reach anything like the present volume of certificates of deposit outstanding. However, we should not underestimate the ability of the banking industry to adapt, especially if regulation Q really should pinch banks for an extended period.

Apart from legal restrictions which may retard the development of negotiable notes, by far the major considerations will be: (1) prospective trends in short-term interest rates, (2) regulation Q, and (3) attitudes of suppliers of bank funds.

(1) Prospective trends in short-term interest rates: If the ceilings established by regulation Q had remained unchanged, the incentives to raise funds through issuing notes instead of certificates of deposit would have been very great indeed if short-term interest rates had been expected to rise further. In such circumstances, banks would have been fearful of losing the funds they had obtained through the issuance of certificates of deposit, because regulation Q would not have permitted them to raise their offering rates, whereas they would be under no such restraint with respect to notes. The fact that banks now may pay 4 percent on any time deposit of more than 30 days and 4½ percent on deposits

[5] In this connection, please see the "Compilation of State Statutes Respecting Limitations on Amounts Banks Can Borrow," dated October 1964, prepared by the Legal Division of the Board of Governors. This is attached as app. A.

[6] See apps. B and C, which calculate the sum of capital plus 50 percent of surplus for the 100 largest National and State banks. The yardstick for national banks is not appropriate for State banks, of course, but it is used because it may, at least temporarily, influence investors' and supervisory agencies' attitudes about "excessive" borrowing.

of over 90 days should provide sufficient leeway for certificates of deposit for the time being, though there is no assurance, of course, that this will remain so for very long.

In the opposite kind of situation, namely, one in which banks expect short-term interest rates to fall substantially and where regulation Q is preventing them from offering market rates of interest on under-90-day certificates of deposit, it would appear that they might have an incentive to issue more notes and fewer certificates of deposit. Presumably they would want to obtain more of their "time" money on a very short-term basis rather than commit themselves to paying prevailing rates for months ahead. Again, the recent revision of regulation Q greatly reduces, and perhaps eliminates, this problem at the moment, because banks can aggressively seek funds in the 30- to 90-day range, from which they were barred for many years.

If short-term interest rates were to fall well below 4 percent and then were expected to remain there for quite some time, there would be much less incentive for banks to borrow for the shortest period possible, and regulation Q would not becloud the use of certificates of deposit for raising "time" money. In such circumstances, bankers' traditional reluctance to show borrowings on their statements probably would carry more weight, and the issuance of notes by a bank might be more likely to cause very conservative corporate treasurers to downgrade the bank. These two considerations for many banks might outweigh the savings to be derived from avoiding reserve requirements and FDIC premiums. However, one would think that such force as these two considerations might have would be much smaller after a large volume of notes had been issued than in an earlier stage in which this had not yet happened. In other words, once banks have made the effort to have State laws liberalized, have persuaded treasurers to obtain the necessary investment authorizations from their committees and boards, have nurtured the growth of a secondary market, and have issued a substantial volume of notes, then the less likely is the prospect of a substantial shrinkage in the issuance of notes relative to certificates of deposits when interest rates subsequently move down to a lower level. On the other hand, should rates move to such lower levels before a market in notes has been developed very fully, then the motivation for issuing negotiable notes might well diminish greatly. They might then become somewhat of a rarity occasionally issued for very short periods by a few venturesome and unorthodox money-market banks. Such notes might then receive not much more than footnotes in textbooks on banking, rather than meriting a full chapter. Should notes displace certificates of deposit on a large scale, however, the same textbooks may have a chapter entitled "Certificates of Deposit—a Transitional Money Market Instrument"?

(2) Regulation Q: As we have noted already, regulation Q has been the principal stimulus to the development of a market for negotiable notes. While regulation Q has commendable objectives, it has tended to introduce distortions into the money market. For example, until the November 24 modification, it effectively debarred banks from competing in the money-market for under-90-day funds and probably tended to make money-market yields higher in the neighborhood above 90 days and lower in the area under 90 days than would have been the case if banks had been able to meet the spectrum of needs of the market directly. Restricting banks' ability to raise funds at the very short end of the maturity spectrum may have been desirable or undesirable, according to one's analysis and criteria, but there seems little doubt that there were consequences for the money market.

By tending to make the slope of the yield curve somewhat steeper, regulation Q fostered the development of intermediaries who "rode the yield curve." In other words, those investors who wished to invest funds for under 90 days, who also wished precise maturities which Treasury bills cannot offer, and who preferred negotiable bank obligations to commercial or finance company paper, would not, of course, buy certificates of deposit on original issue at a sacrifice of 2 or 3 full percentage points. Some other investors, seeing this gap in the financial structure, were willing to buy certificates of deposit maturing at more than 90 days, hold them until they came closer to maturity, and then sell them to these investors who needed shorter maturities.

Regulation Q also has had an effect on bank management of sources and uses of funds whenever interest rates on certificates of deposit have begun to press against the ceilings. Bank managements ask themselves how large a deposit drain may they be subjected to before relief comes, either from a receding of

interest rates or from an elevation of the ceilings. This makes management more conservative in its investment policies and more concerned about having a disproportionate share of the bank's certificates of deposit mature in any given short period.

These psychological effects may be good, from the standpoint of monetary policy. On the other hand, they may tend to force a larger part of total financing into other channels—from money-market banks to non-money-market banks, and from the commercial banking system to nonbank financial intermediaries—which are not so directly under the influence of the monetary authorities, so the net restraint on the availability of credit from all sources combined may be less than might appear from an examination of the assets of the commercial banking system alone, and the impact on relative size classes of banks may be significant. These consequences are not necessarily bad, but they should not be overlooked. Presumably, the equilibrium quantity of bank reserves will be affected, the rate of growth in the money supply consonant with a given level of employment and prices will be changed, and the relative profitability of banks versus nonbank financial intermediaries will be altered. The magnitude of these effects will, of course, be related both to the extent of the squeeze on banks and to the ability of nonbanks to market a larger volume of their obligations in order to finance credit needs that would, under less restrictive regulation Q ceilings, be financed by banks.

The development of unsecured negotiable notes, accordingly, may be regarded as an attempt on the part of commercial banks—especially money-market banks—to minimize any tendency toward a reduction in their relative share of total credit in periods of rising interest rates.

(3) Attitudes of suppliers of bank funds: Banks traditionally have disliked showing borrowings on their statements of condition, presumably because they believed that important depositors would frown on a bank that could not operate on "its own resources." This feeling, both on the part of banks and on the part of their depositors, seems to be changing. It seems reasonable to suppose that the attitude would change much faster if regulation Q placed banks in a bind for an extended period. The fact that notes are on a parity with certificates of deposit in case of liquidation, under the National Banking Act and also under most State laws,[7] should make the adjustment much easier than would be the case if notes had a subordinate status.

The very recent modification of regulation Q may very well retard the development of notes for two reasons. First, banks will have much less incentive to develop a market for them, and, second, if banks are not actively pushing notes, fewer corporate and public treasurers are likely to seek authorization from their principals, enabling them to purchase such obligations. This consideration is particularly important where public treasurers are concerned. They already have authority to acquire certificates of deposit, but probably very few have authority to "lend" to banks. Changes in investment authorizations generally come slowly in the absence of compelling circumstances. With the lifting of ceilings under regulation Q, banks will have much less incentive, at least for the time being, to attempt to persuade local governing bodies to change their investment authorizations.

Secondary market.—If notes ever are to be issued in large quantities, it is interesting to speculate about the need for an active secondary market, similar to the one that exists for certificates of deposit.

If certificates of deposit and notes existed side by side in substantial quantities, there could conceivably be an active secondary market for each. However, it would not be essential that there be such a market for notes. Banks could repurchase notes if the holder needed funds unexpectedly, whereas they have to penalize holders of certificates of deposit who wish to be repaid in advance of maturity. Moreover, banks must charge at least 2 percent more than the rate they pay on a time deposit when they make a loan with the deposit as collateral; they have to follow no such requirement when they lend against the collateral of their own notes. Thus, there is less need for a secondary market in notes. It may be worth pointing out that if notes replaced a substantial proportion of certificates of deposit, the secondary market in certificates of deposit might be weakened: the smaller volume of certificates of deposit would shrink the secondary market in that instrument, while the notes would tend to

[7] As noted on p. 3, Pennsylvania is one exception.

pass through a secondary market less frequently than the certificates of deposit they replaced. Moreover, insofar as the certificates of deposit of the very largest banks became less readily marketable because of a weakening of the secondary market, the premium which these banks enjoy on their certificates of deposit would be reduced. That is to say, the issue rate on certificates of deposit of New York City money-market banks is 5 to 20 basis points lower than the rates on those of other large banks because they are so highly marketable.

Likelihood of smaller banks issuing notes.—Most discussions of the prospects for development of a large volume of notes tend to presume (1) that only the largest banks will use this instrument, and (2) that aggressive use of notes may draw funds from relatively smaller banks to the very large ones. Both of these expectations could well be erroneous. (When we refer to "smaller" banks in this section, we do not mean really small banks, but rather those that are moderately small in comparison with the largest banks whose certificates of deposit regularly are traded in the secondary market. Taking the two groups together, we have in mind a universe consisting of approximately the weekly reporting member banks—some 350 in number.)

To take the second expectation first, it is doubtful that the smaller banks still retain any appreciable amount of funds that the large banks could attract. The development of the negotiable certificate of deposit probably has already enabled aggressive large banks to capture any funds that could be induced to shift.

On the other hand, notes might be an effective instrument for the smaller banks. Notes might enable these banks to tap a national market for funds to an extent that certificates of deposits thus far have not. One large commercial paper dealer has expressed an interest in encouraging banks to issue notes in the same manner as corporations issue commerical paper to dealers. The dealer would buy the notes outright and then would resell them, again like commercial paper. This dealer envisages notes of as small as $25,000 having a market. The maturities of the notes would reflect buyers' needs. There would be no need for a secondary market. If changed circumstances required a buyer to liquidate a note to maturity, arrangements could be made by the dealer to have the issuing bank buy back the note, and to replace the funds by new notes which the dealer would acquire. (The maturity of the new notes, of course, need not correspond with those of the notes repurchased prior to maturity.) Another possibility would be for the bank to lend against its note, if a holder suddenly needed funds; this possibility should be easier for banks than for other issuers of commercial paper.

In a sense, therefore, what the above-mentioned commercial paper dealer appears to have in mind is a splitting of the market for notes into two submarkets: (1) a direct-placement market, which the very large banks would use, and (2) a "dealer market," which "good name" banks would use. That is, the same kind of market structure that exists in the industrial commercial paper market, where the biggest firms can place their paper directly whereas smaller but still "good name" firms can issue paper but only through the medium of a dealer.

Accordingly, with the aggressive assistance of commercial paper dealers, smaller banks may be able to compete more effectively not only with commercial paper but also with certificates of deposits issued by larger banks and with Treasury bills. While a treasurer desiring to place $1 million might have to choose between a dozen or more notes of different smaller banks versus one single certificate of deposit, the commercial paper dealer could put the package together, and a rather small differential in yield might be sufficient inducement to arouse some interest on the part of some corporate treasurers, especially those with only relatively modest amounts to invest. Thus, it is by no means certain that the development of the note instrument would work against the smaller banks; it may be just the opposite. Moreover, whereas the very recent increase in regulation Q ceilings may diminish the interest of the largest banks in issuing notes, it may not have an equivalent negative impact on the plans of commercial paper dealers. And from the viewpoint of the smaller banks, the prospect of being able to tap a broader market for funds in a period of tighter monetary policy may well be rather appealing.

IV. POLICY AND SUPERVISORY IMPLICATIONS OF NOTES

It is exceedingly difficult to speculate about the policy implications of notes, especially now that the interest-rate ceilings of regulation Q may have taken the pressure off of CD's. Nevertheless, some possible implications may be worth exploring.

If changes in State laws should be made so that State banks everywhere could issue notes in whatever amounts their managements saw fit, it is conceivable that notes could drive CD's out of existence. This would be true only if all buyers of CD's and notes regarded them as perfect substitutes for each other. Since notes are subject to neither the 4-percent-reserve requirement nor the FDIC premium, banks could offer notes at a higher yield than CD's without raising their net cost of funds. Competition would force banks to offer the instrument which yielded most to the buyer, and notes would completely displace CD's, barring restrictions on the authority of banks to issue notes and barring any buyer preference for CD's. In the process, State banks would grow at the expense of national banks, unless the present limitations on borrowing by the latter were liberalized.[8]

Under these conditions, notes not only would completely displace CD's, they would also to some extent displace other types of liquid assets in investors' portfolios, because banks would be in a position to offer investors higher returns than before in relation to prevailing yields on Treasury bills and commercial paper.

For any given quoted or nominal rate of interest offered by banks to suppliers of funds, banks would be willing to take in a larger volume of funds than before (because any given quoted rate would be equivalent to a lower net cost as compared with the previous method of obtaining funds through an instrument that was subject to reserve requirements and an insurance premium). Thus, the banking system's demand schedule for "time money" would shift to the right. Since this by itself should not modify the supply schedule of the providers of funds, a disequilibrium would exist at the old rate of interest. A new equilirium presumably would take place at a rate of interest above the old (i.e., CD) rate, and at a volume of bank time obligations greater than the amount previously outstanding.

The increased demand for bank obligations at the new higher interest rate would have its counterpart in a reduced demand for other liquid assets, mainly Treasury bills and commercial paper. It might also reduce the demand for foreign money-market media, such as Canadian and United Kingdom bills, somewhat, and thereby help our balance of payments, although quantitatively the amount might be extremely small.

If banks were to increase their demand for Treasury bills and other liquid asests pari passu with their disposal by other holders, there would be no disturbance in other liquid asset markets. There would merely be a transfer from nonbank holders to band holders without any necessary change in the rates the Treasury and other nonbank issuers of liquid assets would have to pay. In fact, however, it is unlikely that things would operate that smoothly. Banks like to lend, on the average, for longer periods than they borrow. As a result, they would be unwilling to acquire all the liquid assets that others would desire to liquidate. Thus, there would be upward pressure on other liquid asset rates and downward pressure on the yields of those assets banks would be seeking to acquire.[9] The rise in other rates would, of course, reduce the shift out of

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[8] In this connection, the Comptroller has been rather generous in his September 1964 rulings governing the calculation of the maximum borrowing limit of 100 percent of capital plus 50 percent of unimpaired surplus. Paragraph 1100, on lending limits of national banks, Sections (c) : Undivided Profits and Reserves, reads as follows :

"The term 'unimpaired surplus fund' as used in 12 U.S.C. 84 includes all capital accounts (other than capital stock), derived from either paid-in capital funds or retained earnings, not subject to known charges, and which are considered interchangeable by resolution of the bank's board of directors.

"(1) Some examples of capital accounts which are includible in the term 'unimpaired surplus fund' are:

"(i) Surplus (paid in or earned).

"(ii) Undivided profits (paid in or earned—unearned income must be deducted).

"(iii) Taxpaid portion of valuation reserve for loans (includes amounts in reserve for loan losses for which no Federal tax deduction has been or may be taken).

"(iv) Valuation reserve for securities.

"(v) Reserve for contingencies.

"(2) Accounts which are subject to known specific charges are not includible in the 'unimpaired surplus fund.' Some examples of such accounts are:

"(i) Internal Revenue formula bad-debt reserve to the extent taxable.

"(ii) Reserve for dividends declared.

"(iii) Reserve for taxes, interest and expenses."

And ruling 7545 states that the interpretation of the term "unimpaired surplus fund" as contained in paragraph 1100(c) is also applicable with respect to the limitation on the aggregate amount of indebtedness which a national bank may incur (12 U.S.C. 82).

[9] Unless demand for such types of credit simultaneously increased. This might be the case, for example, with business and finance company loans, as corporations and finance companies tended to shift more of their borrowing from the commercial paper market into bank loans, in response to the change in relative interest rates.

other liquid assets into notes, but there is no reason to expect that it would be sufficient to prevent the shift altogether.

The shift from non-CD liquid assets into notes would, by itself, have no effect on bank reserves unless the higher rates induced a shift out of currency or demand deposits into the notes.[10] The scope for such a shift probably is small in present circumstances, because high yields on CD's already have been very successful in promoting frugality in the holding of cash balances.

On the other hand, as maturing CD's were replaced by notes, the reserves held against them would be freed. In the absence of offsetting action by the Federal Reserve (which would be easy to effect), banks could use the released reserves to expand their loans and investments to a level where growth in demand and savings deposits and currency outflow would absorb the released reserves. In the process, there would be downward pressure on the structure of interest rates, upward pressure on prices and money incomes, and the banking system's share of total borrowing by the private and public sectors would tend to be enlarged.

Underlying all of the foregoing analysis are two basic assumptions: (1) Banks are subject to no operative limit, for practical purposes, on their ability to issue unsecured notes, and (2) all holders of CD's regard notes as perfect substitutes for CD's. These assumptions obviously are untrue at the present time. It is by no means obvious, however, that regulatory restraints and market attitudes will not evolve in this direction over time.

But for the immediate future, there will be restraints both on the note-issuing power of banks and the receptiveness of the market. We already have noted the limitations that govern national banks and, in some States, State-chartered banks. In addition, many corporate and public treasurers, and also foreign central banks, presently lack authority to buy unsecured notes of banks. Authority to make such investments may be obtained very slowly indeed, especially by public treasurers. Most public treasurers are unable to make deposits that are not collateralized. Presumably their governing bodies would require the same protection for any notes acquired. What additional problems would this pose for the banks? Changes in the present investment authorizations of public treasurers would require action by thousands of public bodies which traditionally have been very conservative. Such changes probably would take place very slowly. The same can be said about foreign central banks. These, too, would not be eager to shift from CD's into a new type of instrument; in fact, in some cases the underlying central banking legislation would have to be altered, because some central bank acts specify the forms in which the international monetary reserves may be held, and the phrasing in some cases excludes acquisition of notes.

Accordingly, let us examine the situation on the assumption that notes may displace some CD's but not all, and that the two exist side by side.

If the only restraint on notes came from the supply side, there would be no reason why the yields of notes and CD's should not be identical for given maturities. It is only when we introduce buyer preference that we can explain a disparity. Such buyer preference for CD's does exist, as we have seen. The question is how strong is buyer preference for CD's, how fast will the preference diminish, and what rate spread will be needed, in the interim, to promote any substantial substitution of notes for CD's (say, a substitution of $2 or $3 billion)? Only time will answer these questions, and, now that ceilings on CD's have been raised, banks will have less incentive to give high priority to the promotion of this new instrument.

As a result, the amount of free reserves released by substitution of notes for CD's probably will not be very large in the short run, under present circumstances. And even in the longer run, additions to the supply of free reserves from this source should take place so slowly as to create no real difficulty for the FOMC.

If notes were to displace CD's entirely, to take the extreme case, would this weaken or strengthen the power of the Federal Reserve to control bank reserves, money supply and bank credit, or would it leave the Fed's power substantially unaltered?

The process of displacement of CD's would, as we have noted, have reserve effects. So long as the process was orderly, the FOMC would not lose any of its control; the trading desk would merely have to supply a somewhat smaller

[10] Or changed the distribution of deposits as between Reserve city and country banks, which probably would occur, or resulted in a shift from other time deposits.

volume of reserves to support any given rate of growth in the money supply and in bank credit. Insofar as growth of time deposits is regarded as a policy factor, the FOMC could take into account the sum of time deposits and notes, instead of time deposits alone.

But what would be the situation once the process of substitution had been completed? There appears to be no obvious reason to expect that the relevant underlying functions would become any more unstable than before. The public's demand function for currency should not be altered materially. The public's demand for an expanding volume of demand deposits might shift to a slightly lower trend line (because of higher yields obtainable on liquid assets), but fluctuations around the trend should not be wider. If the FOMC should, on occasion, desire to nudge short-term interest rates in one direction or another, this could still be accomplished by varying the rate of additions to bank reserves. As banks were supplied with more reserves, they would tend to bid down the yields on Treasury bills and lower their quoted offering rates on their notes, and if the Fed wished to absorb reserves, banks would become less eager buyers of bills and more eager offerers of notes. The same sort of process presently takes place, except that changes in the volume of CD's outstanding affect required reserves and introduce a complicating element. One might hazard a guess that the FOMC possibly might even operate with greater precision than at present, on the ground that reserve requirements against time deposits tend to create more uncertainties for monetary management than would exist if there were no such requirements.

Consequently, if this tentative analysis is correct, the Federal Reserve need not fear that the displacement of CD's by notes would weaken its ability to affect the banking system, the money market, and the economy as a whole, although the extent of the displacement would have to be taken into account in the establishment of policy targets.

The problems which notes may create for the monetary authorities are more likely to pertain to individual banks rather than to the banking system as a whole (unless the problems of individual banks spread, as might conceivably happen).

Individual bank problems could arise if banks were to become overly aggressive in obtaining funds through issuing notes and were to make inadequate provision for liquidity in their employment of the funds. Brokers and dealers probably would play a major role in promoting any such aggressive issuance of notes; they might tend to be much more interested in increasing the volume of trading than in considering the risks to the banks.

If this sort of situation developed, there might be more cases of resort to the discount window in periods of tightening monetary policy, because it is unlikely that each individual bank, especially the smaller ones, could depend on simultaneously replacing all maturing notes, even though it might be willing to offer a higher rate. Moreover, in the quest for earning assets with a sufficiently high return to cover the costs of funds, some banks would be tempted to extend maturities and to lower their standards of credit worthiness. What really is at issue here is the extent to which bank managements can be relied on to exercise prudence in the absence of strict supervisory regulation. Opinions differ on this issue. It is relevant to reiterate, in this connection, that the issuance of notes, as a practical matter, is likely to involve only banks with nationally known names, and not the thousands of small banks, and especially not the new little banks which have been springing up. Larke banks, as a general rule, tend to be more skilled in managing their sources and uses of funds than are small banks; at the same time. little banks have no complete monopoly on imprudence—large banks can be imprudent, too, even though the odds of their being so may be much smaller.

Any source of funds is capable of abuse by unsound or inexperienced bank management. This already has been seen with respect to CD's. The special danger with reference to notes, however, is that banks which have a strong inclination to "free wheel," or which are unable to resist the temptation to follow competitiors who do have such an inclination, may have somewhat greater opportunities to do so with notes than with CD's, under present law and regulations. Apart from the interest-rate ceilings, the restraints which regulation Q establishes both on prepayment of CD's and on lending against them have served to limit, to some degree, the extent to which banks have been able to tap the national market for money, and this is especially true for non-money-market banks. In this connection, the possibility of any aggressive inclinations of banks being supplemented by aggressive inclinations of money brokers and dealers

seems to be greater with respect to notes than CD's, again because of the applicability of regulation Q to CD's.

The foregoing problems are relevant to the questions of capital adequacy and bank liquidity. The more heavily a bank becomes dependent on any source of funds—whether it be notes, other types of borrowings, or deposits—which may be unstable and which it may not be able to replace quickly with funds from other sources, the more likely it is that it may encounter a situation in which it may have to liquidate earning assets in substantial volume in a relatively brief period. It it does not hold enough liquid assets, it may have to sell inherently sound assets at a capital loss. Borrowing from the Federal Reserve may ease the adjustment but would rarely obviate it completely. To the extent a bank has lowered its credit standards in an effort to make a profit on high-cost funds, the greater will be the need for a strong capital and capital reserve position. Yet, such banks are the ones most likely to be weak in both liquidity and capital funds.

Thus, while there is nothing inherently bad about raising funds by unsecured notes, and while most bank managements are skilled and prudent, the possibilities for abuse may be such that the supervisory authorities will have to be very much on the alert if excesses are not to develop on a larger scale than has occurred through the use of CD's.

V. RECOMMENDATIONS

Notes may eventually come to be a considerable source of bank funds if official policy does not suppress them. The development of this instrument represents an attempt by the commercial banks to circumvent competitive restraints imposed on banks by regulation Q and by reserve requirements. Most of the competitive limitations placed on banks by regulation Q (but not all) have been eased, for the time being, by the recent increase in ceilings, especially in the 30- to 90-day area. The cost of meeting reserve requirements remains unchanged.

The Board has indicated that notes constitute "borrowings," not "deposits" for the purposes of regulations Q and D. As indicated by the analysis in this report, there appears no compelling reason at this time to recommend a change in that position.

The primary responsibility for the wise and prudent use of this instrument is squarely that of management of the individual bank. Issuance of notes by commercial banks is still in an experimental stage, and as matters proceed they should be kept under review through examination procedures and through other means so that the System will be alert to developments.

The subcommittee accordingly recommends that no change either in law or regulation be made at this time in the matter,[11] and that the System take a position of watchful waiting.

ANSGAR R. BERGE,
HOWARD D. CROSSE,
GERALD T. DUNNE,
RALPH T. GREEN,
FREDERIC SOLOMON,
DAVID L. GROVE, *Chairman.*

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[11] Mr. Crosse does not concur in this view.

APPENDIXES TO FEDERAL RESERVE BOARD MATERIALS

APPENDIX A

COMPILATION OF STATE STATUTES RESPECTING LIMITATIONS ON AMOUNTS BANKS CAN BORROW OCTOBER 1964

(Legal Division of the Board of Governors of the Federal Reserve System, Washington, D.C.)

Summary of Limitations on Borrowing by State Banks

The purpose of this summary is to provide a general indication of the types and extent of limitations that have been imposed by State statutes upon the borrowing powers of State-chartered banks. It is based upon the statutory provisions that follow, but does not purport to present authoritative interpretations of those laws. For authoritative interpretations of the borrowing powers of State banks, the best sources would be the appropriate State bank supervisory authorities.

No limit

Thirteen States impose no statutory limitation on borrowing by banks (Alabama, Arkansas, Connecticut, Delaware, Illinois, Indiana, Kentucky, Massachusetts,[1] Missouri, New Jersey, New York, Rhode Island, and South Carolina). Of these, five have expressly granted banks the power to borrow (Connecticut, Delaware, Illinois, Indiana, and New Jersey); however, no opinion is here expressed as to the significance of lack of such express power in other States.

Limit by capital and surplus

1. Thirteen States restrict, to some extent, a bank's borrowing to a sum not exceeding capital and surplus (Arizona, California, Kansas, Montana, Maryland, Nebraska, Nevada, New Mexico, Ohio, Oregon, Texas, Washington, and Wyoming).

2. Several States regulate borrowings that exceed multiples of capital and surplus: two times (Colorado and Idaho) and three times (Louisiana and Missouri).

3. Capital alone governs the limits in three States (Alaska [if to relend], Pennsylvania, and Michigan); in another, borrowings are limited to twice capital in addition to surplus and undivided profits (Georgia).

4. Maine's provisions apply only to nonmember State banks and prevent borrowing in excess of capital, surplus, and undivided profits.

Restrictions on purpose

1. Fourteen States, including some of those using a capital and surplus restriction, prohibit banks from securing borrowed funds for other than "temporary purposes" (Arizona, California, Colorado, Florida, Hawaii, Kansas, Nevada, New Mexico, Oregon, South Dakota, Utah, Washington, Wisconsin, and Wyoming). Various other restrictions, respecting what banks may do with borrowed funds are found in the statutes of five States (Alaska, Idaho, Iowa, Montana, and West Virginia).

2. Twelve States either forbid loans to banks for the purpose of reloaning and/or empower the State supervisor of banks to cause the cessation and/or repayment of loans if the bank has been found to be habitually borrowing to

[1] The Massachusetts Deputy Commissioner of Banks has stated that banking institutions may not issue promissory notes without specific legislative authority.

gain investment funds or otherwise (Alaska, Idaho, Kansas, Montana, North Dakota, Oklahoma, Pennsylvania, South Dakota, Utah, Washington, Wisconsin, and Wyoming).

Other requirements

1. Twelve States provide that some funds may be borrowed only on authority of certain bank officials (Hawaii, Idaho, New Hampshire, North Carolina, North Dakota, Oregon, Utah, Virginia, Washington, West Virginia, Wisconsin, and Wyoming).

2. Twelve States require that certain borrowings be indicated in the bank's reports and/or records (Hawaii, Idaho, North Dakota, Ohio, Oregon, South Dakota, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming).

3. The issuance of a bill to evidence borrowings is necessary in two States (Idaho and South Dakota) and Oklahoma allows borrowing only by issuing notes or through rediscounts.

4. Hawaii requires that money borrowed in behalf of the commercial or savings department be segregated and used only for the benefit of the department for which the funds were secured. Tennessee requires that total liabilities never exceed total solvent assets. Wisconsin allows borrowing only from another bank, subject to some exceptions.

Exemptions

1. Most States exempt from restriction funds obtained from Federal agencies available under congressional acts.

2. Thirteen States allow borrowings exceeding limitations if approved by the State banking supervisory agencies (California, Georgia, Idaho, Kansas, Michigan, Mississippi, Montana, Nevada [up to 50 percent of capital and surplus], New Mexico, Ohio, Oregon, Texas, and Washington).

3. Five States enumerate liabilities which are not to be included within limitations on indebtedness (Georgia, Michigan, Pennsylvania, Texas, and Washington). Of these, Texas broadly exempts any debt evidenced by an investment certificate.

4. Maryland allows banks to be indebted for longer than 90 days only with the approval of the State bank commissioner.

5. Maine exempts from limitation certain borrowings duly approved by bank officials.

Special cases

1. Minnesota requires a certificate to be filed with organiaztion papers stating the maximum debt the bank may incur; which amount the incorporators select.

2. North Carolina places responsibility for control of borrowings in the State supervisor of banks, and in Arizona the supervisor can decrease statutory limits.[2]

3. While New York provides no limitations, question has been raised whether the issuance of unsecured notes may violate a State criminal statute.

ALABAMA

ALASKA STATUTES

Sec. 06.05.255. *Borrowing.*—(a) A state bank may not borrow money to relend in a sum in excess of its paid-up capital nor may it pledge its assets as collateral security in an amount exceeding 50 percent in excess of the amount borrowed. Whenever it appears that a bank is borrowing habitually for the purpose of re-lending the department may require the bank to pay off the borrowed money.

(b) Nothing in this section prevents any bank from rediscounting in good faith and endorsing any of its negotiable notes.

(c) It is unlawful for any bank to issue its certificate of deposit for the purpose of borrowing money. (§ 3.171 Ch. 129 SLA 1951.)

ARIZONA REVISED STATUTES ANNOTATED

§ 6–257 * * * Commercial banks may, subject to such limitations as the superintendent may impose by general regulation, borrow money for temporary purposes and may pledge assets of the bank as security of the loan, but at no time shall the amount for which the bank is liable as borrower be in excess of its combined capital and surplus * * *. As amended Laws 1964, Ch. 41, § 1.

[2] The Arizona Superintendent of Banks has limited to 15 days borrowings that he has not approved.

ARKANSAS

WEST'S ANNOTATED CALIFORNIA CODES

Fin.

§ 1202. *Borrowing for temporary purposes; maximum amount.*—A commercial bank may borrow money for temporary purposes by discounting or otherwise to an amount not in excess of its capital and surplus, but shall not borrow money except as provided in Sections 1204 and 1205 in excess of such amount without the prior written approval of the superintendent.

The amounts of moneys so borrowed by a commercial bank together with the amount of any of its deposits secured by surety bonds shall not at any one time exceed the amount of its capital and surplus without the prior written approval of the superintendent. (Stats. 1951, c. 364, p. 869, § 1202.)

COLORADO REVISED STATUTES 1953

14–17–4. *Borrowing-debentures.*—(1) A state bank may borrow money and issue evidence of indebtedness for a loan for temporary purposes in the amount not exceeding two times its capital and surplus, or in such larger amount, or for such other purposes, as the banking board approves. Debentures, subordinate to deposits, may not be retired without approval by the commissioner, and they shall so provide in express terms.

(2) Any state bank which is, or becomes, a member of the Federal Reserve System, shall not be limited in its borrowing or rediscounting with the Federal Reserve Bank of which it is a member.

Source: L. 57, p. 234, § 1.

CONNECTICUT

DELAWARE

FLORIDA STATUTES ANNOTATED

§ 659.23. *Borrowing.*—A bank or trust company may borrow money and issue evidences of indebtedness for a loan for temporary purposes in the usual course of its business. Added Laws 153 c. 28016 § 2.

CODE OF GEORGIA ANNOTATED

§ 13–2025. *Restriction of bank's indebtedness.*—No bank shall at any time be indebted to an amount exceeding double the amount of its capital stock actually paid in and remaining undiminished by losses or otherwise, plus the amount of the unimpaired surplus and undivided profits, except on account of the following:

First. Moneys deposited with or collected by the bank.

Second. Bills of exchange or drafts drawn against money actually on deposit to the credit of the bank or due thereto.

Third. Liabilities to the stockholders of the bank for dividends and reserve profits.

Fourth. Commercial paper rediscounted.

Fifth. Acceptances as herein authorized.

Sixth. Liabilities incurred by the bank on account of the indorsement of checks, drafts, and bills of exchange, received by the bank on deposit, cashed or purchased by it, and indorsed by the bank:

Provided, however, That in case of temporary emergency, or to pay its depositors, temporary loans, in excess of the amount hereinabove fixed, may be made, when approved in advance by the Superintendent of Banks. (Acts 1919, p. 202.)

REVISED LAWS OF HAWAII 1955

§ 178–55. *Borrowed money, bonds and rediscounts shown on books and reports; resolution required.*—Any bank borrowing money, bonds or rediscounting any of its notes shall at all times show on its books and accounts and in its reports the amount of such borrowed money, bonds or rediscounts. No officer or director or employee of any bank shall issue the note of the bank for borrowed money or rediscount any note or pledge any of the assets of the bank or borrow bonds, except when authorized by resolution of the board of directors entered upon the minutes of the meeting of the board. It shall be unlawful for any bank to issue its certificate of deposit for the purpose of borrowing money.

§ 178–56. *Assets; pledge of, prohibited; exceptions; limitations on borrowed money.*—No bank shall give preference to any depositor or creditor by pledging the assets of the bank, except as otherwise authorized by this part; provided, that any bank may for any temporary purpose borrow money and pledge or hypothecate as collateral security therefor its assets not exceeding fifty per cent in excess of the amount borrowed; provided, further, that the limitation for borrowing purposes may be waived by the territorial treasurer to any extent to which he deems advisable.

Any bank may rediscount with and sell to a federal reserve bank any and all notes, drafts, bills of exchange, acceptances and other securities, with no restrictions, as fully and to the same extent as this privilege is given to national bank members under the terms of the federal reserve act, or by regulations of the federal reserve board made pursuant thereto; provided, that any bank operating and maintaining a commercial and a savings department shall not borrow money, rediscount or hypothecate any assets of the commercial department except for the sole and exclusive use and benefit of the commercial department; nor shall it borrow money, rediscount or hypothecate any assets of the savings department except for the sole and exclusive use and benefit of the savings department.

IDAHO CODE

§26–701. *Borrowing money—Limitations.*—No bank shall borrow money, except to meet its seasonal requirements or unexpected withdrawals. Provided, that at no time shall the bills payable and rediscounts of any bank be permitted to exceed in the aggregate an amount equal to twice the capital and surplus of such bank, except with the written consent of the commissioner, first had and obtained. Whenever it shall appear to the commissioner that a bank is borrowing money in excess of the above limitation, or for purposes other than as specified above, he may require it to reduce such borrowings within a time to be fixed by him. Every bank or trust company is, however, authorized to issue its capital notes or debentures or incur any other obligation, with the consent of the commissioner of finance for money loaned it by the Reconstruction Finance Corporation or any other agency of the United States or by authority or any act of congress now or hereafter in effect, as to all [of] which none of the limitations of this section shall have any application.

§ 26–702. *Borrowing money—Accounting.*—No officer or employee of any bank shall issue the note of such corporation for money borrowed or rediscount any of its paper, or pledge or hypothecate any of its assets, except when authorized by resolution of its board of directors, or by an authorized committee thereof.

In all cases where money is borrowed, the bank shall issue its bills payable therefor. All bills payable shall be carried on the books of the bank, and in all reports of such bank under liabilities as "bills payable" until the same are actually paid, other than by renewal.

ILLINOIS

INDIANA

IOWA CODE ANNOTATED

§ 532.14. *Indebtedness or liability—exceptions.*—Trust companies, state or savings banks, may contract indebtedness or liability for the following purposes: For necessary expenses in managing and transacting their business, for deposits, and to pay depositors, to maintain proper legal reserves, and for other corporate purposes, and the directors of said trust company, state or savings bank shall have the right to pledge as security for said indebtedness or liability such assets of said bank or trust company as may be necessary. Nothing herein contained shall limit the issuance by trust companies, of debentures or bonds, the payment of which shall be secured by an actual transfer of real estate securities for the benefit and protection of purchases or said debentures or bonds, provided said securities shall be at least equal in amount to the par value of such debentures or bonds, and be first liens upon unencumbered real estate worth at least twice the amount loaned thereon.

GENERAL STATUTES OF KANSAS

§ 9-1107. *Temporary borrowing by bank.*—Any bank may borrow an amount not to exceed one hundred per cent of its capital stock and surplus for temporary purposes: *Provided,* That this limitation shall not apply to any borrowing secured by government bonds: *Provided further,* The commissioner may authorize borrowing in excess thereof. Any bank so borrowing may pledge assets in an amount not exceeding one hundred twenty per cent of the amount borrowed. Any pledging in excess of this amount shall be void. No bank shall borrow for the purpose of reloaning, but nothing herein contained shall be construed to prevent any bank from borrowing upon government bonds, or rediscounting and endorsing in good faith any of its negotiable notes, without limitation. No bank shall issue any certificate of deposit for the purpose of borrowing money.

KENTUCKY

LOUISIANA REVISED STATUTES

RS 6:5. *Borrowing money and pledge of assets; requirements.*—No officer of any state banking association, savings bank, or trust company may borrow money and pledge or hypothecate any of its assets except in pursuance of a resolution of the board of directors duly entered upon its minute book, which resolution shall specify the maximum amount to be borrowed from any one bank or person as well as the maximum amount to be borrowed altogether, and shall likewise fix the maximum amount of collateral to be pledged therefor.

RS 6: 6. *Rediscount of loans.*—Whenever any state banking association, savings bank, or trust company borrows upon bills payable, rediscounts, or certificates of deposit issued for borrowed money, or otherwise, for its use, any sum equal to three times its capital stock and declared surplus, it shall not thereafter make any new loans to anyone as long as it owes for borrowed money that amount.

REVISED STATUTES OF MAINE

C. 59 § 118. *Borrowing capacity.*—No trust company, not a member of the federal reserve system, shall be at any time indebted for borrowed money to an amount in excess of its capital, surplus and net undivided profits, except that by vote of a majority of its entire board of directors or executive committee, setting forth the reasons therefor, it may borrow to meet withdrawals of depositors or to prevent loss by sales of assets * * *.

MARYLAND

Art. 11 § 79. *Carrying bills payable or rediscounts in an amount greater than capital.*—No bank or trust company shall carry without the approval of the Bank Commissioner for a longer period than ninety days bills payable or rediscounts in an aggregate amount greater than its paid-in capital and surplus. The period of ninety days herein specified may be extended with the written authority of the Bank Commissioner.

MASSACHUSETTS

MICHIGAN STATUTES ANNOTATED

§ 23.838. *Indebtedness incurred by a bank; limitation; exceptions. Sec. 88.* No bank may borrow money or become indebted or liable to an amount exceeding at any time the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise: This limitation shall not apply to demands of the following nature:

(1) Moneys deposited with or collected by the bank;

(2) Bills of exchange or drafts drawn against money actually on deposit to the credit of the bank, or due thereto;

(3) Liabilities to the shareholders of the bank for dividends and reserve profits;

(4) In case of member banks, liabilities incurred under the provisions of the federal reserve act; and in the case of nonmember banks, liabilities incurred through borrowing under the same conditions as are imposed upon members of the federal reserve system by the provisions of the federal reserve act;

(5) Liabilities incurred under the provisions of the reconstruction finance corporation act;

(6) Liabilities created by the indorsement of accepted bills of exchange payable abroad actually owned by the indorsing bank and discounted at home or abroad;

(7) Liabilities incurred under the provisions of section 202 of title 2 of the federal farm loan act, approved July 17, 1916, amended by the agricultural credit act of 1923;

(8) Liabilities incurred on account of loans made with the express approval of the commission under paragraph 9 of section seventy-four [74] [loans to a bank approved by the bank supervisory agency].

MINNESOTA STATUTES ANNOTATED

§ 300.025. *Organization, certificate.*—Any three persons may form a corporation for any of the purposes specified in section 47.12 [Financial Corporations] by complying with the conditions hereinafter prescribed; * * *. They shall subscribe and acknowledge a certificate specifying:

* * * * * * *

(6) The highest amount of indebtedness or liability to which the corporation shall at any time be subject * * *.

MISSISSIPPI CODE 1942 ANNOTATED

§ 5213. *Borrowing, limit of power of, by banks.*—No bank chartered and doing business under the laws of this State shall issue bills payable or be liable in rediscounts at any time to a total amount in excess of three times its capital and surplus; provided, that this limit may be exceeded by a bank with the consent and approval in writing, of the State Comptroller. Any violation of this provision by a bank shall authorize the State Comptroller to deal with it as a bank being operated in violation of the laws, provided, however, that this section shall in no wise impair any obligation of banks for payment of loans and rediscounts in excess of the limit herein provided, nor shall any bank owing money heretofore borrowed in excess of this limit be held to be acting in violation of the law as to such existing loans.

MISSOURI

REVISED CODE OF MONTANA

§ 5-1037. *Borrowing money—limitations.*—No bank shall borrow money, except to meet its seasonal requirements or unexpected withdrawals. Provided, that at no time shall the bills payable and rediscounts of any bank be permitted to exceed in the aggregate an amount equal to the capital and surplus of such bank, except with the written consent of the superintendent, first had and obtained. Whenever it shall appear, to the superintendent that a bank is borrowing money in excess of the above limitations, or for the purpose other than as specified above, he may require it to reduce such borrowing within a time to be fixed by him.

REVISED STATUTES OF NEBRASKA 1943

§ 8-147. *Rediscounts and bills payable; loans and investments; limitation on amounts; illegal transfer of assets; violations; penalty; membership federal reserve system, effect.*—Except as provided in this section, the aggregate amount of the rediscounts and bills payable of any bank shall at no time exceed the amount of its paid-up capital and surplus, nor shall any bank at any time permit its loans and investments, exclusive of its cash reserve, banking house, fixtures and direct obligations of the United States government, to exceed in the aggregate fifteen times the amount of its paid-up capital and surplus. Any bank may borrow money on its bills payable secured by direct obligations of the United States government in an amount in excess of its paid-up capital and surplus. Any bank may, with the written consent of the director, rediscount paper in an amount in excess of its paid-up capital stock and surplus. No bank shall, without the written consent of the director, transfer, as collateral to its obligation, assets with a face value of more than one and one half times the amount of such obligation. Any transfer of assets of a bank in violation of

this section shall be void as against the creditors of such bank. Any officer or employe of such bank who does, or permits to be done, any act in the violation of this section, and any other person who knowingly assists in the violation of this section, shall be guilty of a felony and shall be punished by a fine of not more than one thousand dollars or by imprisonment for not more than five years. Any bank becoming a member of the federal reserve system may, however, have the same privileges as to rediscounts and bills payable with the federal reserve banks, and may incur liabilities to such banks to the same extent as national banks. Any bank may have the same privileges as to rediscounts and bills payable with the federal intermediate credit banks, and may incur liabilities to such banks, to the same extent as national banks.

Source: Laws 1963, c. 29, § 47. Effective date October 19, 1963.

NEVADA REVISED STATUTES

§ 662.050. *Borrowing of money authorized; limitations on hypothecation.*—1. * * *

2. Any bank may borrow money for temporary purposes, not to exceed the amount of its paid up capital and surplus, and may pledge any of its assets as collateral security therefor.

3. With the written consent of the superintendent of banks and the state board of finance in each instance, a bank may borrow to the amount of 50 percent in excess of its paid-up capital and surplus, and pledge assets of the bank as collateral security therefor. Any indebtedness, however, contracted in excess of the amount limited herein shall be null and void in its entirety.

NEW HAMPSHIRE REVISED STATUTES ANNOTATED 1955

§ 384:16. *Borrowing.*—No savings bank, state bank, or trust company shall hire money or give the note of such institution except by vote of the trustees or directors thereof, duly recorded; and all such notes shall be signed by the treasurer or cashier, and countersigned by the president and at least two members of the board of trustees or directors. And for the purpose of securing such loan or loans said bank or company may pledge, as security therefor, real estate mortgages, notes, stocks, or other securities.

NEW JERSEY

NEW MEXICO STATUTES 1953 ANNOTATED

§ 48-22-28. *Borrowing.*—A state bank may borrow money and issue evidence of indebtedness for a loan for temporary purposes in an amount not exceeding its capital and surplus or in such larger amount or for such other purposes as the commissioner approves.

MCKINNEY'S CONSOLIDATED LAW OF NEW YORK ANNOTATED

Penal Law § 298. *Misconduct by banks and bankers.*—Any banking corporation or private banker authorized to carry on the business of banking under the laws of this state who:

1. Receives, pays out, gives or offers in payment as money to circulate, or who attempts to circulate as money, any bill, note or other evidence of debt issued or purporting to have been issued by any corporation or individual, situated or residing without this state, and which bill, note or other evidence of debt shall, upon any part thereof, purport to be payable or redeemable at any place or by any corporation or individual within this state; or,

2. Issues, utters or circulates, as money, or in any way, directly or indirectly, aids or assists in the issuing, uttering or circulating as money within this state, of any bank bill, note or other evidence of debt in the similitude of a bank note issued or purporting to have been issued by any corporation or individual situated or residing without this state; or procures or receives, in any manner whatever, any such bank bill, note or other evidence of debt with intent to issue, utter or circulate, or with intent to aid in issuing, uttering or circulating the same as money within this state; or,

3. Directly or indirectly lends or pays out for paper discounted or purchased any bank bill, note or other evidence of debt, which is not received at par by such corporation or banker for debts due such corporation or banker; or,

4. Issues or puts in circulation any bank bill or note of any such corporation or banker, unless the same shall be made payable on demand and without interest, except bills of exchange on foreign countries or places beyond the limits or jurisdiction of the United States, and except certificates of deposit payable on presentation, with or without interest, to bearer or to the order of a person named therein, or certificates of deposit payable, with or without interest, to bearer or to the order of a person named therein showing the amount of the deposit, the date of issue and the date when due; but such certificates shall not be issued except as representing money actually on deposit,

Is guilty of a misdemeanor.

Nothing in this section contained shall be construed to prohibit any such corporation or banker from receiving and paying out such foreign bank bills as they shall receive at par in the ordinary course of their business, or to prohibit such corporation or banker from receiving foreign notes from their dealers and customers in the regular and usual course of their business, at a rate of discount not exceeding that which is or shall be at the time fixed by law, for the redemption of the bills of the banks of this state at their agencies, or from obtaining from the corporations, associations or individuals by which such foreign notes are made, the payment or redemption thereof.

As amended L. 1961, c. 612, eff. April 17, 1961.

GENERAL STATUTES OF NORTH CAROLINA

§ 53–43. *General powers.*—In addition to the powers conferred by law upon private corporations, banks shall have the power:

* * * * * * *

(5) Subject to the approval of the Commissioner of Banks and on the authority of its board of directors, or majority thereof, to enter into such contracts, incur such obligations and generally to do and perform any and all such acts and things whatsoever as may be necessary or appropriate * * *.

NORTH DAKOTA CENTURY CODE ANNOTATED

§ 6–03–51. *Borrowing, normal and emergency—Limitations.*—Any state banking association shall have power to borrow money subject to the limitations of this chapter. Money borrowed from correspondent banks shall be evidenced by the promissory note or notes of the borrowing association, and no such association shall issue its certificate of deposit for money so borrowed or otherwise conceal the true nature of the transaction. Nothing herein shall affect the right of a state banking association to receive bona fide deposits from banks or other persons.

§ 6–03–52. *Borrowing and rediscounting—Authorization by directors.*—No banking association shall borrow money, rediscount paper with recourse on it, or pledge securities for money borrowed or rediscounted paper, except in accordance with express authority conferred by resolution of its board of directors indicating the officer or officers who are authorized to borrow, rediscount, and pledge and the extent of their authority. Every such resolution shall be entered in the minute book of the association, but a copy of such resolution certified as such by an officer of the association, authenticated by the seal of the association and accepted and acted upon by another bank or other lender in good faith shall be conclusive evidence of the existence and terms of the resolution.

§ 6–03–53. *Borrowing and rediscounting—Report required.*—Whenever a state banking association shall borrow money or rediscount with recourse such association shall immediately make a full written report of the transaction to the state examiner, which report shall include a full description of all collateral security given or to be given by such association for the credit obtained. Whenever it appears to the state examiner that any association is borrowing money or rediscounting its paper with recourse for the purpose of making or carrying speculative loans or investments or that the association is in an extended or unsound condition, the state examiner after reasonable notice and an opportunity for a hearing may by written order to the association require it to discharge its liability for borrowed money or on rediscounted paper either in full

or to such extent as the order may specify. If the association so notified shall fail to comply with such order within thirty days of the receipt thereof, it shall thereafter cease to make any new loans or investments until such order has been complied with, and any director, officer, or employee of the association who authorizes or in any way participates in the making of any new loans or investment in violation of the provisions of this section shall be personally liable to the association for all losses sustained by it in connection with any such new loan or investment.

PAGES OHIO REVISED CODE ANNOTATED

§ 1105.22. *Power to borrow.*—No bank may borrow money, bonds, or other securities in any sum exceeding the sum of its capital stock and surplus, except with the written consent of the superintendent of banks; but for this purpose the rediscount of notes, bills of exchange, and acceptances is not the borrowing of money. Every such rediscount shall be entered upon the books of the bank, and the total amount of the rediscount shall appear as a contingent liability upon every report of condition made to the superintendent or published by said bank.

OKLAHOMA STATUTES ANNOTATED

6 § 108e [Supp.] * * *

* * * provided, further, that any bank may, as it needs require, borrow money either by means of bills payable or through rediscounts of its negotiable instruments and may pledge assets of the bank as collateral security therefore; provided, that in no event shall said bank pledge or hypothecate its assets as security for deposits herein provided, or for its rediscounts or bills payable in an amount sufficient to create a margin of more than fifty (50%) per centum of the amount borrowed or of the deposits so secured by said bank without the written consent of the Bank Commissioner. Whenever it shall appear a bank is borrowing habitually for the purpose of reloaning, the Bank Commissioner may require such bank to pay off such borrowed money.

Any officer, director or employee of any State bank who violates any provision of the Section shall be guilty of a felony * * *.

OREGON REVISED STATUTES

708.220. *Limitation on borrowing money and collateral.*—(1) Any bank or trust company is authorized and empowered for any temporary purpose to borrow money or to borrow money and pledge or hypothecate as collateral security therefor its assets not exceeding 25 percent in excess of the amount borrowed, except that with the previous consent and approval of the Superintendent of Banks such collateral may be pledged up to but in no case to exceed 50 percent in excess of the amount borrowed. Any amount up to but not exceeding the amount of its capital and surplus may be borrowed without the consent of the Superintendent of Banks, but any amount borrowed in excess of the amount of its capital and surplus at such time actually paid in and remaining undiminished by losses or otherwise, must first be approved in writing by the Superintendent of Banks. No excess loan made to any such bank or trust company shall be invalid or illegal as to the lender, even though made without the consent of the Superintendent of Banks * * *.

708.205. *Borrowed money and rediscounts; records kept; issuing notes or pledging assets; certificates of deposits.*—(1) Any bank or trust company borrowing money or rediscounting any of its notes shall at all times show on its books and accounts and in its reports the amount of such borrowed money or rediscounts.

(2) No officer, director or employee of any bank or trust company shall issue the note of the bank or trust company for borrowed money nor rediscount any note nor pledge any of the assets of such bank or trust company, except when authorized by resolution of the board of directors of the bank or trust company previously made and entered upon the minutes of the bank or trust company, under such rules and regulations and in such form as may be prescribed by the Superintendent of Banks. No bank or trust company shall issue its certifiicate of deposit for the purpose of borrowing money.

PURDON'S PENNSYLVANIA STATUTES ANNOTATED

Tit. 7, § 819–1005. *Borrowing money and pledging assets therefor, limitations on total indebtedness.*—

A. A bank or a bank and trust company may borrow money and may pledge or hypothecate any of its assets as security therefor, but whenever it shall appear to the department that a bank or a bank and trust company is borrowing habitually for the purpose of relending, it may require such bank or bank and trust company to cease such practice.

B. A bank or a bank and trust company shall not, at any time, be indebted, or in any way obligated, whether upon such borrowings, or otherwise, to a total amount exceeding the amount of its unimpaired capital, but the following debts or obligations shall not be included in this limitation:

(1) Moneys deposited with the bank or bank and trust company or collected by it for its customers.

(2) Bills of exchange or drafts drawn against money actually on deposit to its credit or due it.

(3) Liabilities created by the endorsement by the bank or bank and trust company of accepted bills of exchange actually owned and discounted by it.

(4) Liabilities to the shareholders of the bank or bank and trust company for dividends which have been declared.

(5) Liabilities to the holders of undivided interests in any pool of bonds secured by mortgages or any pool of other securities, created by the bank or bank and trust company, or to the holders of undivided interests created by the bank or bank and trust company in any particular bond secured by a mortgage, or in any other security or asset, regardless of whether certificates or participation in such mortgage or securities pool, or in such mortgage, security, or other asset have been actually issued.

(6) The amount of the surplus, the expense fund or other reserves, and the undivided profits of the bank or bank and trust company.

(7) If the bank or bank and trust company is a member of a Federal Reserve Bank, liabilities incurred by it to, or rediscounts of commercial paper made by it with, the Federal Reserve Bank, as a member thereof.

(8) Rediscounts of commercial paper or borrowing of money by bank or bank and trust company during any continuous period, not exceeding three months, unless a longer period is approved by the department.

(9) Liabilities to any Federal or State agencies. 1933, May 15, P.L. 629 art. X, § 1005.

RHODE ISLAND

SOUTH CAROLINA

SOUTH DAKOTA CODE OF 1939

6.0423. *Borrowing money: pledge of assets; limitations; authority of Superintendent required.*—A bank may borrow money for temporary purposes and may pledge as security therefor assets of not to exceed one and one-half times the paid-up capital and surplus of the bank. Any additional pledge of assets in excess of this limitation may be made by such bank only upon written authority of the Superintendent.

6.0424. *Borrowing money: "bills payable" issued; record and report to Superintendent required; similar report on renewals and extensions.*—A bank shall issue its "bills payable" for any money borrowed by it, and shall show on its books and in all reports and statements made by it, the true amount of money borrowed by it. Whenever a bank shall borrow money it shall, within five days thereafter, make a full detailed report thereof to Superintendent, attached to which shall be a true copy of the "bills payable" issued by such bank therefor, together with a full description of the assets pledged to secure the same, which report shall be certified as correct by the president or cashier of the bank. A similar report shall be made as to every renewal or extension thereof and such borrowed money shall be promptly repaid whenever required by the Superintendent.

TENNESSEE CODE ANNOTATED

45–230. *Liabilities not to exceed assets*—* * *

It shall not be lawful for any bank, directly or indirectly, to increase its total liabilities beyond the amount of its total solvent assets; * * *

VERNON'S STATUTES OF TEXAS ANNOTATED

Art. 342-602. *Liability Limit—Exceptions.*—No state bank shall without the prior written consent of the Commissioner be indebted or liable for an amount in excess of its capital and certified surplus except on account of the following:

1. Money on deposit with or collected by it.
2. Bills of exchange, checks or drafts drawn against money actually on deposit to the credit of the bank or due to said bank.
3. Liability to stockholders on account of the capital stock, surplus and undivided profits.
4. Liabilities arising under or pursuant to the provisions of the Federal Deposit Insurance Corporation Act, the Federal Reserve Act, the Reconstruction Finance Corporation Act, the Federal Agriculture Credit Act of 1923, or pursuant to any or all amendments to any or all said acts.
5. Indebtedness evidenced by investment certificates or certificates of indebtedness.
6. Liability on endorsement of notes, bills of exchange or other evidences of indebtedness actually owned by said bank and sold or endorsed with or without recourse, provided said sale or endorsement shall have been previously approved by the board of directors of said bank.

UTAH CODE ANNOTATED

§ 7-3-43. *Preference by pledging assets forbidden—Borrowing for reloaning—Rediscounts.*—No bank or bank officer shall give preference to any depositor or creditor by pledging the assets of the bank as security; *provided*, that commercial banks may borrow money for temporary purposes and may pledge assets of the bank not exceeding fifty percent in excess of the amount borrowed as collateral security therefor, and that savings banks may borrow money and pledge or hypothecate their securities as provided in section 7-3-44; *and provided further*, that any bank may qualify as depositary for United States deposits or postal savings funds or other public moneys by the deposit of the securities required by law, and not otherwise. Whenever it shall appear that a bank is borrowing habitually for the purpose of reloaning the bank commissioner may require such bank to repay such borrowed money. Nothing herein contained shall prevent any bank from rediscounting in good faith and indorsing any of its negotiable notes. Any bank borrowing money or rediscounting any of its notes shall at all times show on its books and in its reports the amounts of such borrowed money or rediscounts. No officer of any bank shall issue the note of such bank for money borrowed or rediscount any note, except when authorized by resolution of the board of directors of a bank.

VERMONT STATUTES ANNOTATED

T. 8 § 1021. *Annual reports.*—Annually, on or before July 20, every bank shall make a report to the commissioner, showing accurately on the condition thereof as it was at the close of business on June 30 preceding. Such report shall embrace the following particulars, or such of them as the commissioner prescribes:

* * * * * * *

(9) Amount of each item of other liabilities;

* * * * * * *

CODE OF VIRGINIA

§ 6-80. *Banks borrowing money; reports; resolutions.*—Any bank or trust company borrowing money or rediscounting any of its notes shall at all times show on its books and accounts and in its reports the amount of such borrowed money or rediscounts. No officer, director or employee of any bank or trust company shall issue the note of such bank or trust company for borrowed money or redicsount any note or pledge any of the assets of such bank or trust company, except when authorized by resolution of the board of directors of such bank or trust company previously made and entered upon the minutes of such bank or trust company, under such rules and regulations and in such

form as may be prescribed by the chief examiner of banks; provided, it shall be unlawful for any bank or trust company to issue its certificates of deposit for the purpose of borrowing money.

REVISED CODE OF WASHINGTON ANNOTATED

§ 30.04.140. *Pledge of securities or assets prohibited—Exceptions.*—No bank or trust company shall pledge or hypothecate any of its securities or assets to any depositor, or creditor, except that it may qualify as depositary for United States deposits, postal savings funds or other public funds, or funds held in trust and deposited by any public officer by virtue of his office, or funds held by the United States or the state of Washington, or any officer thereof in trust, or for funds of corporations owned or controlled by the United States, and may give such security for such deposits as are required by law or by the officer making the same: *Provided,* That any bank or trust company may borrow, for temporary purposes, not to exceed in the aggregate amount the paid-in capital and surplus thereof, and may pledge as security therefor assets of such corporation, not exceeding one and one-half times the amount borrowed.

30.04.150. *Limits of indebtedness.*—No bank or trust company shall become or at any time be indebted or in any way liable to an amount exceeding the amount of its capital stock and surplus, except on account of demands of the nature following:

(1) Moneys deposited with or collected by the bank or trust company;

(2) Bills of exchange or drafts drawn against money actually on deposit to the credit of the bank or trust company, or for money owed it;

(3) Liabilities to its stockholders for dividends or reserved profits;

(4) Liabilities incurred under the provisions of the Federal Reserve Act;

(5) Liabilities incurred under the provisions of the Reconstruction Finance Corporation Act, the Federal Intermediate Credit Bank Act or to any similar lending or credit corporation now existing or hereafter created under the authority of an act of the Congress of the United States, or of any state;

(6) Liabilities created by the indorsement of accepted bills of exchange payable abroad, actually owned by the indorsing bank or trust company and discounted at home or abroad;

(7) The supervisor, at any time, for good cause shown, by order in writing, for a limited period and to an amount not in excess of the amount approved by the supervisor and stated in the order, may permit a bank or trust company to borrow for temporary purposes in excess of the amount of its paid-in capital stock and surplus and pledge assets to secure the loan; but in such a case the borrower shall make no new loan or investment until the money borrowed shall have been repaid, except such loans as may be made, with the approval of the supervisor, to protect assets already owned: *Provided,* That such bank or trust company shall have power to borrow in excess of the aggregate amount of the paid-in capital and surplus at such bank and/or trust company of the Reconstruction Finance Corporation, of the Federal Reserve bank, or the Federal Intermediate Credit bank, or of any other similar lending or credit corporation now or hereafter created by act of Congress; and to pledge as security therefor such assets as may meet the requirements of the lending corporation.

30.04.160. *Borrowing to reloan—Rediscounts—Penalty.*—When it shall appear to the supervisor that any bank or trust company is habitually borrowing for the purpose of reloaning, he may require such corporation to pay off such borrowed money. Nothing herein shall prevent any bank or trust company from rediscounting in good faith and indorsing any of its negotiable notes, but all such moneys borrowed and all such rediscounts shall at all times show on its books and in its reports. No certificates of deposit shall be issued for the purpose of borrowing money. No officer of any bank or trust company shall issue the note of such corporation for money borrowed or rediscount any of its notes except when authorized by resolution of its board of directors or by an authorized committee thereof. Violation of any provision of RCW 30.04.140 or 30.04.150 or of this section shall constitute a felony.

WEST VIRGINIA CODE OF 1961

§ 3194.[12]. *Borrowing by Banking Institution; Record of Collateral.*—Any banking institution organized and authorized to transact business hereunder may borrow money, rediscount any of its notes, or borrow bonds for the use of the bank, in order to maintain its legal required reserve, or meet any emergency that may arise. The books and accounts of such banking institutions shall at all times show the amount of such borrowed money, bonds or rediscounts. No officer, director or employee of any such banking institution shall issue the note of such banking institution for borrowed money, or rediscount any note or pledge any of the assets of such banking institution except when authorized by resolution of the board of directors of such banking institution: Provided, that it shall be unlawful for any such banking institution to issue its certificate of deposit for the purpose of borrowing money.

It shall be unlawful for such banking institution to pledge or hypothecate more than two dollars of the book value of any of its assets for each one dollar of borrowed money: Provided, however, that any such banking institution, when authorized by resolution of the board of directors of such banking institution, with the consent in writing of the commissioner of banking, may borrow money from and contract for loans with the Reconstruction Finance Corporation, authorized and functioning pursuant to an act of Congress of the United States of America, approved January twenty-two, one thousand nine hundred thirty-two, or any other agency authorized by an act of Congress of the United States of America, or with any person or persons, and may pledge, hypothecate, assign, rediscount and/or sell to said Reconstruction Finance Corporation, or other authorized agency of the United States, or any person or persons, any assets or securities belonging to any such banking institution in such manner or form as may be approved, and subject to any and all terms and conditions in connection with the granting thereof imposed, by such Reconstruction Finance Corporation, or other authorized agency of the United States, or other person or persons, as collateral security for the payment of any and all such loans.

An accurate record of all securities and exact copies of all notes withdrawn from the files of such banking institutions, to be pledged as collateral for borrowed money or other purposes, shall be kept in the files of such banking institution at all times.

WISCONSIN STATUTES ANNOTATED

221.33. *Assets not to be pledged as security.*—(1) No bank or bank officer shall give preference to any depositor or creditor by pledging the assets of the bank as collateral security. A state bank may deposit with the treasurer of the United States, or in the custody of federal reserve banks or branches thereof designated by the judges of the several courts of bankruptcy, so much of its assets not exceeding its capital and surplus as may be necessary under the act of congress approved June 25, 1910, and all amendments thereof, to qualify as a depository for postal savings funds, other government deposits and as depository for bankrupt estates, debtors, corporations and railroads under reorganization under U.S. bankruptcy laws, and amendments thereto, and receivers, trustees and other officers thereof appointed by any U.S. district court or by any bankruptcy court of the United States and that in acting as such depository a state bank shall have all the rights and privileges granted to banking institutions under section 61 of the U.S. bankruptcy act, and amendments thereto; and any bank may borrow money for temporary purposes, and may pledge assets of the bank not exceeding 50 per cent in excess of the amount borrowed as collateral security therefor. Any state bank so authorized by the commissioner of banks, who complies with s. 223.02 shall be exempt from furnishing the bond specified in s. 221.04(6), and shall be entitled to the same exemption as to making and filing any oath or giving any bond or security as is conferred on trust company banks by s. 223.03(8), but it is unlawful for any bank to borrow money unless the board of directors has adopted a resolution which shall be effective for a period of not to exceed 6 months, unless sooner rescinded designating the bank from which the money may be borrowed, the maximum amount for which the bank may become indebted at any one time, and the names of the officers who may sign the promissory note evidencing the indebtedness. A bank may pledge assets in an amount not to exceed 4 times the amount of its capital and surplus to the federal reserve bank

(as fiscal agent of the United States) of the federal reserve district in which it is located, except that no such pledge shall be made in excess of the amount of its capital and surplus without the consent of the commissioner of banks. Whenever it appears that a bank is borrowing habitually for the purpose of reloaning, the commissioner may require such bank to repay money so borrowed. Nothing herein contained shall prevent any bank from rediscounting in good faith and indorsing any of its negotiable notes if the same has been authorized by a recorded resolution of the board of directors.

History.—Subsec. (1) amended by L. 1963, c. 42; L. 1963, c. 130.

WYOMING STATUTES 1957

§ 13-28. *Preference to depositors or creditors prohibited; exception; rediscounting of negotiable instruments.*—No state bank or banker shall give preference to any depositor or creditor by pledging the assets of such bank as security, except that such bank or banker may qualify as depository for United States deposits, postal savings funds or other public funds, by deposit of the securities required by law and not otherwise; provided that any bank may borrow for temporary purposes, not to exceed, in the aggregate amount, the paid-in capital and surplus of such bank, and may pledge, as security therefor, assets of such bank not exceeding one and one-half times the amount borrowed; provided, also, that when it shall appear to the state examiner that any bank or banker is habitually borrowing for the purpose of reloaning, he may require such bank or banker to pay off such borrowed money. Nothing herein shall prevent any bank from rediscounting in good faith and indorsing any of its negotiable notes. It shall be unlawful for any bank to issue its certificate of deposit for the purpose of borrowing money. Any bank borrowing money for rediscounting any of its notes shall at all times show in its books and in its reports the amount of such borrowed money or rediscounts. No officer of any bank shall issue the note of such bank for money borrowed, or rediscount any note, except when authorized by resolution of the board of directors of such bank. It shall be unlawful for any state bank coming under the provisions of this chapter to sell or rediscount "without recourse" any notes or other negotiable securities on which the bank is in any way liable under purchase or guarantee agreements. And every such purchaser of any such notes or negotiable securities purchased "without recourse" shall look to the maker or guarantor thereof only for payment; provided, that any state bank that is a member of the federal reserve system may borrow money on its bills payable and may rediscount any note or negotiable instrument in such manner as required by the rules, laws, and regulations of the federal reserve banks; and, provided, further, that any state bank may be permitted to pledge more of its assets for borrowing money than herein provided, upon first securing permission and approval to do so from the state examiner.

APPENDIX B

NATIONAL BANKS[1]

[In thousands of dollars]

State	Capital	Surplus	Undivided profits	Capital notes and debentures	Capital plus 50 percent of surplus	Capital plus 50 percent of surplus less notes and debentures	Capital plus 50 percent of surplus plus 50 percent undivided profits	Capital plus 50 percent of surplus plus 50 percent undivided profits less notes and debentures
1. Alabama	15,000	15,000	7,180		22,500.0		26,090.0	
2. Arizona	24,906	48,791	14,184		49,301.5		56,393.5	
3. California	382,862	713,638	288,744	100,000	739,681.0	639,681.0	884,053.0	784,053
4. Colorado	8,500	16,500	6,031		16,750.0		19,765.5	
5. Connecticut	13,600	29,000	11,254		28,100.0		33,727.0	
6. District of Columbia	19,204	41,926	13,623		40,167.0		46,978.5	
7. Florida	9,000	13,500	6,769		15,750.0		19,134.5	
8. Georgia	12,500	27,500	8,422		26,250.0		30,461.0	
9. Hawaii	7,000	13,000	7,593		13,500.0		17,296.5	
10. Illinois	185,000	187,500	16,731		278,750.0		287,115.5	
11. Indiana	19,036	45,964	11,906		42,018.0		47,971.0	
12. Maryland	20,923	53,577	13,342		47,711.5		54,382.5	
13. Massachusetts	65,000	175,000	41,429		152,500.0		173,214.5	
14. Michigan	79,800	160,200	55,900		159,900.0		187,850.0	
15. Missouri	27,940	45,060	18,289		50,470.0		59,614.5	
16. New Jersey	33,536	59,464	23,431		63,268.0		74,983.5	
17. New York	379,293	531,986	234,140	30,000	645,286.0	615,286.0	762,356.0	732,356
18. North Carolina	24,867	50,133	9,785		49,933.5		54,826.0	
19. Ohio	78,445	152,982	30,667		154,936.0		170,269.5	
20. Oklahoma	29,415	56,585	27,782		52,207.5		66,098.5	
21. Oregon	52,613	62,387	52,071		83,806.5		109,842.0	
22. Pennsylvania	170,146	451,854	80,798		396,073.0		436,472.0	
23. Rhode Island	12,000	24,000	10,493		24,000.0		29,246.5	
24. Tennessee	21,000	34,000	9,190		38,000.0		42,595.0	
25. Texas	175,211	199,794	45,269		275,108.0		297,742.5	
26. Washington	30,000	45,000	26,588		52,500.0		65,794.0	
Total	1,896,797	3,243,341	1,071,611	130,000	3,518,467.5	3,388,467.5	4,054,273.0	3,924,273
Total, excluding New York	1,517,504	2,711,355	837,471	100,000	2,873,181.5	2,773,181.5	3,291,917.0	3,191,917

[1] Paine, Webber, Jackson and Curtis; 1964 ed., "100 Largest Banks and Other Representative Banking Institutions."

NOTE.—For 12th district banks, notes and debentures issued so far in 1964 have been included.

Appendix C

State Banks [1]

[In thousands of dollars]

State	Capital	Surplus	Undivided profits	Capital notes and debentures	Capital plus 50 percent of surplus	Capital plus 50 percent of surplus less notes and debentures	Capital plus 50 percent of surplus plus 50 percent undivided profits	Capital plus 50 percent of surplus plus 50 percent undivided profits less notes and debentures
1. California	269,028	293,890	67,137	135,000	415,973.0	280,973.0	449,541.5	314,541.5
2. Connecticut	13,945	24,000	8,941		25,945.0	25,945.0	30,415.5	30,415.5
3. Delaware	6,203	25,000	3,597		18,703.0	18,703.0	20,501.5	20,501.5
4. District of Columbia	6,600	18,400	9,146		15,800.0	15,800.0	20,373.0	20,373.0
5. Georgia	15,000	30,000	11,437		30,000	30,000	35,718.5	35,718.5
6. Illinois	188,900	280,100	45,309		328,950.0	328,950.0	351,604.5	351,604.5
7. Indiana	10,800	29,200	4,293		25,400.0	25,400.0	27,546.5	27,546.5
8. Kentucky	6,000	19,000	6,558		15,500.0	15,500.0	18,779.0	18,779.0
9. Louisiana	2,800	27,200	17,114		16,400.0	16,400.0	24,957.0	24,957.0
10. Massachusetts	46,620	85,685	31,749		89,462.5	89,462.5	105,337.0	105,337.0
11. Michigan	34 680	81,617	34,190		75,488.5	75,488.5	92,583.5	92,583.5
12. Minnesota	53,553	148,053	176,652		127,579.5	127,579.5	215,905.5	215,905.5
13. Missouri	65,688	59,314	25,005	25,000	95,345.0	70,345.0	107,847.5	82,847.5
14. North Carolina	21,351	41,750	6,408		4,226.0	42,226.0	45,430.0	45,430.0
15. New Jersey	13,012	48,988	10,755		37,506.0	37,506.0	42,883.5	42,883.5
16. New York	1,146,412	1,835,231	468,608	3,350	2,064,027.5	2,060,677.5	2,298,331.5	2,294,981.5
17. Ohio	114,616	244,450	40,192		236,841.0	236,841.0	256,937.0	256,937.0
18. Pennsylvania	62,571	137,429	42,591	15,000	131,285.5	116,285.5	152,581.0	137,581.0
19. Rhode Island	7,000	18,555	7,428		16,277.5	16,277.5	19,991.5	19,991.5
20. Tennessee	12,500	27,500	7,808		26,250.0	26,250.0	30,154.0	30,154.0
21. Texas	23,000	27,000	4,190		36,500.0	36,500.0	38,595.0	38,595.0
22. Utah	17,032	23,518	9,417		28,791.0	28,791.0	33,499.5	33,499.5
23. Virginia	12,162	17,838	6,471		21,081.0	21,081.0	24,316.5	24,316.5
24. Washington	12,000	26,000	7,469		25,000.0	25,000.0	28,734.5	28,734.5
25. Wisconsin	22,896	103,366	6,779		74,579.0	74,579.0	77,968.5	77,968.5
Total	2,184,369	3,673,084	1,059,244	178,350	4,020,911.0	3,842,561.0	4,550,533.0	4,372,183.0
Total, excluding New York	1,037,957	1,837,853	590,636	175,000	1,956,883.5	1,781,883.5	2,252,201.5	2,077,201.5

[1] Paine, Webber, Jackson, and Curtis 1964 edition "100 Largest Banks and Other Representative Banking Institutions."

NOTE.—For 12th district banks notes and debentures issued so far in 1964 have been included.

APPENDIX D

(Discount)

THE FIRST NATIONAL BANK OF BOSTON

BOSTON, MASS.

Promissory note
$1,000,000

On (date) for value received, the undersigned, The First National Bank of Boston, a national banking association, promises to pay to the order of:

----

at the head office of the undersigned, 67 Milk Street, Boston, Massachusetts 02106, the principal sum of One Million Dollars, ($1,000,000).

THE FIRST NATIONAL BANK OF BOSTON

By ——— ———,
Senior Vice President.

APPENDIX E

(Interest in arrears)

THE FIRST NATIONAL BANK OF BOSTON

BOSTON, MASS.

Promissory note
$1,000,000

On (date) for value received, the undersigned, The First National Bank of Boston, a national banking association, promises to pay to the order of:

----

at the head office of the undersigned, 67 Milk Street, Boston, Massachusetts 02106, the principal sum of One Million Dollars ($1,000,000), together with interest on such principal sum at the rate of four (4) per centum per annum from the date hereof until such principal sum shall become due.

THE FIRST NATIONAL BANK OF BOSTON

By ——— ———,
Senior Vice President.

APPENDIX F

CERTIFICATE OF DEPOSIT

The FIRST NATIONAL BANK *of* BOSTON
BOSTON 6, MASSACHUSETTS

1651

HAS RECEIVED ON DEPOSIT AND ON

WILL PAY TO $

SPECIMEN

WITH INTEREST AT THE RATE OF PER CENT PER ANNUM FOR ACTUAL DAYS ON 360 DAY BASIS UPON SURRENDER OF THIS CERTIFICATE, PROPERLY ENDORSED IF NECESSARY. NO PAYMENT BEFORE MATURITY. NO INTEREST THEREAFTER.

PAYABLE IF DESIRED AT BANKERS TRUST COMPANY, NEW YORK, N. Y.

(DATE OF ISSUE) AUTHORIZED OFFICIAL

(The letter below is in response to request of Representative Reuss during hearings. See p. 156, pt. 1.)

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM,
OFFICE OF THE CHAIRMAN,
Washington, D.C., February 4, 1966.

Hon. HENRY S. REUSS,
House of Representatives,
Washington, D.C.

DEAR MR. REUSS: During the Joint Economic Committee's hearings last month you requested comments on whether reserve requirements on time deposits are meaningless, on the desirability of raising reserve requirements on time deposits as an anti-inflationary measure; and on the desirability of a higher reserve requirement on negotiable certificates of deposit.

The Board believes that the present authority is not meaningless, and should be continued. The desirability of maintaining reserve requirements against deposits stems, in the main, from the contribution they make to effective functioning of monetary and credit policies. Abolition of reserve requirements against time deposits would widen significantly the differential between requirements on demand and time accounts. Shifts in public preferences between these two classes would, in these circumstances, complicate the task of monetary policy by tending to produce even wider fluctuations in total bank credit and bank deposits than occur under present arrangements.

This does not imply, however, that reserve requirements against time deposits should be equal to those on demand deposits. The public also readjusts its financial asset portfolios by shifting between time deposits and claims against nonbank financial intermediaries, and between time deposits and market securities. The effects of these shifts on financial market conditions, and on economic activity and prices, are minimized when reserve requirements on time deposits are relatively low.

Required reserves on time deposits also provide some liquidity to individual banks. Liquidity is needed because savings accounts are effectively payable on demand, and certificates and other time deposits are potentially volatile and display higher turnover rates than savings deposits. The automatic availability of cash through required reserves to meet deposit withdrawals amounts to a small proportion of any deposit loss, but the contribution to individual bank liquidity is not negligible. Abolition of such reserve requirements would thus increase the supervisory difficulties of bank regulatory agencies in insuring that banks maintain adequate liquidity.

Operational considerations also lead to the conclusion that reserve requirements against time deposits should be retained. Removal of these reserve requirements would require offsetting actions by the Federal Reserve to absorb the reserves released to prevent excessive expansion of bank credit, in the course of which serious adjustment problems might arise for many individual banks, since the mixture of deposits between demand and time accounts varies markedly among banks of different sizes and in different locations.

Equity considerations might seem to favor removal of reserve requirements against time deposits at member banks, since other intermediaries are not required to hold non-interest-bearing assets. You will recall that the President's Committee on Financial Institutions took the position that these inequities should be corrected by requiring (*a*) that all commercial banks be subject to the reserve requirements specified by the Federal Reserve and (*b*) that reserve requirements similar to those on time and savings deposits at commercial banks be introduced for shares at savings and loan associations and deposits at mutual savings banks.

As you know, the Board has been authorized to adjust reserve requirements on time deposits in response to developments in the economy. We do not conceive of this as a decision that can be made in the abstract, once and for all. We have had a wide variety of aspects of this problem under review and expect to continue to review possible use of this authority, along with other measures, in the light of economic conditions as they develop.

Sincerely yours,

WM. MCC. MARTIN, Jr.

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