# BANKING ACT OF 1935

EXTRACT FROM HEARINGS

BEFORE THE

## COMMITTEE ON BANKING AND CURRENCY
## HOUSE OF REPRESENTATIVES

SEVENTY-FOURTH CONGRESS

FIRST SESSION

ON

# H. R. 5357

STATEMENT OF

MARRINER S. ECCLES

GOVERNOR OF FEDERAL RESERVE BOARD

MARCH 4, 5, 6, 11, 12, 13, 14, 15, 18, 19, 20, 1935

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# BANKING ACT OF 1935

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**MONDAY, MARCH 4, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Gentlemen, we have with us this morning Governor Eccles of the Federal Reserve Board, who will discuss title II of H. R. 5357, and I think Governor Eccles would like to proceed without interruption until he shall have concluded a preliminary discussion of the bill, after which, of course, he will be glad to answer any questions and furnish any information that may be desired by members of the committee.

Governor Eccles, we shall be glad to have you proceed in your own way for such time as you desire, without being interrupted.

## STATEMENT OF GOV. MARRINER S. ECCLES, OF THE FEDERAL RESERVE BOARD

Mr. ECCLES. I am sorry that I do not feel entirely up to par today. I have been laboring under a rather heavy cold. I had thought, at first, to make a rather extended verbal statement with reference to the legislation. I decided, however, on account of the way I feel, to make a brief written statement of the general outline of the legislation. I believe this will in a general way cover the philosophy underlying section 2 of the bill.

The CHAIRMAN. Title II?

Mr. ECCLES. Title II of the bill. So that I will just proceed to read this statement, if I may.

In recommending banking legislation at this time, it is recognized that the Congress has before it an unusual number of urgent matters that are engaging its attention, and that legislation in order to deserve your consideration at this session must not only be important in general but must also be urgent at this particular time.

We are not unmindful of the fact that within the past 2 years you have passed the Emergency Banking Act, the Banking Act of 1933, the Securities Exchange Act, and other important pieces of legislation dealing with banks. One purpose of this legislation has been to meet emergency conditions, and it is now proposed to incorporate into permanent legislation the features of the emergency laws that have proved to be valuable.

Another purpose of recent banking legislation, and particularly of the banking bill of 1933 and of the portions of the Securities

Exchange Act that deal with powers of the Federal Reserve Board, has been to prevent the recurrence of speculative excesses which preceded the recent break-down of our banking machinery and were partly responsible for this collapse. These bills were largely inspired by the difficulties that came to a head in 1928 and 1929, and it is gratifying to know that we now have on our statute books measures that will go far toward preventing the recurrence of conditions such as prevailed during the speculative orgy of these years.

At the present time, however, there appears to be no immediate danger of excessive speculation. The present need is to so modify our banking law as to encourage the banking system to give a full measure of cooperation to efforts at economic recovery. It is even more important from the longer time point of view to so modify our banking structure and administration as to have it become an influence toward the moderation of fluctuations in employment, trade, and business. This would tend not only to avoid the particular evils that came to a head in 1928 and 1929, but to so regulate underlying conditions as to diminish the possibility of a speculative boom getting under way. For when speculation is once under way it is extremely difficult to control, and the only means of preventing excesses is to combat conditions that are favorable to their inception and early development.

In order to accomplish this it is necessary to improve our machinery of monetary control, which is the principal objective of title II of the proposed bill.

More specifically these objectives are to increase the ability of the banking system to promote stability of employment and business insofar as this is possible within the scope of monetary action; as a necessary step in that direction, to concentrate the authority and responsibility for the formulation of national monetary policies in a body representing the Nation; to modify the structure of the Federal Reserve System to the extent necessary for the accomplishment of these purposes, but without interfering with regional autonomy in matters of local concern; and finally to relieve the banks of the country of unnecessary restrictions that handicap them in the proper performance of their functions and thus to enable them to contribute more effectively to the acceleration of recovery.

In my opening remarks I wish to direct your attention particularly to four proposals incorporated in title II of the bill. Other provisions of the bill I wish to leave for your consideration, with the understanding that I shall be glad to answer any questions that you may wish to ask about them.

The four questions which I wish to discuss this morning are: (1) The proposal to combine the offices of chairman of the board of directors and governor of the Federal Reserve banks, and to have the appointments to this combined office subject to approval by the Federal Reserve Board (sec. 201 (1), pp. 38–41); (2) modification of the machinery for determining open-market policies of the Federal Reserve System (sec. 205, pp. 43–44); (3) transfer of the determination of eligibility requirements from the statute to the Federal Reserve Board (sec. 206, pp. 45–46); and (4) liberalization of provisions relating to real-estate loans (sec. 210, pp. 49–51).

### 1. COMBINING GOVERNORS AND CHAIRMEN

As you know, the present law provides that the Federal Reserve Board appoint 3 directors of each Federal Reserve bank and that 1 of the directors appointed by the Board be the chairman of the board of directors. It appears to have been the intention of the framers of the Federal Reserve Act that the chairman of the board of directors be the principal executive officer of each bank and the law makes him also the official representative of the Federal Reserve Board at the bank. In practice, however, it has developed that the directors appoint an executive officer for whom they have adopted the title of governor of the Federal Reserve bank, a title that is not mentioned in the law, and that these governors have become the active heads of the Federal Reserve banks.

The proposal in the bill is to recognize the existing situation by giving the governor of a Reserve bank a status in the law and to combine his office with that of the chairman of the board of directors. It is, of course, essential that the holders of these combined offices be approved by the Federal Reserve Board. The Board, you will note, will no longer appoint a chairman of the board, but will merely have the power to approve or disapprove the appointment of the governor, who will also be chairman of the board. In this proposal there is no encroachment on the autonomy of the individual Reserve banks. It merely reestablishes the original principle of the Federal Reserve Act that the Federal Reserve Board, which has responsibility for national policies and for general supervision over the Reserve banks, shall be a party to the selection of the active heads of the 12 Reserve banks. This change will work towards smoother cooperation between the Board and the banks and will establish within the banks a greater unity of administrative control than now exists. It will also result in considerable saving through the elimination of one of the two highest officers in each Federal Reserve bank.

### 2. OPEN-MARKET OPERATIONS

From the long-time point of view the recommendations dealing with changes in the machinery for determining and carrying out the open-market policies of the Federal Reserve System are essential. Open-market operations are the most important single instrument of control over the volume and the cost of credit in this country. When I say credit in this connection I mean money, because by far the largest part of money in use by the people of this country is in the form of bank credit, or bank deposits. When the Federal Reserve banks buy bills or securities in the open market, they increase the volume of the people's money and lower its cost; and when they sell in the open market, they decrease the volume of money and increase its cost. Authority over these operations, which affect the welfare of the people as a whole, must be vested in a body representing the national interest.

Under existing law open-market operations must be initiated by a committee consisting of representatives of the 12 Federal Reserve banks, that is, by persons representing primarily local interests.

They must be submitted for approval or disapproval to the Federal Reserve Board, and after they have been approved by the Federal Reserve Board, the boards of directors of the Federal Reserve banks have the power to decide whether or not they wish to participate in the operations. We have, therefore, on this vital matter a set-up by which the body which initiates the policies is not in a position to ratify them; and the body which ratifies them is not in a position to initiate them or to insist on their being carried out after they are ratified; and still a third group has the power to nullify policies that have been initiated and ratified by the other two bodies. In this matter, therefore, which requires prompt and immediate action and the responsibility for which should be centralized so as to be inescapable, the existing law requires the participation of 12 governors, 8 members of the Federal Reserve Board, and 108 directors scattered all over the country before a policy can be put into operation.

It requires no further explanation to show that the existing machinery is better adapted to delay and obstruction than it is to effective operation, and that it results in a diffusion of responsibility which prevents the necessary feeling of complete authority and responsibility by a small group of men who can be held accountable by the Congress and the Nation for the conduct of this matter that is of national importance.

The proposal in the bill is to set up a committee of 5, 3 of whom shall be members of the Federal Reserve Board and 2 governors of Federal Reserve banks. This proposal would have the advantage of creating a small committee with undivided responsibility. It is not clear, however, that this arrangement is the best that can be devised for the desired purpose. The Federal Reserve Board, which is appointed by the President and approved by the Senate for the purpose of having general responsibility for the formulation of monetary policies, would under this proposal have to delegate its principal function to a committee, on which members of the Board would have a bare majority, while governors of the banks would have 2 out of 5 members.

From the point of view of the Board the disadvantages of this arrangement are that a minority of the Board could adopt a policy that would be opposed to one favored by the majority. It would even be possible for one member of the Board by joining with the two governors to adopt a policy that would be objectionable to the seven other members of the Board.

The placing of this authority in such a committee would also have the disadvantage of giving one important power, the power of open-market operations, to the open-market committee, while other fundamental powers are vested in the Board. These powers could be utilized to nullify the actions of the open-market committee. For example, the committee might adopt a policy of easing credit, while the Federal Reserve Board would be in a position to tighten credit, either by raising discount and bill rates or by increasing member-bank reserve requirements. Also the Board, through its power of prescribing regulations for open-market operations, could conceivably interfere with the carrying out of the policies of the committee. While it is not contemplated that such extreme situations would occur, it does not seem desirable to amend the law in a manner that might result in such unreasonable developments.

Upon further study it would appear that the best way in which to handle this proposal would be to place the responsibility for open-market operations in the Federal Reserve Board as a whole and to provide for a committee of five governors of Federal Reserve banks to advise with the Board in this matter. The Board should be required to obtain the views of this committee of governors before adopting a policy for open-market operations, discount rates, or changes in reserve requirements.

Such an arrangement would result in the power to initiate open-market operations by either a committee of the governors or by the Board, but would place the ultimate responsibility upon the Federal Reserve Board, which is created for that purpose. In this connection I should like to quote President Woodrow Wilson, who in his address to the joint session of Congress on June 23, 1913, said:

> The control of the system of banking and of issue * * * must be vested in the Government itself, so that the banks may be the instruments, not the masters, of business and of individual enterprise and initiative.

3. ELIGIBILITY OF PAPER

It is proposed to give the Federal Reserve Board authority by regulation to determine the character of paper that may be eligible as a basis of borrowing at the Federal Reserve banks. This is particularly important at this time because it would encourage member banks to pay less attention to the form and maturity of paper that is offered by would-be borrowers and to concentrate their attention on the soundness of such paper. At present many banks are unwilling to extend loans to borrowers who have assets that are unquestionably sound because they lack the assurance that in case of a withdrawal of deposits they would be able to liquefy these assets at the Federal Reserve banks.

In times of emergency it has been necessary to remove existing restrictions and to give discretion in the matter to the Federal Reserve authorities, as was done under the Glass-Steagall Act of 1932. This act, however, was passed after a great many banks had gone to the wall at least partly because of lack of eligible paper and its provisions insofar as they relate to borrowing from the Reserve banks, have now expired. I think they expired yesterday.

What is proposed is not, as has been sometimes alleged, a policy of opening the doors of the Federal Reserve banks to all kinds of paper, regardless of its soundness. On the contrary, it is proposed to place emphasis on soundness rather than on the technical form of the paper that is presented.

Experience under emergency laws shows that the Federal Reserve banks and the Federal Reserve Board have exercised caution and, though they have extended credit on ineligible assets to the extent of $300,000,000, all but $1,500,000 of this has been paid back and the banks have suffered no considerable losses. It would appear safe, therefore, to intrust discretion in the matter to the Federal Reserve Board, which is always in session and, therefore, in a position to consider emergencies promptly without being under the necessity of proclaiming them by an appeal to Congress and thereby aggravating the situation, and being obliged to wait for Congress to be in session and to act on the matter.

Another phase of this problem is that the total volume of paper eligible for discount held by member banks at the present time is only about $2,000,000,000, or less than 8 percent of the resources of the banks, and even in 1929 it was only about $4,000,000,000, or a little more than 12 percent. While this amount is sufficient in the aggregate to provide access to the Federal Reserve banks, there were many individual banks that did not possess sufficient eligible paper. Even more important than that, is the fact that in a period of timidity the banks tend to refrain from making loans, except on paper eligible for discount at Federal Reserve banks. This is even now a factor causing liquidation in many communities and preventing adequate expansion of credit in others.

A bank that would conduct its business on the theory of having only such assets as can be disposed of at will in times of crisis, when the national income has been cut in two, cannot serve its community adequately. Such a bank would confine its operations to the purchase of the most liquid open-market paper, with the consequence that it would neglect its local responsibilities and would nevertheless find it difficult to earn enough from the low returns on such paper to cover expenses and dividends. The banks should be in a position to meet the needs of their communities for all kinds of accommodation, both short and long term, so long as the credits are sound, and they ought to have the assurance that all sound assets can be liquefied at the Federal Reserve bank in case of an emergency.

### 4. REAL-ESTATE LOANS

Closely allied to this matter of eligibility is the proposal that the limitations on real-estate loans be modified so as to permit member banks better to supply the needs of their communities for mortgage loans. This proposal does not introduce a new character of loan, it merely relaxes existing limitations on real-estate loans which national banks have made for 20 years. What the bill proposes is to modify the requirements so as to make them more realistic and to enable the member banks better to serve their communities. Coupled with the provisions in regard to eligibility, these proposals ought to result in greater willingness of member banks to lend on real estate and, therefore, to an improvement in the mortgage market and a stimulation of construction which is essential to business recovery.

Member banks hold about $10,000,000,000 of the people's savings, and it is therefore proper and necessary that they invest a part of their funds in long-time undertakings. The separation of commercial banking from savings banking may be theoretically desirable, but it cannot be accomplished in this country without disrupting existing machinery, while the need for increased activity in building is urgent. Member banks are suffering from the competition of many Government and other agencies that are entering the field of real-estate loans, and it is a matter of self-preservation for the banks to be able to hold and expand their activities in this field.

The details of the bill as proposed may have to be modified. The problem is a difficult one because the laying down of specific percentages of value presents many perplexities. In some regions, and at some times, a 75-percent loan on real estate is conservative. while at other times a 50-percent loan may be too liberal. It may be best in this matter, as in others, to vest discretion in the Federal Reserve Board to prescribe such rules and regulations about real-estate loans as in its judgment would operate most effectively in the public interest.

OTHER PROPOSALS IN TITLE II

Other sections of title II of the bill which I have not discussed may be briefly enumerated: Provision that directors of the Federal Reserve banks shall not serve for more than 6 consecutive years. This would prevent crystallization of any one interest in the management of a Reserve bank. A change in the qualifications of members of the Federal Reserve Board to make these qualifications more descriptive of the functions of the Board. An increase in salary of future appointive members of the Board and provision for pensions. Grant of power to the Board to assign specific duties so as to be relieved of detail. Placing of obligations guaranteed by the United States Government on the same basis as direct obligations of the Government. Repeal of collateral requirements against Federal Reserve notes. These requirements serve no useful purpose and have been sources of serious trouble at critical times. Clarification of the authority of the Board to raise or lower reserve requirements—the bill as introduced authorizes changes in reserve requirements for different districts or classes of cities. It might be modified by eliminating changes by districts and classifying cities into two groups—(1) Reserve and Central Reserve cities and (2) other cities. Authority for the Federal Reserve Board to waive capital requirements for admission of insured banks into the system prior to July 1, 1937, when all banks, in order to be insured, must be members of the Federal Reserve System. This might be broadened so as to authorize the Board to waive not only capital but all requirements and to permit existing banks to continue permanently with their present capital, provided it is adequate in relation to their liabilities.

TECHNICAL PROVISIONS

Title III of the bill contains a number of sections proposed by the Comptroller of the Currency and by the Federal Deposit Insurance Corporation. Sections in which the Federal Reserve Board is interested are in the nature of technical improvements of a noncontroversial nature of the same general character as those contained in the so-called "omnibus banking bill" which was reported favorably by the Banking and Currency Committees of both Houses of Congress in June 1934, but failed of enactment in the closing days of the Seventy-third Congress.

For example, a provision that a holding-company affiliate, which is a holding company by accident and is not engaged in the business of holding bank stock, shall be exempted from the requirement of obtaining a voting permit. Another example is the provision that member banks for the purpose of calculating reserve requirements shall be allowed to deduct from gross deposits the amounts that are due them from other banks rather than be allowed to deduct these amounts only from the deposits they hold for other banks. The existing provision has resulted in injustice to country banks, which hold no deposits for other banks, and are, therefore, unable to get the benefit of the deduction which city banks can make. There is also a proposal intended to simplify the provisions of the Clayton Antitrust Act in regard to interlocking bank directorates and to facilitate the administration of these provisions by the Federal Reserve Board.

Provisions in title III, as well as in title II, are still being studied and improvements and modifications in technique and in phraseology are being developed. I shall, therefore, appreciate an opportunity to submit to the committee for its consideration a number of amendments to the bill before final action is taken. It would also be helpful if the committee would permit the Board's counsel to cooperate with the committee's counsel in the final perfecting of the phraseology of the bill.

Thank you.

The CHAIRMAN. Gentlemen, in view of the physical difficulties under which Governor Eccles is laboring this morning, I have assured him that we would excuse him, when he had finished his general statement. Governor Eccles, if you desire that we do so, we shall be glad to let you go on tomorrow morning, and the committee will meet at 10:30 o'clock.

(Whereupon the committee adjourned until 10:30 a. m., Tuesday, Mar. 5, 1935.)

# BANKING ACT OF 1935

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**FRIDAY, MARCH 5, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Gentlemen, we will come to order. Governor Eccles, the committee will be glad to have you resume your discussion of title II of the bill. You may proceed as far as you desire without interruption.

## STATEMENT OF HON. MARRINER S. ECCLES, GOVERNOR, FEDERAL RESERVE BOARD—Resumed

Mr. ECCLES. I made a general statement yesterday, and it occurred to me that it might be helpful to the members of the committee if I discussed, more or less informally and possibly in more detail, some of the features of the bill.

It is proposed to combine the office of the chairman of the board of directors and the Governor of the Federal Reserve bank. At the present time each of the 12 Reserve banks has 9 directors. Six of those directors are elected by the stockholders of the banks, that is, the member banks; three of them are appointed by the Federal Reserve Board.

These directors are appointed for 3-year terms. Of the 6 directors appointed or elected by the member banks, 3 are bankers, known as "class A" directors; 3 must be selected from commerce, agriculture, or industry, and are known as "class B" directors. One of the three directors appointed by the Federal Reserve Board, known as "class C" directors, is selected or appointed as chairman of the board of directors of each Federal Reserve bank. He is also the Federal Reserve agent. He is a full-time, highly paid official; and originally it was conceived that he would be the executive head of each Federal Reserve bank.

The governors of the Federal Reserve banks are not mentioned in the Federal Reserve Act. The act provides that the directors of the bank shall select such officers and employees as are necessary to conduct the affairs of the bank.

The title of "governor" was given by the nine directors to the person selected by them as the operating head of the bank. In practice, the position of the governor has become an outstanding and important position, and in nearly every instance he has become the head of the bank. He is not a director of the bank; he is elected by the board of directors; the nine members of the board of directors.

The Federal Reserve Board has no legal relationship with the governor of the bank, has no responsibility in his selection except that it passes on his salary. Its official relationship with the bank is through the chairman and Federal Reserve agent, whom the law designates as the Board's official representative at the Federal Reserve bank.

It is proposed, in this legislation, as a matter of efficiency, coordination, and good organization, to do away with this dual relationship and to combine the office of governor with that of chairman, making the governor and the chairman a class C director. The board of directors of each Federal Reserve bank will select the governor and the chairman; but this selection must be subject to the approval of the Federal Reserve Board.

You will observe that the Federal Reserve Board will not have the power of appointment of the chairman, which will be given to the local board and combined with the office of governor; the appointment will be subject to the approval of the Federal Reserve Board.

This will make for better coordination and economy, will do away with the possibility of cleavage, by reason of the dual organization of the chairman, appointed by the Board in Washington, and the governor, selected by the local board.

Although the directors of the banks are appointed for a period of 3 years only, in practice many of the directors have served since the beginning of the Federal Reserve System. It is thought advisable to limit the term of office of all of the directors to two consecutive terms, totaling a period of 6 years. This is proposed to avoid the crystallization of control or authority in any one group or combination.

It is felt that, in each Federal Reserve district, there are many able men to represent the bank members and also commerce and industry, as well as the Board at Washington, which appoints the three class C directors; and that the public nature of the Reserve System is such that it would be to the interest of the System to have a limit upon the terms of the directors.

It is recognized that there may be a loss of some very able men as the result of this restriction, but it is believed that there will be more gained as a result of this policy than will be lost.

It is interesting to note that two, and I believe three, of the Federal Reserve banks have adopted the policy, without it being prescribed by law, of limiting the terms of their class A and class B directors, that is, the directors elected by the member banks, to 3 years. The New York bank and the Dallas bank, and I think the Atlanta bank, rotate the offices of their class A and B directors. They find this in the interest of harmony among their member banks; and it is felt that, if it is in the public interest to do that in the case of those banks, it would be well to do it in the case of all banks and to place the limitation to 6 years in the law.

Since this proposal was made, there has been considerable discussion, and I find that, almost universally, it is looked upon with a great deal of favor by the banks throughout the country. I find that there is considerable feeling among many of them that there has been a certain amount of crystallization of control in small groups.

I met with a group of bankers on Friday, and without exception, they were all very favorable to that restriction.

Admission of insured nonmember banks: I am discussing this briefly, in the order in which the proposals appear in the bill—the admission of insured nonmember banks is in section 202. It is recognized that many of the nonmember banks could not readily qualify as members of the Reserve System, and that a very great hardship and injustice would be imposed upon them, if they were required to become members of the Federal Reserve System under the present legislation, and under the rules and regulations for membership. It is, therefore, proposed that the Federal Reserve Board should have authority to waive the capital requirements.

I suggested yesterday, in connection with this particular feature of the bill, that the authority for the Federal Reserve Board to waive the capital requirements for admission of insured banks into the System, prior to July 1, 1937, when State banks are required to be members of the Reserve System in order to be insured, might be broadened, so as to authorize the Board to waive not only the capital requirements, but all requirements, and to permit existing banks to continue permanently with their present capital, provided it is adequate in relation to their liabilities.

I think it is desirable to have unification of the banking system, and I recognize that possibly the most likely way of getting it is through all banks becoming members of the Federal Reserve System.

In many instances, the capital of nonmember banks, is less than the minimum amount required—$50,000, and their volume of business is such that they do not require and cannot possibly use and support a capital of $50,000 with an adequate surplus, which is also desirable.

It is also recognized that certain of the rules and regulations for membership would make it very difficult for many banks to qualify under those rules and regulations; and it is, therefore, the desire of the Federal Reserve Board to so modify the law and its rules and regulations as to make it possible, under reasonable conditions, for nonmember banks to get the benefits of membership. I believe those benefits are very real. Particularly would that be true if the present law is amended in some of the particulars as provided for in the proposed bill. I refer to the change in the present eligibility features; also the recognition of the desirability of using the savings and time funds in longer term lending, or in the real estate loan field. These provisions would give to many of the nonmember State banks the support that otherwise would not be available to them, if it were possible for them to continue to operate as nonmember banks.

In section 203, it is recognized that it would be desirable to change the present language with reference to the qualifications for membership on the Board, as a recognition of the fact that the functions and duties of the Federal Reserve Board are such as to make it a body representing the Nation, rather than any group or combination of groups. In recognition of that, it is provided in the bill that future appointive members of the Board shall be men who are qualified by education or experience or both to participate in the formulation of economic and monetary policies, which seems to me to be the central and most important function of the Federal Reserve Board.

It is recognized that membership on the Federal Reserve Board is one of the most important, responsible, and powerful positions of the Nation. It is, therefore, believed that the position should attract, by reason of its importance and responsibility, the best qualified men in the Nation to deal with these monetary and economic problems. It is felt that the men on the Board should be independent and, therefore, it is recognized that their compensation should be such as to enable them, without having to have an independent, private income, to live in Washington in the manner that their position would require. It is proposed that the compensation for future appointive members be increased to $15,000 per year, the salary now received by members of the Cabinet. Their salary was originally equal to that of Cabinet members, but later the Cabinet salaries were increased. The proposal is to reestablish this equality. It is also proposed that there be a pension or retirement provision, so that members of the Board who have severed their outside connections and serve in this position, will not feel a dependency that otherwise they may feel.

I do not believe the pension provision in the bill fully and adequately meets the situation. It provides that any of the present members may retire at the age of 70, and that future appointive members must retire at the age of 70. It also provides that, upon retirement, they will receive a pension of $12,000 per year, when they have served the full period of 12 years, or more, and a proportionate amount when they have served not less than 5 years. It would seem to me that, in order to attract the ablest men obtainable for this position, to make them willing to accept positions on this Board as careers, and to sever all other connections, a pension should be provided for future appointive members, irrespective of the age at which their terms may expire.

It seems to me that this would have the effect of inducing these men to accept positions of this sort during the most active and remunerative period of their lives; otherwise, they might not be willing to accept.

It does not seem fair to ask a person, of the caliber that Board members should be, to accept a position and serve for a 12-year term—we will say from the ages of 48 to 60—and at the end of the period of 12 years, if not reappointed, to be obliged to go out and undertake to reestablish connections, which were severed and neglected for a period of 12 years.

It would seem to me that, in the public interest, it would be well to provide that, if a member is not reappointed, he would receive the full pension, if he has served a full term or longer; but if he is offered a reappointment and prefers not to serve, of course he should not be given a pension. I believe that would make for greater independence on the part of the members of the Board.

As to the term of the office of Governor of the Board: There has been a good deal said about the provision in the proposed legislation that the term of the Governor as a member of the Board shall expire when he is no longer designated as the Governor by the President.

The present law provides that the Governor shall be designated by the President to serve at his pleasure, the designation being from among the Federal Reserve Board members. As a practical matter, when the Governor is no longer designated as Governor by the President, it is because the President is desirous of having someone else serve as Governor.

Mr. GOLDSBOROUGH. As I understand it, you approve of that provision?

Mr. ECCLES. What is that?

Mr. GOLDSBOROUGH. You approve the provision allowing the President to remove the Governor, whenever he sees fit?

Mr. ECCLES. Well, I have no objection to it. I think that, as a practical matter, it is reasonable. In some of the other central banks there are similar provisions with reference to the executive heads of the banks.

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

Does that answer your question, Mr. Goldsborough?

Mr. GOLDSBOROUGH. Yes; from your standpoint, I think it does.

Mr. ECCLES. Referring again to the term of office——

The CHAIRMAN. Suppose you let me ask a question right there: Is not the practical situation such that the administration has that power and may exercise it, but under this bill there will be a technical recognition of that power and a definite fixing of responsibility, at least within limitations?

Mr. ECCLES. Well, the only change—I do not think it will be material, but the only change in this bill over the present legislation is that when the Governor is no longer designated as Governor by the President, his term as a member of the Board will expire, whereas, at the present, when he is no longer designated as Governor, his term as a member does not expire. This means that if he is no longer designated as Governor and he does not resign as a member, there will be no vacancy on the Board to which the President could appoint the person he desires to designate as Governor, unless he designates an existing member of the Board. There is this disadvantage under the existing law: When a member is no longer designated as Governor and resigns as a member—which is the only thing that a Governor could do, and a person who would not do that would certainly not be a proper person to act as Governor—he is precluded for a period of 2 years from entering the banking field. That is a deterrent in the present law to a man accepting that office. If he is taken from the banking field, he is required to sever all connections with the banking business for an indefinite time, that is, for as long as he is designated as Governor, and that may be for 2 or 3 or 4 years. When he is no longer designated as Governor, he resigns as a member; and, if he has not served out his term as a member, he is precluded for 2 years afterward from entering the banking field again.

If he has served out his term as member, he may immediately enter the private field.

Now, what I should like to propose here is that the Governor's term as a member do not expire when he is no longer designated as Governor; that is, leave the law as it is with reference to his term as a member, but provide that, if he chooses to resign as a member when he is no longer designated as Governor, his term as a member be considered to have been fulfilled.

Mr. HOLLISTER. That is not what this new statute says, is it?

Mr. ECCLES. No; I am offering this as a suggested change: Whereas the bill provides that he shall automatically cease to be a member of the Board when he is no longer designated as Governor, I am suggesting that it be changed so as to provide that, if he does not choose to continue to serve as a member when he is no longer designated as Governor, he would be free to enter the banking field, without taking a 2-year vacation.

Mr. GOLDSBOROUGH. Your view is that they should resign voluntarily, and the 2-year application should apply; but if they are removed as Governor and they see fit——

Mr. ECCLES. It should not apply.

Mr. GOLDSBOROUGH. It should not apply?

Mr. ECCLES. That is right.

Mr. GOLDSBOROUGH. That seems to me to be sound.

Mr. ECCLES. It seems to be fair and will remove a deterrent; and it seems to me that it will accomplish the object of making it a more attractive position in the future than it has been in the past.

Mr. HOLLISTER. Would it not also attract something else, or accomplish something else? This is drafted to give the President the opportunity, if he cares to do so, to make a clean sweep, to completely clean up the whole Federal Reserve Board in a few days, does it not?

Mr. ECCLES. Well, of course, I think that if we are going to conceive of a President that would resort to what would be considered sharp practice, he would possibly have more direct ways of cleaning it up than that. I think a President that would resort to that sort of thing would possibly have other ways of meeting the situation.

Mr. HOLLISTER. Presidents have in the past, unfortunately, done things that some of us would not back up; but, as a matter of fact, as the bill is drafted, it permits the President, if he cares to, to remove successively every member of the Federal Reserve Board, appoint him as Governor, and undesignate him; whereupon, he immediately retires from the Board?

Mr. ECCLES. Yes; that is correct.

Mr. HOLLISTER. So the suggestion you make would at least eliminate the possibility of that happening, when we had a man in the White House that might adopt such sharp practices?

Mr. ECCLES. Yes.

Mr. CROSS. Mr. Chairman, may I make a suggestion as a member of the committee?

The CHAIRMAN. Certainly.

Mr. CROSS. I would like to make this suggestion: That Mr. Eccles be permitted to go ahead and finish his statement; and then that he submit the amendments that he would suggest; and then when he gets through with his statement, just as Mr. Goldsborough suggested the other day, each member of the committee be given a chance to ask questions, because every member has many questions, or a number of questions, on this section that they would like to ask. I am afraid that, if we start like this, we will never finish or get anywhere. That is my suggestion.

The CHAIRMAN. Well, I certainly expect that every member of the committee will have the opportunity you refer to, and I will recognize members in an orderly way, so that every member will be allowed to ask questions.

Mr. CROSS. The point is, we will not have a coordinated idea of this by going in and out, and I think it is much better to let him finish, and then later on let him bring his proposed amendments to the bill, and then we can take up those amendments and let him discuss those amendments in a much more uniform way, and every member will get a grasp of the bill. That seems to me to be the best way to proceed.

The CHAIRMAN. All right, Mr. Eccles, you may proceed.

Mr. ECCLES. Assignment of duties: There is no controversy over that question. It is just a practical way of enabling the Board to meet the problems of increased responsibility that are placed upon them by delegating to others many of the routine duties, so long as they do not involve questions of policy.

Open-market operations: Inasmuch as this was covered quite fully in my statement yesterday, I do not believe that I can add very much to it. There will likely be a good many questions that will develop in connection with that, because, under that heading, the whole question of monetary control heads up.

I explained yesterday the way the open-market operation is now organized, the manner in which the bill provides for it to be operated, and the amendments suggested to the proposals in the bill.

Eligibility for discount: The eligibility requirements of the present law do not seem to me to meet the changed conditions that we now have in the Nation, compared with the conditions that existed at the time the Federal Reserve was established. The amount of eligible paper available now held by banks is a very small part of the total resources of the banks. Even in 1929 it was only slightly over 12 percent of their loans and investments, and today I understand it is less than 8 percent. Approximately $2,000,000,000 is the total amount of the paper which would be considered eligible by the banks themselves. It was found, when the depression commenced and as it continued, that the banks did not have eligible paper to meet their shrinking deposits, brought about by the general liquidation of bank loans and by hoarding; and that, in order to avoid closing they were forced to sell such bonds as they had upon the market. These bonds were considered, at one time, to be secondary reserves, because they were listed. Banks also brought pressure upon all loans which came due during the period, and were forced to refuse new credit, feeling, of course, that they had to have as large cash reserves as possible and be as liquid as possible. They were bringing pressure to collect loans that came due, and to sell the securities that they had, wherever they could do so without taking too large a loss. That attitude on the part of the banks throughout the Nation was largely due, it seems to me, to the fact that they did not have eligible paper in sufficient quantities to meet the demand and could not get help at the Federal Reserve banks unless the paper was eligible.

Therefore, in an effort and under pressure to get liquidity, they froze themselves so completely that they finally closed the entire banking structure. So it was found out that, in the final analysis, in a depression, there is no liquidity, except that liquidity which can be created by the Federal Reserve or the central bank through its power of issue.

This was finally recognized when great damage had been done, when thousands of banks had been closed unnecessarily, when millions of individuals and institutions had been forced to the wall through the lack of available credit, or through pressure to pay existing debts. Millions of depositors lost hundreds of millions of dollars as the result of those closings.

We finally recognized that we did not have to have eligible paper and we did not have to back our currency with gold or eligible paper or even with Government bonds. We finally recognized that, in order to get the banks open, we could take any sound asset into the Reserve bank and issue Federal Reserve bank notes. When that happened nobody wanted their money, the runs stopped, and liquidation stopped to a very great extent. Certainly, the pressure was very greatly relieved.

Now it seems to me that it is only being a realist to recognize that the Reserve banks, subject to rules and regulations made by the Reserve Board, should have the power to meet emergencies, should have the power to loan to member banks upon sound assets, rather than see the banks close, or rather than see unnecessarily drastic liquidation forced upon the community.

This provision does not mean inflation. Before the banks today, as a whole, would have any occasion to use the Reserve System, they would have to extend billions and billions and billions of dollars of credit, because of the excess reserve position that they now occupy. But, if the provision is there, it will make the banks feel altogether different about extending credit today. It will make them recognize that they do not have to have 90-day or 6-month paper in order to make loans, when that type of demand for credit does not exist to more than a very limited extent.

This, to my mind, is one of the most important features of the legislation at the present time. It will tend to do more toward inducing recovery through credit expansion than any other feature of the bill. The banking system must be made, to provide the money and credit required, if it is going to justify its existence. At the present time, that is largely provided by the Government. The banking system, the commercial banking system——

Mr. GOLDSBOROUGH. You say it is being provided by the Government?

Mr. ECCLES. To a very large extent.

Mr. GOLDSBOROUGH. We were under the impression that the Government borrowed the money that it is now providing, from the banks; is that not correct?

Mr. ECCLES. That is very true. The banks are willing to extend credit on Government bonds.

Mr. GOLDSBOROUGH. We have provided the banks with $13,000,000,000, about, have we not?

Mr. ECCLES. Well, I do not know the exact amount, but——

Mr. GOLDSBOROUGH. That is an approximation.

Mr. ECCLES. But whatever amount of Government bonds the banks have purchased—it is not $13,000,000,000, but, including what the Federal Reserve System has, I think it is nearly $13,000,000,000—the Government is doing the lending through the various Government lending agencies, such as the Home Owners' Loan Corporation, the Farm Credit Administration, and the Reconstruction Finance Corporation. Those are the three most important agencies and, of course, we know they have put out billions and billions of dollars, and the banks have largely taken Government bonds and bonds guaranteed by the Government, and the Government, in substitution, has taken the loans of the individual and the corporations. So that it has been a process of the banks liquidating their private loans, and the Government taking them over, and the banks providing the funds to take Government bonds or bonds guaranteed by the Government. And, of course, if continued, it seems to me that the banks are going to have very great difficulty in justifying their existence.

Mr. GOLDSBOROUGH. When they can only live by the Government furnishing nearly one billion dollars a year in interest, which they do not earn, it seems to me your statement is worthy of very serious consideration.

Mr. ECCLES. I recognize that, and I have also told many of the banks that the provisions of this legislation with reference to this eligibility feature, and with reference to this real-estate loan feature, are to give them an opportunity to utilize their funds in the direct field of lending and get the Government out. Otherwise they will find that the Government will have taken over the banking business, not because the Government wanted to, but because the banks forced it to.

Purchase of United States guaranteed obligations: It is provided that obligations guaranteed by the United States Government should be put on the same basis as direct obligations. There seems to me to be no justification for discrimination; that they should be eligible for purchase by the Reserve banks without regard to their maturity, in the same manner that direct obligations of the Government are eligible for purchase by the Federal Reserve banks.

Collateral for Federal Reserve notes: It is provided that the position of Federal Reserve agent as such shall be eliminated and that the position of chairman of the Federal Reserve bank shall be combined with that of the governor. The Federal Reserve agent acts as a trustee, holding the collateral against which Federal Reserve notes are issued, at least 40 percent in gold certificates and the balance in eligible paper or Government bonds, or both. It was thought, originally, that the amount of currency outstanding at any time was influenced or regulated by the amount of commercial paper, which represents the activity or the volume of trade or business. It has been found that there is very little relationship between the volume of Federal Reserve notes and the volume of commercial borrowing. Of course, that is due to the fact that currency, as such, plays so small a part in our money system and that bank credit or deposit currency plays a major role. The amount of currency or Federal Reserve notes outstanding will depend upon the demand for currency by member banks. The member banks discount or borrow from the Reserve banks in order to maintain their required reserve balances with the Reserve banks. Member banks draw currency to meet the demands of their customers. It is not felt that the collateral put up back of the Reserve notes in any way restricts the use of currency. It is not felt that collateral adds anything to their security. They are now guaranteed by the United States Government; they are a first lien on all the assets of the Reserve banks. Whenever notes are issued or deposits created by the Reserve banks, there are assets to offset the liabilities of the Reserve banks, whether the liabilities consist of notes or of deposits of their member banks.

There would seem to be no more reason to secure notes which they issue than to secure deposit liabilities to their member banks. The Reserve banks are required to hold gold certificates equal to not less than 40 percent of their notes outstanding, and gold certificates or lawful money of not less than 35 percent of their deposit liability and——

Mr. WOLCOTT. Gold certificates?

Mr. ECCLES. Well, of course, they have no gold. There is no proposal to change that. The assets of the banks, on the other side, consist of gold certificates and other money that they may hold, and Government bonds and bills or rediscounts.

Mr. HANCOCK. Could you properly call those notes "asset currency"?

Mr. ECCLES. What is that?

Mr. HANCOCK. Could you properly call those notes "asset currency"?

Mr. ECCLES. I do not just understand what you mean.

Mr. HANCOCK. I do not want to begin questioning you, but right on that point you made the statement that it was not necessary that notes have any particular banking value.

Mr. ECCLES. Yes.

Mr. HANCOCK. In that they constitute a lien against all of the assets of the banks.

Mr. ECCLES. That is right.

Mr. HANCOCK. Now, would you consider such notes as asset currency?

Mr. ECCLES. Well, they are the obligations of the banks that issue them and are guaranteed by the United States Government. They are not asset currency, in that they are not backed specifically by this or that particular asset or assets, except to the extent that there is at least 40 percent of gold certificates held, and there would be other certificates back of them. The liabilities of the bank would be offset by its assets. So, to that extent, there are assets in the form of gold certificates, Government bonds, or loans and discounts, back of all the notes issued, just as there are back of all of the deposits of the bank. The value back of the Federal Reserve notes is determined by the assets of the Reserve banks. In 1932 it was found impractical to restrict the issue of these notes as they were restricted, when gold was leaving the country very rapidly and when the banks held very limited amounts of commercial paper. The requirements of the law had to be suspended in 1932, and Government bonds had to be accepted as substitutes for commercial paper as the basis for issuing notes, in order to release the excess amount of gold that had to be held in the absence of commercial paper. So it was found that the restriction imposed at the time, and the only time when the provisions of the law were tested at all, they had to be suspended.

The CHAIRMAN. It might be well to remember definitely the date of that action.

Mr. ECCLES. Well, you probably remember it. It was in 1932, February 27, 1932.

Reserve requirements: The Federal Reserve Act, as amended by the act of May 12, 1933, provides that, with the consent of the President, when an emergency is declared to exist, the Federal Reserve Board has power to change the reserve requirements of member banks. It is proposed to recognize this emergency provision as a permanent provision and to give to the Board the power to change reserve requirements, without declaring that an emergency exists and without the approval of the President. This is a function of monetary control almost equal in importance to open-market operations, and it is felt to be necessary that the Board have this power, particularly in order to control an inflationary condition, should one develop.

It is conceivable that the reserves of the member banks may be greatly in excess of the amount of Government bonds and paper held by the Reserve banks. The sale of those securities in the market would not be sufficient to absorb the excess reserves: and therefore, the increase of reserve requirements would come into use as a means of controlling an inflation of credit. It would be expected to be used only as a method secondary to open-market operations. Changes in reserve requirements would be used at a time when open-market operations failed to meet the situation.

Mr. CROSS. I might suggest that I remember the conditions that existed in the world, the speculation on the stock exchange; do you think it would be wise to have a provision so that you could designate certain particular banks, where they had increased their reserve, rather than apply to all banks, everywhere, at any time?

Mr. ECCLES. I do not believe so. I think money is too much like water; it seeks a place where it can——

Mr. FORD. Seeks it own level?

Mr. ECCLES. Yes; it seeks a level, and of course that level is based upon the return it can get.

We have proposed here that changes in reserve requirements might be a pplied to two classes of cities: Central reserve and reserve cities in one class and country banking areas in the other. It is conceivable that different reserve requirements could be applied to the reserve cities, if that is where speculation was going on and where the excess of reserve was, which is usually the case. There is an element of time in money seeking its level. Just what it is, I do not know that anybody can say. But increases in reserves might be applied first to the reserve cities and then later to the other areas, if it seems to be necessary, rather than to apply them at the same time universally. I do not believe that you could consider it beyond that. I do not believe it would be practicable to apply it to individual banks. The Federal Reserve Board has the power now to regulate margin requirements on collateral and brokers' loans, which is one of the most effective instruments of speculation control, I think, now available. I believe that, had it been available in 1928 and 1929, it would have possibly been helpful in controlling or restricting the speculative orgy that we went through.

The CHAIRMAN. Governor Eccles, the House has been in session for a little while, and there are matters that require the attendance of Members, and I am sure you will be glad to desist until tomorrow, anyway. We will adjourn until 10.30 o'clock tomorrow morning, and we expect to have the pleasure of having you back again with us.

(Whereupon the committee recessed until 10.30 a. m., tomorrow, Wednesday, March 6, 1935.)

# BANKING ACT OF 1935

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House of Representatives,
Committee on Banking and Currency,
*Washington, D. C., Wednesday, March 6, 1935.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. Gentlemen, we will come to order. Some of us have to appear before the Committee on Rules this morning, and I have to leave in a few minutes. I am going to suggest that, unless Governor Eccles decides to proceed further without interruption, that the committee will now proceed to discuss with him title II of the bill. If you desire further time without interruption, we shall be glad for you to have it. We do not want to hurry you in the least. It is our desire to permit you to have ample time to express your views, in your own way, fully, after which the committee, of course, will desire to interrogate you.

Mr. Eccles. I have finished my principal statement.

Mr. Kopplemann. May I ask a question?

The Chairman. Certainly.

Mr. Kopplemann. There may be some questions that I want to ask on title II, but I am not prepared to do that today. I suppose that Governor Eccles will be here tomorrow?

The Chairman. Yes; you will have ample opportunity to do that. I am taking it for granted, of course, that that will be done, if it is necessary to meet your convenience.

Mr. Eccles. I finished the discussion yesterday of the proposals, with the exception of the one relative to the real-estate loans.

The Chairman. The committee will be glad to hear you further on that provision, or any other, without interruption, if you so desire.

Mr. Eccles. I finished them all with the exception of that yesterday, and it seems to me to be one of the important issues, and it might save time to say something about that.

The proposal is to amend the act to permit the national banks, as well as other member banks, to make first-mortgage loans on improved real estate for a period up to 20 years; that is, if the loans are amortized so that they would be paid off over that period of time; to reduce the period from 5 years to 3 years in cases where the loans are not amortized, and to increase the amount that they can loan from 50 to 60 percent of the value of the real estate.

It is also proposed to increase the amount, the total amount of bank funds that can be loaned, from 50 percent of time funds of a bank up to 60 percent, including in the amount loaned, however, other real estate excepting the banking houses.

You recall that I suggested yesterday that the proposed bill be amended, if we think it advisable to amend it, so as to give the Federal Reserve Board the power to determine the conditions of real-estate loans by regulation, the reason for this being that to try to put into the statute a limitation of 60 percent of the amount of savings will work a very great hardship on many State banks. We find that some of the State member banks and many of the State nonmember banks already have in excess of 60 percent of their time funds in real-estate loans. It would seem. therefore, that they would be required to cease making real-estate loans and to liquidate the loans they had as they fell due.

Also, it seems that to try to fix in a bill or in a statute a provision permitting 75 percent of the appraised value of property might not be desirable. It is felt that the situation would be better met if the Board had the power to fix the rules and regulations to meet this matter; that it would make it much more flexible than if it is put in the statute.

The member banks of the country have about $10,000,000,000 of savings or time funds. The New England area and the New York area are largely served by mutual savings banks. More than 50 percent of the deposits of the banks, outside of that area, consist of savings deposits. These funds are equivalent to the funds that the mutual savings banks are receiving from the people in the area that they serve. The banks are required to pay interest on these time funds. The maximum rate of interest at the present time is fixed at 2½ percent. It is impossible for these banks to pay that interest and to loan these funds on short-time paper.

In the first place, there is not available a sufficient amount of short-time commercial loans to utilize more than a fraction of the demand deposits, much less the savings deposits; and as a result the banks hold a very large volume of idle funds.

There has been no restriction imposed upon banks with reference to their investments in long-term bonds. They have been permitted not only to invest all of their savings funds but as much of their commercial funds as they desire, in long-term bonds, railroad bonds, utility bonds, foreign bonds, and industrial bonds. I cannot see that it is so much more desirable to permit banks to invest in long-term listed bonds than it is to loan their funds on improved real estate on an amortized basis in their local communities.

The fact that bonds were listed and, therefore, supposed to be marketable, was considered a justification for the investment of funds in bonds as compared with the investment in real estate. The depression proved that the ready market for bonds was only there at prices that bankrupted the banks, if they were forced to sell in the market that existed. More banks became insolvent as a result of the depreciation of their bond accounts than as the result of their real-estate loans. The fact that bonds were listed and were greatly depreciated put the banks, when the examiners came into a condition of insolvency, because of the difference between the quoted market price and the cost of the bonds; whereas in the case of real-estate loans it was not expected that there should be a ready market for them, and so long as they were not in default, they were considered to have the value of the amount of the loan. It was the depreciation shown on the bonds and stocks, because of the quoted market, that impaired and in many cases wiped out the capital of the banks.

It seems to me that, if we want to be so restrictive in the matter of real-estate loans, because they are long-term investments of funds which are likely to be drawn out on demand, we should also be restrictive with reference to the investment of funds in long-term bonds. I believe that the banks should be permitted to invest their funds in long-term bonds and in long-term amortized mortgages. Particularly is that true with reference to their savings or time funds. The reason is that otherwise they have no way to use their funds, except to buy Government bonds, or bonds guaranteed by the Government.

Mr. GOLDSBOROUGH. You mean you think it is the duty of society to support the banks?

Mr. ECCLES. No; I am not saying that. I am talking about the condition that exists.

Mr. GOLDSBOROUGH. As far as society is concerned, it is interested in banks only insofar as the banks are useful to society?

Mr. ECCLES. That is correct. Either the banks holding these $10,000,000,000 of time funds must be prepared to lose those funds to the savings and loan associations, to mutual savings banks, or to others, or they must be put in a position to use the time funds in the long-term investment field.

I am convinced that it is not possible for the majority of banks in this country to operate with demand deposits alone. The volume of these funds is not adequate for profitable operation except in the larger institutions, and to take time deposits away from the banking system would reduce the size of many banks to the point where they would be unable to exist.

If our private banking system is expected to provide credit in other ways besides buying Government obligations or obligations guaranteed by the Government, then it seems to me that some of the provisions of this proposed legislation are essential, the one with reference to eligibility and the one with reference to real-estate loans.

There is nothing new about national banks loaning on real estate, since they have made such loans for 20 years. They have loaned, however, for a limited period of 5 years on a straight mortgage, which makes for a much more unsound loan than a longer-term amortized loan.

I believe that covers what I have to say, Mr. Goldsborough, and I will be glad to answer any questions.

Mr. GOLDSBOROUGH. Suppose we begin the regular examination. Mr. Cavicchia has a question.

Mr. CAVICCHIA. Mr. Chairman, I think this would be the proper place in the record for the Governor to tell us, if he knows, to what amount the mortgages of national banks are held or were held in 1933 or today, if he knows.

Mr. ECCLES. I do not know off-hand, but I have it here. On October 17, 1934, under the law in effect, the national banks had authority to lend up to $3,400,000,000. Under the new proposal the limit would be about $4,400,000,000 for national banks and about

$6,800,000,000 for all banks. The total amount of actual loans on real estate by all member banks at the end of 1934 was $2,273,000,000.

Mr. GOLDSBOROUGH. Governor Eccles, you wanted to say something else?

Mr. ECCLES. I was going to say that in connection with my discussion of the provisions of the bill I have suggested certain proposed amendments or revisions for your consideration. I would like, in closing, to call those to your attention in the order in which they were suggested.

Mr. GOLDSBOROUGH. As this hearing naturally will be protracted, we are not going to hurry you, and you may do so.

Mr. ECCLES. In section 201, the first section discussed, it was suggested that the governors and chairmen of the Federal Reserve banks be approved by the Federal Reserve Board every 3 years rather than annually so that their terms as governors and chairmen would coincide with their terms as class C directors.

Mr. GOLDSBOROUGH. What page is that on, please?

Mr. ECCLES. That is section 201. That is the one with reference to combining the offices of chairman and governor.

Mr. WILLIAMS. On page 39 of the bill.

Mr. ECCLES. This, as you will notice, is a slight modification, and it is just offered as a suggestion.

There has been some criticism about the necessity of approving the appointment of the governors each year, whereas they will be appointed as class C directors for 3 years. I personally can see no necessity of approving their appointments every year and feel that it is well to consider the suggestion that they be approved every 3 years instead.

Section 202: On the question of admitting insured nonmember banks to the Federal Reserve System, the suggestion is that the Board have authority to waive not only the capital requirements but all other requirements for admission, and that the Board be permitted to admit existing banks to permanent membership, without requiring an increase in capital, provided that their capital funds are adequate in relation to their liabilities.

Mr. GOLDSBOROUGH. When you refer to the capital, you mean the capital and surplus combined?

Mr. ECCLES. What is that?

Mr. GOLDSBOROUGH. You mean the capital and surplus combined?

Mr. ECCLES. The law requires $50,000 capital at the present time, and many banks——

Mr. GOLDSBOROUGH. I know, but I think you say, "Providing its capital is adequate"?

Mr. ECCLES. No; I would think you should take the capital and surplus in determining the adequacy.

Section 303: The suggested modification of the pension provision is for the purpose of giving Board members a greater degree of independence. It has been suggested that each member of the Board, regardless of age, who has served as long as 5 years, whose term expires and who is not reappointed, shall be entitled to a pension on the same basis as though he were retiring at the age of 70. I discussed that to some extent yesterday.

Section 203: It has been suggested also that a Governor of the Federal Reserve Board, who is not redesignated by the President may, if he chooses, continue his membership on the Federal Reserve Board. That is the way the law is now, and the new bill that is being considered, as you will recall, provides that his term as member of the Board shall cease when he is no longer designated as Governor. It has been suggested that, as a result of that, the President could designate each member of the Board and then no longer designate him, and finally create a new Board completely. So, in order to eliminate that criticism, this is the suggested amendment: That the Governor could continue as a member of the Board even if he is not designated as Governor; but that if he resigns from the Board upon not being redesignated, it would be considered that he had served out his term and he would not be precluded, by reason of having resigned under those circumstances, from entering business for a period of 2 years.

In section 205, it is suggested that authority over open-market operations be vested in the Federal Reserve Board, but that there be created a committee of 5 governors of the Federal Reserve banks selected by the 12 governors of the Federal Reserve banks, and that the Board be required to consult this committee before adopting an open-market policy, a change in the discount rates, or a change in member bank reserve requirements.

Mr. GOLDSBOROUGH. Is there any interpretation in your suggested amendment as to what the consultation would consist of? Expressing it another way, would the Board be bound to accept the suggestion of these five men, or any one of them?

Mr. ECCLES. No. It is a question of giving the governors a hearing and making a record before the Board can act; but the Board would have the final responsibility for the action.

Mr. GOLDSBOROUGH. That is the intent, but I am not sure it is entirely clear. Of course, that can be clarified.

Mr. ECCLES. Yes; that is the intent. The Board would be charged with the responsibility and they would have the power to initiate, but before taking action they would be required to advise with and get an expression of the views of the committee of the governors, or the governors could initiate and come to the Board and make their recommendations for the consideration of the Board.

Mr. FORD. Should there be a time limitation on how long you have to wait for that consultation?

Mr. ECCLES. Well, I would provide that, of course, the Board should be able to make rules with reference to that.

Section 209: It is suggested that the Board should not have the power to change the reserve requirements by Federal Reserve districts. I discussed that, I think, to some extent yesterday. It has been suggested, further, that the member banks be classified in the two groups, one comprising member banks in the central reserve and reserve cities, and the other all other member banks. Changes in the reserve requirements, therefore, would have to be either for the country as a whole, or for the financial centers, as against the country districts.

Section 210: Real-estate loans: It has been suggested that the conditions on which real-estate loans may be granted by member banks be left to the discretion of the Federal Reserve Board, to be determined by regulations. I see no objection to accepting also some geographical limitation as to where loans could be made, that is, some specified distance from the banking houses. Of course, there is no limitation as to the field where banks can loan funds on bonds, but there seems to be a good deal of opposition to the elimination of the geographical limitation on real-estate loans. I do not believe it is of sufficient importance to have any disagreement over.

Well, now, those are the suggested modifications.

Mr. FORD. Just one word on that geographical limitation: In cities where the Federal Reserve banks to whom the various banks have to go for these loans, if the geographical limitation is put in there, very often there is very keen competition between cities and the city in which the Board is located, and if it were limited, it might mitigate against another city that did not have a bank, as to the character of loans that they would be willing to discount. With the geographical limitation, I think, in many instances, it might have a very bad effect.

Mr. ECCLES. You mean in the case of real-estate loans?

Mr. FORD. Yes, sir.

Mr. ECCLES. Well, I do not just get the point of your question.

Mr. FORD. Let me illustrate it in another way: Let us say that the main branch of the Federal Reserve is at San Francisco. Well, now, the geographical limitation, for instance, leaves the city of San Diego out of that limitation: and if there were some loans coming in from there, and there happened to be competition, for instance, in water transportation between those two points, and somebody on that Board was anxious to work a little against San Diego, it might be possible and something like that might come up, because it has come up in other things.

Mr. ECCLES. Well, in the case of San Diego, in that case San Diego would discount with the Los Angeles branch.

Mr. FORD. That limitation would not touch the branches?

Mr. ECCLES. The limitation is a mileage limitation from the bank that makes the loan, the idea being that the bank in an area should loan funds in the area in which it is acquainted, where the officers can personally be informed as to the property upon which they are lending; whereas, if there is no geographical limitation, the funds may be loaned in far-removed areas, a thousand or two thousand miles away, as the case may be.

Mr. FORD. If it applies to branches, that is all right.

Mr. ECCLES. The advantage of taking the limitation off is this: That in an area that has a surplus of funds beyond the demand for real-estate loans, it could invest those funds through some correspondent institution where there is a shortage of real-estate money, just as our insurance companies in New York and other points loan money over the United States and building and loan companies have loaned in a more or less wide area, and as the mutual banks loan in far-removed areas.

Mr. GOLDSBOROUGH. Mr. Hancock, you may proceed, if you desire.

Mr. HANCOCK. Mr. Chairman, I have listened with intense interest to the very able and enlightening statement made by the Governor of the Federal Reserve Board with respect to the purpose and philosophy of this important measure, and to his detailed explanation of its mechanics. It occurs to me, however, that since it is such an important and far-reaching measure and is somewhat intricate, that the committee should arrange immediately to have the Governor's testimony reduced to writing so that we may have a chance to fully analyze and digest it before we go into the questioning of the Governor. I hope the clerk will arrange to have this done at once.

I am not so much concerned with the mechanics as I am the purpose and philosophy of the bill. How it will be administered is, of course, vitally important.

I want to ask the Governor what is the difference between this measure and an outright central bank?

Mr. ECCLES. Well, I do not know just what you mean by "central bank." You mean by that a bank that is owned by the Government, and a bank with branches?

Mr. HANCOCK. I would like to have an explanation of that, and then I will ask you another question.

Mr. ECCLES. There are a good many different kinds of central banks and——

Mr. HANCOCK. Well, let me ask you this, Governor: What would be the practical difference between the system proposed herein and the Federal monetary authority that the committee last year studied, conducted hearings on, and considered?

Mr. ECCLES. I am not familiar with what the committee worked on last year. I could not give you a comparison between Federal Reserve operations and what was proposed under that bill, because I am not familiar with it.

Mr. HANCOCK. Well, briefly, here is what the Federal monetary authority undertook to do: It undertook to set up what you might term a supreme court of finance insulated against political and commercial banking domination, and vested in that supreme court of finance or authority the sole note-issuing power of the Nation. It would have owned and controlled all of the gold, all of the metallic base; and it would have had the right to control the open-market operations through the sale and purchase of Governments, the control of the rediscount rate, and other essential powers to control or regulate the volume and cost of money for the national welfare.

Mr. ECCLES. Speaking of the central bank, the Federal Reserve System has always been expected to perform certain functions of a central bank. It was set up on the basis of a certain regional autonomy, due, I suppose, in part, to the opposition to centralization in this country at the time the Federal Reserve System was set up, and due, also, in part, to the size of the country and the different economic conditions that existed in the different regions. The Reserve Board was set up as a coordinating agency for these 12 banks, which have 25 branches.

The proposed bill in no way changes the physical structure. The ownership of the Federal Reserve bank is left with the member banks. In most of the countries of the world, the central bank is a privately owned institution. Instead of being owned by the member banks, it is owned by the public.

There is no change being made in the number of directors, 9 directors, and the majority of them are selected by the stockholders of the member banks—6 of the 9. A limitation is being put, however, upon the terms of these directors. The general structure of the bank is not being changed.

It is proposed, however, that the appointments of governors should be approved by the Board. That is so that they would be in a more direct relationship, a more responsive relationship to the Federal Reserve Board, so that the Board's coordination of the system would be through the governor, rather than through the chairman and agent. This is the reason for the proposed combination of the offices of Governor and Chairman. Such coordination would be further effected through the Board's control over open-market operations and discount rates. The Board today approves the discount rates. There is no change in the matter of the discount rates proposed in the bill, but there is a change regarding the open-market operations.

Mr. HANCOCK. And that is the heart of the bill, is it not?

Mr. ECCLES. Well, it is the most important feature and——

Mr. HANCOCK. That is the main method or means by which you control the supply of money?

Mr. ECCLES. Well, the question of reserve requirements is also a feature secondary——

Mr. HANCOCK. Secondary?

Mr. ECCLES. I think secondary to the other features.

Mr. HANCOCK. But the open-market operation is the primary and most effective feature?

Mr. ECCLES. That is right. The other is secondary. The open market is the primary feature.

Mr. HANCOCK. And under the terms of this bill, the open-market operations are vested entirely in a Government board?

Mr. ECCLES. No; vested in the Federal Reserve Board under this bill if changed in the manner which has been suggested.

Mr. HANCOCK. Yes, but under this bill, that Board is appointed by the President and confirmed by the Senate?

Mr. ECCLES. That is right, for terms of 12 years, and the open-market power is vested in the Board. Today the Board has a veto power over open-market policy. The governors have an open-market committee. The 12 governors elect a committee of 5, and that committee is a committee charged with the responsibility for the initiation of open-market operations. The Federal Reserve Board either approves or disapproves or induces them to modify their program; but the Board cannot initiate. And then, if the policy is initiated by the open-market committee and is approved by the Board, the Board is not in position to require that the banks carry out the policy. So it is proposed in this bill to place the authority and responsibility in a small body, and the Board——

Mr. HANCOCK. Under the bill proposed you can initiate the policy and then enforce its execution, can you not?

Mr. ECCLES. That is right.

Mr. HANCOCK. So it really gives you complete control over the money supply?

Mr. ECCLES. That is right. Now, to that extent, it is centralizing that function to a greater extent than it has ever been centralized. Responsibiliy is always felt more keenly when it becomes a personal responsibility, and it seems to me it is desirable to place that responsibility in a small body, either in the Board or somewhere else.

The responsibility for the exercise of these important functions of monetary control should be in one body, either the Board or some other body. It should not, to my mind, be divided to such an extent that it can result in obstruction, lack of action, lack of coordination, and lack of a feeling of responsibility.

There are many important functions the Reserve banks have outside of the open-market operations, and there is no idea of taking away from the regional banks all of the functions which they now have. As a matter of fact, if the Board is given the authority it is requesting here in the bill, to delegate some of its authority, I believe that there are some of the duties that the Board could delegate to the regional banks beyond the responsibilities the banks now have. The regional banks carry the reserves of the member banks. The regional banks pass upon the credits to the member banks. It is through the regional banks that the Board operates in the approving of banks for membership, in the issuing of voting permits, in the examinations of banks, in the matter of reduction of capital structure, or in the matter of consolidations. All of the important relationships with all of the banks and the public in the area where the Reserve banks are, are handled by the management and directors of those banks; and there is no idea of taking away any part of this, or attempting to centralize those functions here in the Federal Reserve Board.

Mr. HANCOCK. In effect, Governor, does not this bill undertake to bring back home the sovereign power vested in the Congress to coin money and regulate the value of it?

Mr. ECCLES. Well, it brings to the Federal Reserve Board the power, and, of course——

Mr. HANCOCK. And through that Board back to Congress?

Mr. ECCLES. That is right, because——

Mr. HANCOCK. Is it not an unpleasant fact, Governor, that this power has been farmed out to private interests for years and years?

Mr. ECCLES. Well, the power really has not been exercised to any great extent. Up until 1922 there was not any recognition of the fact that, by the open-market operations, you affected the supply of money. There was no special machinery for open-market operations in the original Federal Reserve Act. In 1922, during a period when some of the banks were buying securities as investments, it was observed that it influenced the situation in New York, and they began to realize that these 12 Reserve banks, acting independently, in buying and selling for their own investment account, from a purely earning standpoint—in other words, operating as commercial banks would—had a real influence and effect on the money market. The result of that was a self-appointed committee of governors to work together, so as to have a coordinated program of buying and selling; and I believe it was not until 1933 that the open-market committee was recognized in the law.

Mr. HANCOCK. Governor, based on your statement yesterday, would it be unfair to interpret this bill as the last clear chance to save the autonomy of private banks of America?

Mr. ECCLES. Will you state that question again?

Mr. HANCOCK. I said, would it be fair to interpret this bill as the last clear chance to save the private commercial banks in America from their own destruction?

Mr. ECCLES. Well, that would be a question rather difficult for me to answer.

Mr. HANCOCK. I am asking you the question, Governor, in the light of what you said yesterday.

Mr. ECCLES. I think this bill will certainly tend to make it possible for the private banking system to function in a much more satisfactory and adequate manner than it has in the past.

Mr. HANCOCK. Nothing could be more desirable.

To use the expression that you used before the Senate committee in 1932, this measure, idealistically speaking, is designed to bring the money world back into relations with the real world, is it not?

Mr. ECCLES. Well, it is designed to create a condition of stability, stable business, we will say, so far as it can be done through monetary policy. The important thing today is not so much, as so many people believe, to increase the quantity or volume of money, as it is to increase the velocity of money that is already in existence.

Mr. HANCOCK. I believe you take the position as I do that the velocity of money has a greater effect upon business activity than the quantity or volume?

Mr. ECCLES. The volume of money is a very important element, and I think that, in a period of great business activity and full employment, or reasonably full employment, to reduce the quantity of money is very effective in controlling inflation. A small reduction in the quantity of money, through open-market operations, in certain periods, would be very effective.

Mr. HANCOCK. It always, however, tends to decrease business activity?

Mr. ECCLES. That is right, and it is—well, it would tend to decrease business activity, and possible excess reserves would be wiped out. That would force the banks into borrowing, and that would materially restrict credits and raise rates, and tend to slow up the volume of business. However, when you permit a condition to develop, such as has developed during the past 4 or 5 years, when you first had a great period of deflation, of loans held by the banks, and bills held by the Reserve banks were allowed to run off, the volume of money was being extinguished at a terrifically rapid rate. From 1929 to the period of the bank holiday, about one-third of our total bank deposit money was extinguished, largely, through the liquidation of bank credit. This liquidation was forced upon the banks in part by their inability to go to the Federal Reserve banks with assets and meet the withdrawals of depositors, who were hoarding their funds, because of banks failing.

Mr. HANCOCK. It was an emergency situation and the very time the banks should have stepped in boldly as a rescuer or savior? Of course they were no able to go as far as they could go if this bill is passed.

Mr. ECCLES. Well, two things seem to me to have been necessary.

Mr. HANCOCK. In other words, the Reserve banks were affected by the same emotional disease that the member banks were; is that not correct?

Mr. ECCLES. They were increasingly restrictive in the kind of paper on which they would extend credit, and, of course, the law put limitations on the type they could take. Now, as to whether or not, by acting sooner or acting more vigorously in the open market, they could have stopped the period of deflation, that is, of course, a debatable question. Some will argue that had they acted more vigorously and sooner than they did, when there was a tremendous shortage of funds due to hoarding and due to the gold that was pulled out of the country and went abroad, that it would have turned the tide of deflation.

Mr. HANCOCK. There was never, during that period, coordinated action on the part of the Federal Reserve System as a whole, was there? Were not some banks operating at cross purposes with others?

Mr. ECCLES. I do not know. I do not know exactly what you mean by "coordinated."

Mr. HANCOCK. I mean this: That some of their actions were not in unison or accord with a national policy, looking to unified operations for the good of the entire country?

Mr. ECCLES. Well, I think the governors met and discussed the problem, and I think they also met here in Washington with the board and——

Mr. HANCOCK. I do not think there is any question about their having met, but what unified effective policy did they agree on?

Mr. ECCLES. Well, they reduced the discount rate, and they bought securities in the market, beginning with the autumn of 1929, but more vigorously after the passage of the Glass-Steagall Act in February 1932.

Mr. GOLDSBOROUGH. I will say that they continued that until the danger of the passage of the Goldsborough bill was over, and then it immediately stopped.

Mr. HANCOCK. Governor, what constructive thing did the Federal Reserve Sytem do, after deflation was halted, to aid in bringing about recovery? Would you mind telling this committee that?

Mr. ECCLES. Well, of course, in view of the fact that the entire banking structure collapsed and had to completely close, it is difficult to imagine how anything very much worse could have happened.

Mr. HANCOCK. Well, I believe in your statement made before the Senate committee in 1932——

Mr. ECCLES. 1933; in February of 1933.

Mr. HANCOCK. You referred to the fact that you considered the Federal Reserve System an emergency system; is that correct?

Mr. ECCLES. Well, I do not think so. I would not consider the Federal Reserve System an emergency system; it is a system that certainly should be able to regulate the volume of money. If the banks and the money system under capitalism cannot meet the emergency, the Federal Reserve System is the only agency we now have to do it. In other words, through the Federal Reserve System, we say that we succeeded in financing a war; and we know now this contributed very greatly toward the financing of the extraordinary expenditures of the war, in the absence of putting on taxes high enough to do that.

The Reserve System has, of course, been very helpful in the clearing of checks, and it has been a very great improvement over the system that was employed prior to the Federal Reserve System. It has speeded up immensely, immeasurably, the clearing of financial transactions throughout the country.

Mr. HANCOCK. Governor, if we had put on sufficient taxes during the war period, a large part of our present financial difficulties would have been avoided, would they not?

Mr. ECCLES. Well, I do not know that I could agree to that. I do not think that the financial troubles of the present are due to the war. We do not lack and did not lack in 1929 any material and physical thing that we had before the war and after the war. We had an increase in our total man power and in our capital production facilities.

The CHAIRMAN. Let me interrupt. Did not we experience our greatest period of prosperity in all of our history subsequent to the war and prior to this panic?

Mr. ECCLES. We had replaced every physical loss, and even the loss of man power as the result of the war by a very great amount from the end of the war up to 1929.

Mr. HANCOCK. Well, Governor, is it not a fact that our present war debts largely represent profits made during and out of the war?

Mr. ECCLES. Well, certainly, during the period of the war, we did not consume and use, as a nation, more than we produced. As a matter of fact, during that——

Mr. HANCOCK. And in that way, we did not impoverish ourselves?

Mr. ECCLES. We did not impoverish ourselves at all, because we used much less than we produced, because we furnished the Allies a tremendous amount of goods, which created the interallied war debts; so there was no occasion for a huge war debt, if the population had all been put upon a basis whereby there would have been no advantages to any group or class, and there would have been no profits as a result of that operation.

In other words, if the resources of the Nation had been mobilized in the interests of the Nation, for war purposes, we would not have needed any inflation, we would not have needed the credit that was extended. Our present situation indicates we are just as able now, in this country, to meet the problems of the depression as we would be to meet the problems of war. No one would question the fact that our ability to fight a war would depend upon the men and materials and our capital facilities in the form of our factories, systems of transportation, and so on. The question of money would not be the measure of our ability to fight a war in this economy of abundance. Neither is our ability to fight the depression in this economy of abundance a problem of money.

Mr. HANCOCK. It is a question of distribution?

Mr. ECCLES. Yes; it is a question of distribution. The depression, to my mind, was not brought about through a shortage in the volume; and by an increase in the volume of money after 1929 it would not have been possible to have avoided the depression. It might have deferred it or delayed it; but so long as we had such an inequitable distribution of wealth production as currently produced, so that our capital production facilities were all out of balance with the buying power of the people, the velocity was sure to slow up and a depression was inevitable.

Mr. HANCOCK. Governor, with respect to the question of debt—and then I will get to this bill again—I want to ask you this question, do you think a nation can impoverish itself by employing its men and materials in improving its equipment and resources?

Mr. ECCLES. No; I cannot see how a nation can impoverish itself by adding to or producing wealth. In my opinion, we might impoverish certain individuals if we do not distribute the wealth that is produced through giving employment.

Mr. HANCOCK. Then all we need today in this country of rich resources is, for our money to go to work; is that correct?

Mr. ECCLES. That is correct.

Mr. HANCOCK. Will this new bill help to restore confidence and put it to work?

Mr. ECCLES. Well, I cannot answer that; I can only express an opinion. It is my belief that it will; it is one of the factors that will help; it will make it possible for the banks to lend funds in fields in which they have been unwilling and unable to lend before. Whether or not they will find borrowers is another question. There is a great absence of people who are willing to borrow, even on long terms, or on any terms.

In connection with what I said, in order that I may not be misunderstood, I happened to read the other day an account of the last report of the Brookings Institute, which finds that the excessive savings went into speculation: Too much thrift held slump cause. It seems to me that has a very important bearing upon this question of the volume and quantity of money and the velocity of money.

Mr. HANCOCK. Said in a different way, you mean that too much labor went into capital goods?

Mr. ECCLES. That is right. [Reading:]

The institution, in the third of a series of investigations to ascertain whether maldistribution of income is a primary cause of the depression, found that the first need is for greater spending for goods rather than more savings.

Money going into savings, the report made public last night points out, is not immediately spent for consumption, and the rapid growth of savings in the twenties resulted in too much money going into speculation and not into actual buying of goods.

The report disputed several traditional economic concepts. Theoretically, according to one school of thought, savings go into the expansion of plant and other physical facilities, but the institution found that so much money was saved that there was a plethora.

Instead of going into either consumption goods or capital goods, it went into speculation which served to inflate the prices of securities and to produce financial instability.

In announcing the report, the institution cautioned that it did not suggest the individual of moderate means should, as a matter of policy, save less, but that "the problem is one of aggregate savings in proportions to aggregate consumption."

The phenomenon of an excessive supply of savings is, the report said, something new. In the past there has usually been a dearth of savings, with resulting difficulties in expanding the Nation's productive facilities.

The report further disputed the theory that business expansion begins with expansion of capital goods, holding rather that such expansion begins after people begin to buy.

The report noted that "a large part of the savings of individuals and business corporations has gone to finance Government deficits" since the depression.

The same institution, as I recall, gave the figures ofthe distribution of the national income—I think it was in 1929—showing that one-tenth of 1 percent of the families at the top of the list received the same income as 42 percent of the families at the bottom of the list; or in other words, the average income, per family, at the top, was equivalent to the average income of 420 families at the bottom.

Mr. HANCOCK. In the peak year, Governor, in 1929——

Mr. HOLLISTER. Pardon me, but I want to ask what report that is that he is quoting from?

Mr. ECCLES. That is the report of the Brookings Institute, The Capacity to Consume.

Mr. GOLDSBOROUGH. And that is the 42 percent the Brookings Institute wants to spend?

Mr. ECCLES. Well, the thing that they find is that that 42 percent was not responsible for very much saving. The one-tenth of 1 percent, of course, were unable to use their income in consumers' perishable and durable goods; and they, therefore, had to find an outlet in the investment field, or in the field of capital or producers' goods, until we reached a point where our capacity to produce was all out of relationship to our ability to consume but not our capacity to consume and——

Mr. HANCOCK. Which is a whale of a difference?

Mr. ECCLES. Yes; our problem is no longer one of production, which it has been for generations, while we were building the country, while we were a debtor Nation, and when we had a rapidly increasing population.

Our problem is one of distribution. By distribution we mean not the distribution of the existing wealth but the distribution of the wealth production as it is currently produced; and the most effective day to do that, in times of prosperity, is through the income-tax system. One of the greatest mistakes, I think, that was ever made during a period of prosperity was to reduce income taxes rather than to maintain them at the high war point and use the funds collected to reduce the Federal debt; and then when unemployment developed to use the Federal credit to take care of unemployment.

Mr. HANCOCK. Governor, I think that same report to which you referred just now also showed this startling information: That in the peak year, 1929, 68.9 percent of the American families had gross incomes of less than $1,500.

Mr. FORD. May I make an observation there, Mr. Chairman?

The CHAIRMAN. Yes, Mr. Ford.

Mr. FORD. In 1929 there were 22,000,000 people in the United States, at the peak of our prosperity, who were living at or below the subsistence line; there were 45,000,000 people that were just getting by; there were 25,000,000 that were fairly well off; there were 15,000,000 that were rich; and there were 10,000,000 wallowing in wealth; and those are figures which were gotten out by a responsible organization.

Mr. FISH. And what is the subsistence line?

Mr. FORD. It is just being able to live by a little help from the country or relatives or somebody else; just getting by.

Mr. FISH. On the basis of income, it depends on the cost of living, but what is a subsistence income?

Mr. FORD. Well, I do not know what it is, because it depends on the section. It might be $15 in one part of the country and might be $25 in another and $40 in another, depending on what part of the country you live in.

Mr. HANCOCK. Governor, do you subscribe to the thought or belief that the control of a nation depends upon the control of its credit?

Mr. ECCLES. I do not know that I understand your question.

Mr. HANCOCK. By that question I mean that unless the Nation, through its central Government, controls the credit or note-issuing power of the Nation the Nation cannot be used for the protection and welfare of all of the people?

Mr. ECCLES. Well, I think there must be a control over the money system.

Mr. HANCOCK. That means credit, does it not?

Mr. ECCLES. It is not necessary to control the credit relationships of individuals among themselves, nor the credit corporations extend on accounts, and so forth.

Mr. HANCOCK. Of course not; but our money system is 90 percent credit or check currency. You made that statement before the committee.

Mr. ECCLES. Well, 90 percent of our payments are made by checks on deposits, which is credit money; and it is necessary for a nation to exercise control in the public interest over the money system.

Mr. HANCOCK. Well, now, this bill is designed to insure control of the credit of the Nation in the interest of the Nation as a whole, is it not, and without interference with the normal functioning of the banks?

Mr. ECCLES. That is correct.

Mr. FORD. Otherwise, socialize it?

Mr. ECCLES. Well, it depends on what you mean by "socialize." Of course, I read yesterday a statement of Woodrow Wilson's conception of the Federal System, and I do not need to go beyond the statement of the President in whose administration the organization of this System was set up.

Mr. HOLLISTER. What is the purpose of that statement, Governor?

Mr. ECCLES. It is the purpose of setting up the System. He said:

> The control of the system of banking and issue must be vested in the Government itself, so that the banks may be the instruments, and not the masters, of business and of individual enterprise and initiative.

Mr. HOLLISTER. Did anybody ever suggest that the Government should have the control of issue?

Mr. ECCLES. He has suggested the control of issue——

Mr. HOLLISTER. Did anybody else ever set up the contention that the Government was only for issue?

Mr. ECCLES. The theory was that these banks would control the issue.

Mr. HOLLISTER. It was not the Government. The banks were not identical with the Government, and nobody ever suggested that, did they?

Mr. ECCLES. That is true, but the thought was, that the Federal Reserve Board and the chairmen of these banks, who were appointed, were the representatives of the Government, or the people through the Government.

Mr. HOLLISTER. The Federal Reserve Board was, but not the Federal Reserve System?

Mr. ECCLES. The chairman of the Federal Reserve banks was appointed by the Federal Reserve Board, and was at that time looked upon as the executive head of the banks.

Mr. HOLLISTER. And the chairman appointed by the Board was to completely control the individual Federal Reserve banks?

Mr. ECCLES. No; the Federal Reserve banks, of course, were to be controlled by their board of directors.

Mr. HOLLISTER. Who were not Government appointees?

Mr. ECCLES. That is right.

Mr. HOLLISTER. Except certain of them?

Mr. ECCLES. That is correct.

Mr. HANCOCK. Governor, I wanted to ask you one more question. Do you think that the legitimate consumer demand or requirements for credit in this country can and will be met, as long as banking is a career?

Mr. ECCLES. Why, yes; I think so.

Mr. HANCOCK. I asked you that question because I understood you to refer to the fact that by providing independence or competence for Federal Reserve Board directors they could take hold of such positions and make careers of them and not have to look to outside income.

Mr. ECCLES. That is right.

Mr. HANCOCK. It is my thought that banking should never have been a career but always a profession. I hope you understand what I mean.

Mr. ECCLES. Are you speaking of the private commercial bank, or are you speaking of the Federal Reserve bank?

Mr. HANCOCK. I am speaking of all kinds where the public is involved and their welfare at stake.

Mr. Chairman, they are all the questions I care to ask at this time, but I reserve, of course, the right to discuss with the Governor the various sections of the bill. In your absence I made a request that the hearings up to now be printed, because it is humanly impossible for any man to digest all of the statements and suggestions made by the Governor, without having a written statement before him.

Mr. ECCLES. Let me answer Mr. Hollister's question about the control of issue because my associate has brought to my attention this statement in the law:

> The Board shall have the right, acting through the Federal Reserve agent, to grant in whole or in part, or to reject entirely, the application of any Federal Reserve bank for Federal Reserve notes.

Mr. HOLLISTER. In other words, the Federal Reserve Board may limit the issue of notes, but may not increase the issue of notes at will?

Mr. ECCLES. That is right.

The CHAIRMAN. Gentlemen, it is probable that the H. O. L. C. bill will be taken up in the House tomorrow. I am not in a position to say definitely about that, but I will know in a little while. I thought we would not have any meeting of the committee tomorrow, and we appeared before the Rules Committee and asked for a rule, and we asked that we be given 1 day for debate of something like 4 hours on the bill. We are hoping that request will be granted. As soon as I can see the Speaker I can ascertain whether the bill will come up tomorrow or not. If it does, I wish you gentlemen would help me give information about it. If the bill comes up tomorrow, I suggest that the committee hold a meeting tomorrow afternoon at 3 o'clock, and just as soon as I can get that information I will have it telephoned to your office.

Suppose we say that we will meet at 3:30 this afternoon if the bill comes up.

Mr. HANCOCK. If the bill does not come up tomorrow, Governor Eccles will come back. Is that correct?

The CHAIRMAN. If the bill does not come up, Governor Eccles will come back; yes.

(Thereupon, the hearing in the above-entitled matter was adjourned temporarily.)

# BANKING ACT OF 1935

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**MONDAY, MARCH 11, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall presiding.

The CHAIRMAN. Gentlemen, we have Governor Eccles with us this morning to resume the discussion of this bill, H. R. 5357, and it is Mr. Williams' time to ask questions, if you desire, Mr. Williams.

Mr. WILLIAMS. All right. Governor Eccles, I understand the main purpose of title II of this act is to enlarge and further centralize the powers of the Federal Reserve Board, in order that it may have increased influence and power over the expansion and contraction of credit of this country. That is to be done mainly through the open-market committee, fixing discount rates and controlling the reserves of the member banks. Those are the agencies through which it is to operate. Am I correct in that assumption?

Mr. ECCLES. That is correct.

Mr. WILLIAMS. Now, to what extent by the operation or by the use of these agencies by the Federal Reserve Board, can the general commodity price levels in this country be controlled, in your judgment?

Mr. ECCLES. It is impossible to say. The proposal to give to the Federal Reserve Board, with the advice of the Governor's committee, the responsibility for the use of these monetary controls, the discount rate, the reserve requirements, and the open-market operation is for the purpose of maintaining stable business conditions, insofar as this is possible by monetary means. A stable price level does not necessarily mean stable business conditions.

It seems to me that we are far more interested in full employment than we are in stable prices. If stable prices at some given index figure would leave an army of unemployed, it does not seem to me that this is the objective that would satisfy this country.

Mr. WILLIAMS. Well, you will agree, will you not, that it is very desirable, as far as possible, to have stable prices?

Mr. ECCLES. Yes; I agree to that.

Mr. WILLIAMS. And that the purchasing power be the same yesterday, today, and forever, you might say, so far as we can make them so?

Mr. ECCLES. I agree that wide and rapid fluctuations in prices are inflationary and deflationary and tend to create conditions that are unfavorable to business stability.

Mr. WILLIAMS. I judge you are not in favor of fixing certain commodity price levels as the goal toward which the Board should strive in its expansion and contraction policy?

Mr. ECCLES. I would prefer that it be not made the central objective of the banking bill.

Mr. WILLIAMS. Do you think it is practicable to do that?

Mr. ECCLES. I do not think it is.

Mr. WILLIAMS. On the other hand, there is considerable criticism in the country of the policy which places, entirely without any limitation, the matter in the hands of a few men, or the Board, this great authority; do you think there is any danger along that line?

Mr. ECCLES. The control over the volume of money and credit that the Federal Reserve Board can exercise through its use of three instruments of monetary control, would not necessarily tend to expand the amount of money in use in a depression such as we have at the present time.

Mr. WILLIAMS. Right in that connection, in the use of this word "money", what do you mean?

Mr. ECCLES. I mean demand deposits and currency.

Mr. WILLIAMS. Bank credit?

Mr. ECCLES. Yes; bank credit, deposits in commercial banks and currency. More precisely it is deposits subject to check, exclusive of bank float and interbank deposits, plus United States Government deposits.

Mr. WILLIAMS. Bank demand deposits?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And currency?

Mr. ECCLES. Yes; that is right.

Mr. WILLIAMS. Is that what we mean when we talk about money now?

Mr. ECCLES. That is right.

Mr. WILLIAMS. I want to have that understanding as we go along.

Mr. ECCLES. That is correct.

Mr. WILLIAMS. Now, you say it would not necessarily result in expansion, that the policy should not or might not result in expansion during a period of depression?

Mr. ECCLES. You may create excess reserves through your open-market policy, but unless the borrowers are willing to borrow from the banks, and the banks are willing to lend to borrowers, you would not create a further increase in your money supply. You would increase the reserves of member banks, which would make for an inducement for the banks to lend and tend to result in a reduction in rates of interest, making for cheap money; but you must have borrowers who are willing and able to borrow before you can create additional money.

Mr. WILLIAMS. Is there no relation between the quantity of money and the volume of business that the country does?

Mr. ECCLES. No exact relation. The volume of money is an important factor, but the use of that money is an equally important factor in determining the amount of business.

Mr. WILLIAMS. Well, now, going back, for instance, to 1928, with a certain volume of money at that time and amount of business, how does that compare, we will say, with 1933?

Mr. ECCLES. In 1928 it was estimated that the national income was about $83,000,000,000. According to the Department of Commerce's figures, in 1933 the national income was about $47,000,000,000. The money supply in June 1928 was $26,400,000,000 and in 1933 it was $19,900,000,000. The ratio of the national income to the volume of money was 3.12 in 1928 and 2.35 in 1933. That brings out the point that I think you have in mind. I would estimate that in 1934, with a national income somewhere between $50,000,000,000 and $55,000,000,000, with an average volume of money of around $23,000,000,000, the number of times that your volume of money turned over was very little over two times. At the same rate of velocity that existed in 1928 and 1929, with the present volume of money, the national income should now exceed $75,000,000,000, which indicates that simply increasing the volume of money does not increase the national income proportionally. It seems to me that the reason for that is quite obvious.

The distribution of the ownership of money determines whether or not it is going to be put into use. Money is put into use by corporations and individual investors, who are led to believe that there is a profit in the investment or use of funds.

Mr. WILLIAMS. Well, then, did the increase in the volume of money build up reserves in the banks of the country? Would that not stimulate business itself, to the extent that it would make more money available, and would lead the banks, by reason of the unusual and unnecessary amount of money on hand, to try to get it out into the field of action? In other words, it would not be earning them anything, and it would furnish them an incentive to lend on more reasonable and better terms, would it not?

Mr. ECCLES. It has caused a very great reduction in interest rates, which is an inducement to the borrower, to the extent that the borrower can use the money profitably. Money is created by debt. Our banking system creates money——

The CHAIRMAN. Right there, Governor Eccles, you say money is created by debt; you mean by that, bank credit?

Mr. ECCLES. Yes; that is right. I mean that the banking system, the process of loaning money, extending credit, increases bank deposits. In the absence of individuals and corporations who are willing and able to borrow, the banks have created additional funds by purchasing Government bonds. The purchase of Government bonds has increased bank deposits.

Mr. WILLIAMS. Well, the volume of money times the velocity represents the national income, does it not, but they have both got to be there——

Mr. ECCLES. They have both got to be there; yes.

Mr. WILLIAMS. You have got to have volume and velocity like you have in physics to have momentum?

Mr. ECCLES. That is right. You cannot have velocity of the means of payment unless you first create a means of payment. You may create a means of payment and if it is in the hands of those who are unwilling to spend it, you do not create business activity.

Mr. WILLIAMS. Now, Governor, let us go to the question in this second title here of issue by the Federal Reserve banks. This act, as

I understand it, removes the necessity for any specific collateral back of any particular issue?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And simply permits the banks to issue upon their assets? Of course, all of that is to be done under the rules and regulations of the board, I assume, the Federal Reserve Board? Now, in other words, who is going to control how much they issue?

Mr. ECCLES. The volume of notes issued depends in the first instance on the demand for cash by the public and more remotely on the amount of deposits the Federal Reserve banks have created for their member banks, either by extending loans to them or by open-market operations.

Mr. WILLIAMS. Who is going to determine whether an issue has back of it sound assets, or not?

Mr. ECCLES. The Federal Reserve banks' credit departments will determine that by the type of loans or type of credit which they extend to the member banks.

Mr. WILLIAMS. Now, let me see that I understand. The policy that has been heretofore followed has been that the Federal Reserve agent has had charge of that, has he not, or a representative of the Board?

Mr. ECCLES. The Federal Reserve agent holds the collateral, consisting of gold certificates, eligible paper, and Government bonds. Originally it had to consist of gold and eligible paper. The Glass-Steagall Act of 1932 permitted Federal Reserve notes to be backed by Government bonds in the absence of a sufficient amount of commercial paper.

Mr. WILLIAMS. The application for issue is made to the Federal Reserve agent?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And he was required to have sufficient assets, in his judgment, back of that issue; that is, they were required to put up with him particular assets on a particular issue that they called for; is that correct?

Mr. ECCLES. It was figured as a whole, the total amount of notes that each Federal Reserve bank had outstanding, backed by gold certificates and bonds and other collateral that was deposited with the Federal Reserve agent. But it seems to me that, in order to understand what is back of the Federal Reserve notes, we must consider the balance sheet of the Federal Reserve bank. The liabilities of the Federal Reserve bank to the public consist chiefly of deposits of the member banks and of Federal Reserve notes.

Against these liabilities the Reserve banks hold assets, consisting of investments in bills, Government securities, discounts to its member banks, and gold certificates.

It is impossible to issue Federal Reserve notes as liabilities without either an offsetting decrease in deposits or an offsetting increase in assets, in the form of gold certificates, Government bonds, eligible bills, or loans to member banks; and the only question that could arise regarding the security back of Federal Reserve notes would be in connection with loans which the Federal Reserve bank made to the member banks. If they made loans which were bad, whether eligible paper or whether loans secured by what would be considered as sound assets, and the losses on those loans were in excess of the capital and surplus of the reserve bank, then in theory the United States Government would have to be called upon to make good the guaranty of the Federal Reserve notes outstanding. But that is the only way in which there could be any question as to the backing of the Federal Reserve notes. At all of the central banks, except the Federal Reserve System and the Bank of England, notes are issued without any specific backing.

Mr. WILLIAMS. Now, Governor, I want this clear in my mind——

Mr. HOLLISTER. May I ask one question right there, Mr. Williams?

Mr. WILLIAMS. Yes.

Mr. HOLLISTER. Is it not true, however, that there is a statutory limit in most of the countries as to the amount of that issue?

Mr. ECCLES. Well, I could not say.

Dr. Goldenweiser advised me there is no such statutory limit.

Mr. WILLIAMS. Let me ask you this question: In the application of a reserve bank under our present system, to the Federal Reserve agent for an issue, has that application ever been denied?

Mr. ECCLES. I do not think so.

Mr. WILLIAMS. When an application is made, who passes on it?

Mr. ECCLES. That is a formal matter; it is almost an automatic operation. The amount of notes that any Reserve bank requires to meet the demands of its deposits would be turned over to it by the Federal Reserve agent in exchange for the necessary collateral lodged with the Federal Reserve agent.

Mr. WILLIAMS. Now, are you saying that would be left entirely to the Federal Reserve banks?

Mr. ECCLES. The amount of issue will be determined by the call which the member banks make for currency, and when they make a call for currency they must have deposits with the Reserve bank, just as an individual who wants currency must have funds in a commercial bank to be able to draw down that currency.

Mr. WILLIAMS. The part I am trying to get at is whether or not the central Board, the one that has control or the one you want to place more power in—whether or not they have control over the amount of issue of each one of these Federal Reserve banks?

Mr. ECCLES. The Federal Reserve Board has technical control over the amount of issue under the present law, but it has found that it is useless to control note issue after the member banks have acquired deposits, and under the proposed law the Federal Reserve Board would not have this purely technical or theoretical control. The reason that the control is only theoretical is that, when member banks wish to withdraw their deposits in cash, no Reserve bank can refuse to pay out the cash, and the Federal Reserve Board cannot take the responsibility for preventing it.

Mr. WILLIAMS. Then, the Federal Reserve agent simply is an administrative officer; he has no discretion about it, but he is simply a trustee with these funds in his hands?

Mr. ECCLES. The Federal Reserve bank would have to close if the member banks asked for currency in lieu of their accounts and were refused.

There is no more justification for requiring specific collateral back of Federal Reserve notes, which are the liabilities of the Reserve banks, than there is for requiring specific security to be pledged against the deposits of the Federal Reserve bank. Why should Federal Reserve notes outstanding be given a preferred status over the deposit liability of the Reserve banks?

Mr. WILLIAMS. Then, do you think it is a sound policy for the Government to guarantee these notes and at the same time have no control over their issue at all?

Mr. ECCLES. I do not think that a controlled issue would be a particle different than an issue that is not controlled, because the Reserve banks are required to issue currency whenever member banks have deposits and desire to draw down those deposits in currency. It is in the determination of the volume of credit extended to member banks for the purpose of creating the deposits that the real control of the note issue lies. They cannot draw down currency unless they have established balances with the Reserve bank, and have put up acceptable assets, in which case they can drawn down their deposits in currency in the same manner that any individual depositor of a commercial bank is able to draw his deposits in currency. Whenever a bank is unable to pay out the deposits in currency, that bank must close.

Mr. WILLIAMS. They are turning out currency on what they call "acceptable assets" as security?

Mr. ECCLES. Who is?

Mr. WILLIAMS. The Federal Reserve bank? If a member bank wants to borrow money, how do they get it?

Mr. ECCLES. They put up collateral.

Mr. WILLIAMS. Who passes on that collateral?

Mr. ECCLES. The Federal Reserve banks.

Mr. WILLIAMS. And they get money for it? That is, the member banks get money for it?

Mr. ECCLES. Yes; they get credit.

Mr. WILLIAMS. And that is guaranteed by the United States Government?

Mr. ECCLES. They get deposit credit for it.

Mr. WILLIAMS. Of course, that is money?

Mr. ECCLES. Yes; that is right.

Mr. WILLIAMS. And the Government itself is back of it, and still it is simply the deposit of eligible security in the judgment of the Federal Reserve bank?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And they have entire control and jurisdiction over it?

Mr. ECCLES. Over the assets which they will take, yes.

Mr. WILLIAMS. And pass on the question as to whether they are good or bad?

Mr. ECCLES. That is right.

Mr. WILLIAMS. All right.

The CHAIRMAN. Governor Eccles, do you mean that they have entire control over the kind of assets they accept? They pass upon the acceptability of assets entered as collateral as to solvency and technical eligibility, but when it comes to fixing the rules of eligibility under the present law, they are governed by the rules laid down in the act, are they not?

Mr. ECCLES. That is correct. They have discretion as to the acceptability of assets or as to the type of paper which they will take from member banks, subject at the present time to the eligibility requirements of the Federal Reserve Act.

In the future, if the present eligibility features of the act are removed and discretion given to the Federal Reserve Board to determine the eligibility requirements, the Reserve banks would have discretion within the rules and regulations laid down by the Federal Reserve Board. However, it would not be mandatory and it is not mandatory in the present law, that the Federal Reserve banks loan to member banks. They simply have authority to loan to member banks upon what is considered eligible paper.

The proposed amendment would give the Federal Reserve banks the power to loan to member banks on paper submitted to them, provided it met the requirements laid down by the Federal Reserve Board.

Mr. WILLIAMS. Yes; I understand the only difference in the existing law and the proposed law in that respect is, as it is now it is a part of the statutory limitation, and the other is to leave it to the rules and regulations of the Board as to what is eligible?

The CHAIRMAN. Let me ask you a question right there now: This might happen, technically speaking, that under the new law the Board could make regulations defining the eligible paper which would be more restrictive than the rules fixed in the present law, or if the Board saw fit, it could liberalize those rules, but it could work either way?

Mr. ECCLES. I think so.

The CHAIRMAN. So it does not work arbitrarily in either direction?

Mr. ECCLES. That is right.

The CHAIRMAN. Under the new bill, that is correct?

Mr. ECCLES. That is correct, yes.

Mr. WILLIAMS. What, in your opinion, should be the policy in that respect, liberalized or made more restrictive?

Mr. ECCLES. I think it would depend a great deal upon the conditions that confronted the country. In 1930 and 1931 it would have been in the interests of the banking system and in the interest of the entire country if the Federal Reserve banks had been permitted to loan to member banks on any sound assets, when many of them had very little or no commercial paper. The failure of the member banks to be able to borrow from the Federal Reserve banks forced a condition of great deflation. It forced the banks to refuse to extend loans as they fell due, and forced them to sell their bonds, their securities on the market. It resulted in liquidating or extinguishing, through credit contraction, about $20,000,000,000 of our total bank deposits, including time deposits. A good deal of that, of course, was the result of tying up deposits in closed institutions; but the total volume of deposits was greatly reduced, partly because of the inability of the member banks to get relief by going to the Federal Reserve bank, until we finally liquidated our banking structure to such a point that it became entirely frozen and closed.

And in getting it open, we finally had to recognize, as an emergency matter, that the Federal Reserve banks could loan to their member banks on all sound assets and that the Federal Reserve banks could issue notes secured by any sound assets, without resort to gold, Government bonds, or eligible paper.

The CHAIRMAN. Now, let me interrupt you with something that should be said right here. It not only went to the extent that you have pointed out, but as an emergency measure we provided that such loans might be made to nonmember banks and currency issued to nonmember banks on the same rules and regulations; is that not what happened?

Mr. ECCLES. That is correct.

The CHAIRMAN. So we were forced to do that in the hour of distress, instead of having anticipated and provided for it in advance?

Mr. ECCLES. Yes; Mr. Chairman, that is correct.

Mr. WILLIAMS. Right in that connection, to what extent has it worked?

Mr. ECCLES. When people can get their money, they do not want it. I think the law was very effective, because it stopped banks from closing. Instead of the Federal Reserve being required to make loans to meet the demand, money which had gone into hoarding to the extent of anywhere from $1,500,000,000 to $2,000,000,000 in currency that was drawn from the banks beyond what was the normal use or need of currency, tended to come back into the banks. That enabled the banks to pay off the Federal Reserve banks, so that the amount of borrowing by the member banks from the Reserve banks today is practically negligible: whereas, in 1933, it was very large.

Mr. WILLIAMS. Then instead of increasing the necessity for borrowing has actually decreased it?

Mr. ECCLES. The requirements; yes.

Mr. WILLIAMS. That has actually decreased?

Mr. ECCLES. That is right.

Mr. WILLIAMS. There has been no demand upon the Federal Reserve Board since the passage of this act, I take it, from what you say, to borrow upon these general assets, I will say, which were not heretofore eligible, such as real-estate securities, long-term bonds, and things of that kind; there have not been any of them offered as security to the Federal Reserve banks for the purpose of obtaining loans?

Mr. ECCLES. I think it is section 10 (b) of the Federal Reserve Act, as amended by the Emergency Banking Act, which says that, under exigent circumstances, member banks are permitted to borrow from Reserve banks on their time or demand note secured to the satisfaction of the boards of directors of the Reserve banks. There was some use made of that provision, but not very much, because it put a bank in a position, where it applied for credit under the terms of that provision, of admitting that it was in great distress and exigent circumstances that it required special treatment by the board of the Federal Reserve bank, which meant that a bank would only resort to that, would only use the borrowing right, as the very last resort.

Mr. WILLIAMS. To what extent are real-estate loans used for the purpose of acquiring loans from the Federal Reserve?

Mr. ECCLES. I could not say to what extent, but there has been some borrowing from Reserve banks on bills payable backed by real-estate mortgages, and other collateral put up to secure the notes of the banks.

Mr. WILLIAMS. It is the intention of this bill, as I understand it, to so amortize real-estate loans as to make them eligible for discount?

Mr. ECCLES. Not for discount.

Mr. WILLIAMS. Well, for loans?

Mr. ECCLES. Yes.

Mr. WILLIAMS. As security for loans?

Mr. ECCLES. Yes; the bill provides that the act be amended to authorize Federal Reserve banks, subject to the regulations of the board, to discount for a member bank all commercial, industrial, or agricultural paper, and to make advances to a member bank on its promissory notes secured by any sound assets.

Mr. WILLIAMS. And that includes real-estate loans, of course?

Mr. ECCLES. Collateral loans, bonds, or any other sound assets.

Mr. WILLIAMS. And the purpose of this—not of this section, but of the real-estate section—is to so liberalize real-estate loans, by amortizing them over a long period of time, as to make them eligible as a permanent policy, to encourage additional loans by national banks and member banks on real estate, in order that they can, if necessary, dispose of those in time of distress and get money from the Federal Reserve banks?

Mr. ECCLES. So long as the commercial banking system is permitted to take savings deposits, I see no reason why those savings funds cannot be loaned on amortized real-estate loans in the community of the bank.

Mr. WILLIAMS. I agree with that, myself. I absolutely agree with that, but the purpose is, as far as it can be done, to liquefy real-estate loans?

Mr. ECCLES. Yes.

Mr. WILLIAMS. I think we all agree that that cannot be done as a policy, but as far as it can be done——

Mr. ECCLES. In a depression, only the Federal Reserve can liquefy assets. Real-estate loans are no different than any other type of paper in a great deflation.

Mr. WILLIAMS. Of course, they have been, for the reason that there has been no place to discount them.

Mr. ECCLES. In a great depression there is no other place to go. And they do not have to be real-estate loans. They may be loans on collateral, or they may be investments in bonds. When the market is depressed, as it was for a period of several years, that meant bankruptcy for any bank that liquidated its assets on the existing market, and that condition tended to close many banks.

Mr. WILLIAMS. Is it the thought of the Federal Reserve Board that there should be no limitation at all, upon these amortized real-estate mortgages?

Mr. ECCLES. You mean no limitation as to the percentage——

Mr. WILLIAMS. No; I do not mean on the percentage of valuation, but on the amount of the loan on each individual property.

Mr. ECCLES. There is no limitation now, under the real-estate provision of the National Banking Act under which they have operated for 20 years, with the exception of the limitation of 10 percent of the capital and surplus on any one loan.

Mr. WILLIAMS. Real-estate loans have not heretofore been eligible for discount with the Federal Reserve bank, except as an emergency measure?

Mr. ECCLES. There is over $2,000,000,000 of real-estate loans in member banks.

Mr. WILLIAMS. Have they been able to put those loans up with the Federal Reserve bank?

Mr. ECCLES. Only when an emergency was created and then they were permitted as an emergency matter to do that.

Mr. WILLIAMS. That is exactly what I say, except as an emergency measure, they never have been eligible for loans?

Mr. ECCLES. That is right.

Mr. WILLIAMS. This act proposes to make them eligible?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And it is not thought to place any limitation, at all, upon them?

Mr. ECCLES. You mean limitation as to——

Mr. WILLIAMS. As to the amount? Here is an apartment house or hotel, or some other business institution, on which they want to make a loan of $100,000,000, for example——

Mr. ECCLES. One bank is limited in the amount of a loan they can make to any one borrower to 10 percent of its capital and surplus. So it has that limitation on it.

Mr. WILLIAMS. There is to be an increase under this act?

Mr. ECCLES. No; there is no change in it, at all.

Mr. BROWN of Michigan. As a matter of fact, it is a decrease, that is, 10 percent of the time deposits?

Mr. ECCLES. No; any bank can loan any borrower up to a total of 10 percent of its capital and surplus.

The CHAIRMAN. You mean that a loan can be made on any collateral or without collateral?

Mr. ECCLES. That is right. That has always been a provision of the Banking Act.

Mr. WILLIAMS. There is a provision in here, is there not, limiting it as applied to real estate?

Mr. ECCLES. No; the limitation is 50 percent of the time deposits and 50 percent of the appraised value of the property, which is the only limitation in the present act with reference to real estate.

Mr. WILLIAMS. It is expanded to what it was, in effect?

Mr. ECCLES. It is proposed to increase it from 50 to 60 percent, but the 60 percent also includes other real estate which is not included in the 50 percent in the present law.

Mr. WILLIAMS. Then loans to each institution heretofore have been limited to 25 percent of the capital and surplus on real estate?

Mr. ECCLES. Or 50 percent of its time deposits, whichever was greater.

Mr. WILLIAMS. What I am trying to get at is, it is expanded and enlarged, or is it not?

Mr. ECCLES. Yes; from 50 to 60 percent and up to 100 percent of its capital and surplus, whichever is greater.

Mr. WILLIAMS. Instead of 25 percent, it is now extended to the full amount of its capital and surplus?

Mr. ECCLES. Yes.

Mr. WILLIAMS. Or 60 percent——

Mr. ECCLES. Of its time deposits.

Mr. WILLIAMS. Of its time deposits?

Mr. ECCLES. Right. I suggested that those limitations be taken out of the act and the Federal Reserve be charged with the responsibility of determining regulations with reference to the real-estate loans.

Mr. WILLIAMS. Do you think there ought to be no limitation in that respect in it, except the regulations and rules of the Board?

Mr. ECCLES. That is right.

Mr. WILLIAMS. Or whatever limitation they saw fit to place?

Mr. ECCLES. That is right.

Mr. WILLIAMS. It ought not to be made a statutory provision?

Mr. ECCLES. That is right.

Mr. WILLIAMS. For the reason that it would give them more flexibility in the local communities, in the different localities, and at different times, under differing conditions?

Mr. ECCLES. Many of the nonmember State banks have, at the present time, more than 60 percent of their time deposits in real-estate loans, and some of the member State banks have more than 60 percent. That would mean that those banks would be required to liquidate their real-estate loans, in order to comply with the 60-percent requirement. Many State banks are not limited in the amount of their deposits that they can loan upon real estate.

Mr. WILLIAMS. I am very much concerned about this provision regarding real-estate loans, because I have been under the impression, by reason of the fact that these loans were short-term loans, not amortized loans, the banks were not able to handle them at all in a period of depression.

Mr. ECCLES. You mean under the present bill?

Mr. WILLIAMS. Yes; under the present act, the law as it is now?

Mr. ECCLES. That is correct.

Mr. WILLIAMS. And this act proposes to amortize them over a period of years and make them eligible for discount and furnish a market, somewhat, for them when the time comes when the banks have to have their money. I think, myself, it is a very wise provision in the law.

I believe that is all I care to ask at this time.

Mr. FORD. Might I ask a question, Mr. Chairman, just a question?

The CHAIRMAN. Yes; indeed.

Mr. FORD. Suppose the Federal Reserve has taken considerable volume of real-estate loans, what provision is there for the Federal Reserve bank, itself, to dispose of them, should they want to?

Mr. ECCLES. There would be no occasion for the Federal Reserve bank to dispose of them, so long as the member bank that borrowed the money was solvent. The member bank would owe the Federal Reserve on its bills payable, secured by mortgages which it had taken.

Mr. FORD. Suppose a member bank failed?

Mr. ECCLES. The Federal Reserve bank would be required to liquidate that mortgage or collect it or sell it, just as any other asset.

Mr. FORD. It could sell it, though?

Mr. ECCLES. Yes; it could sell it.

Mr. FORD. It is not just put in there and held static?

Mr. ECCLES. No; it would liquidate any asset or loan of the member bank which it held just the same as the member bank would undertake to liquidate the loan of an individual or corporation borrower.

Mr. WILLIAMS. Governor, there is this question that I want to ask you before I finally quit: Under our present system, or under the system proposed in this bill, what do the Federal Reserve banks pay for the privilege of issuing money?

Mr. ECCLES. They do not pay anything.

Mr. WILLIAMS. Do not pay anything?

Mr. ECCLES. No.

Mr. WILLIAMS. Now, as you know, there is considerable agitation, a good deal of comment in the country, about the Government owning these institutions. What would be the difference in effect if the Government did own them?

Mr. ECCLES. The individual member banks are the owners today. However, they are limited to 6 percent dividends on their stock. The earnings of the Reserve System in excess of 6 percent are held by the Reserve banks, and at one time——

Mr. WILLIAMS. Right in that connection, do they not belong to the stockholders?

Mr. ECCLES. Not under the law, not beyond the 6-percent dividends.

Mr. WILLIAMS. Of course, I understand we had, by legislation, to take it away from them. They were claiming to own it, were they not?

Mr. ECCLES. Yes; I think that there possibly was some claim to that effect. Personally, I would see no objection to requiring that the earnings of the Federal Reserve banks, beyond the limitation of 6-percent dividends to member banks, should be turned over to the Government when the surplus of the Reserve banks has reached an amount equal to its capital.

Mr. WILLIAMS. If the Government, however, can own and operate them as successfully as private institutions have done, why not give the 6 percent to the Government rather than to the private banks, as well as the reserves and the surplus?

Mr. ECCLES. It is now provided in the law that, in case of liquidation, any surplus remaining, after the payment of all debts, dividend requirements, and the par value of the stock, shall be paid to and become the property of the United States. I see no advantage in the Government taking over the stock of the Reserve banks.

Mr. WILLIAMS. It would not cost the Government anything to do that, would it?

Mr. ECCLES. I think it would; yes. The Government could not take over the stock without paying the member banks, any more than the Government could purchase any other asset without it costing it anything.

Mr. WILLIAMS. The purchase of the stock is already in the Federal Reserve banks, the purchase price of it?

Mr. ECCLES. That is right.

Mr. WILLIAMS. And if you took it over, it would simply own it instead of the Federal Reserve System owning it; the funds then with which the stock was paid for would be in the hands of the Government, would they not?

Mr. ECCLES. No; the United States Treasury would have to make payment to each member bank for its stock in the Reserve System, and the stock would be transferred from the ownership of the individual member banks, which own stock in the respective Federal Reserve banks——

Mr. WILLIAMS. Then, in taking over the System, we would get the assets that belong to the bank, that were paid in there by the member bank, would we not, for their stock?

Mr. ECCLES. When you bought the stock held by a member bank in the Federal Reserve System, you would naturally have—that is, the Government would naturally have the assets represented by stock which it purchased. That is correct.

Mr. WILLIAMS. And that is sound, really, after all; it would not cost the Government anything?

Mr. ECCLES. It might be—it would not cost it in the sense that it would be paying out funds without getting an equivalent asset; it would be an investment, rather than an expense, but it would cost the same——

Mr. WILLIAMS. They would get the stock?

Mr. ECCLES. That is right.

Mr. WILLIAMS. The stock the member banks now own? Now, I believe I asked a question awhile ago, that if the Government can own and operate the banks and issue money, instead of private institutions, why not do that and save the 6 percent that we are now paying.

Mr. ECCLES. You would not save 6 percent. For the Government to buy the stock, it would be required to raise the money that is used to purchase the stock, and in raising that money it would borrow it. If it borrowed it or raised it as they raised funds for other purposes, it would be required to pay whatever interest the Government debt was required to bear, in order to float the funds to get the money to buy the stock.

At the present time, the last offerings of Government securities bore a rate of $2\frac{7}{8}$ percent; so in that case, you would save $3\frac{1}{8}$ percent, the difference between 6 percent and $2\frac{7}{8}$ percent.

Mr. WILLIAMS. Even so, why not save it?

Mr. ECCLES. The answer is, perhaps, that there is no more reason for the Government to invest in this business so long as it controls the money supply, than in any other business.

Mr. HOLLISTER. Might I ask one question there?

Mr. WILLIAMS. Yes; go ahead.

Mr. HOLLISTER. That would be on the theory that you could necessarily buy the stock at par. There is nothing, is there, in the law which would permit the Government, unless it is some new theory of confiscation hitherto unannounced—there is nothing by which the Government could expressly pay the member bank which owns a particular amount of stock in a particular Federal Reserve bank—there is nothing by which the Government could compel that bank to sell its stock at par if it chose to put a price on it of $200 or $300 or $400, is there?

Mr. ECCLES. That is a legal question that I do not feel I am prepared to answer.

The CHAIRMAN. Let me suggest that if you answer that question you also tell us what you would do about the stock of the State bank that is a member of the Federal Reserve System.

Mr. HOLLISTER. I am assuming that the Government is trying to buy stock in a Federal Reserve bank owned by individual member banks. That would be a matter of contract between the Government and each individual stockholder bank as to what the Government would be willing to pay and what the member bank would be willing to surrender its stock for.

Mr. ECCLES. That would seem to be the situation, and that is a legal question.

Mr. HOLLISTER. If you are not prepared to answer the question, I would rather not interfere with Mr. Williams. I do not want that to remain open without some comment, but I will refer to it later.

Mr. WOLCOTT. May I ask a question, Mr. Williams?

Mr. WILLIAMS. Well, yes.

Mr. WOLCOTT. Do I understand there is about $450,000,000 in that fund which has been turned over to the Federal Treasury over and above this 6 percent that was used—or we used one-third of it, did we not, in subscribing for stock?

Mr. ECCLES. The Federal Deposit Insurance Corporation? That was $140,000,000——

Mr. WOLCOTT. Was it not one-third of that fund?

Mr. ECCLES. No; it was more than one-third. The Treasury put $150,000,000 and the Reserve System——

Mr. WOLCOTT. $149,000,000?

Mr. ECCLES. I think it was $140,000,000.

Mr. WOLCOTT. $139,000,000, I think it was.

Mr. ECCLES. It made a total of $290,000,000 that was supplied by the Reserve banks and the Treasury.

Mr. WOLCOTT. Out of this Reserve System?

Mr. ECCLES. Out of the surplus of the Federal Reserve bank.

Mr. WOLCOTT. That could be used in payment of interest on these bonds, and after that the full 6 percent and all over and above that would go to the Government?

Mr. ECCLES. You mean, then——

Mr. WOLCOTT. This reserve that is already in it——

Mr. ECCLES. Yes; but that money was paid out by the Reserve banks to the Federal Deposit Insurance Corporation, and therefore the Reserve banks no longer have those funds. Those funds are owned by the Federal Deposit Insurance Corporation and——

The CHAIRMAN. Let me correct you just a moment.

Mr. WOLCOTT. We reimbursed the Federal Reserve bank for that, did we not?

The CHAIRMAN. We did not give any money to the Federal Deposit Insurance Corporation, but we merely subscribed to its capital stock.

Mr. ECCLES. Yes.

Mr. WOLCOTT. Indirect loans——

Mr. ECCLES. You do not think that the capital stock has very much value, then, do you? The law provides that the stock of the Federal Reserve banks can receive no dividends.

The CHAIRMAN. Tim will tell that.

Mr. ECCLES. The first banking bill——

The CHAIRMAN. It has made pretty good profit up to now.

Mr. ECCLES. Title I of the banking bill provides that the Federal Deposit Insurance Corporation's capital of $290,000,000 can be reduced to a nominal amount, and the balance put to surplus, so there would not be an impairment of capital, if it became necessary to put up these funds.

Mr. WILLIAMS. I would like to remark, in that connection, that so far as I am concerned, that will not be done, because I believe the banks themselves ought to bear that burden.

Now, coming back to the original proposition, Governor, whether or not the Government, as a practical proposition, can own and operate the Federal Reserve banks on as sound a financial basis, and render the same service and save these expenses, in the long run, if you have dividends that are being paid to the banks on the stock—if that can be done, why should it not be done?

Mr. ECCLES. I believe that the ownership of the stock by the Government would not necessarily be of any particular benefit or value in the operation of the Federal Reserve System. I believe that through the adoption of the provisions of this bill, the control would be effective and the responsibility fixed, and it should be just as effective in operating the system in the public interest as it could be operated if the Government owned the stock. It gets down to a matter of human intelligence. The management of the banks or the management of the System would have to be directed in some manner by some means. I see no reason why a management selected with the Government owning the stock would insure the System being operated in the public interest anymore than would be the case with the members of the Federal Reserve Board being appointed by the President of the United States, as is now provided, and the governors and chairmen of the individual banks selected by the local directors of the bank, subject to the approval of the Federal Reserve Board. There is a great advantage in keeping regional ownership and interest in the Reserve banks.

Most of the central banks of the world are privately owned. The bank which is just being set up in Canada, after a good deal of investigation and study and consideration, is owned by the public. I understand the stockholders elect the directors, but the Governor of the bank must be approved by the finance minister, and he has very great power and responsibility.

It is not so much who owns the bank as it is the way the bank is set up and the responsibility with which it is charged.

Mr. WILLIAMS. Is it your thought that Government-owned central banks can operate as economically and as efficiently and as much in the interest of the people of the country as our present system?

Mr. ECCLES. I do not think that the fact that it may be Government-owned, in and of itself, should make any difference. It may be operated as efficiently and it may not be operated efficiently. That, as I say, gets to the human problem, after all.

Mr. WILLIAMS. The ownership of it, in that respect would make no difference?

Mr. ECCLES. I do not think so, not necessarily. If the management of the banks, the personnel of the board consisted of efficient men who would feel independent to use their best judgment and thought in carrying out the affairs of the institution, the ownership would make no difference. If, on the other hand, people were appointed to operate the system for purely political reasons, rather than with reference to their qualifications, and they were made to feel subservient to the point where their best judgment was not exercised, then of course the system, under those conditions, would be badly and inefficiently and ineffectively operated.

Mr. WILLIAMS. Of course, the central idea in this legislation here, as is stated at the very beginning, is to try to increase and centralize the power in the Federal Reserve Board over the System, and I think properly so because I think that the Government and Congress and the administration should have control of the monetary system. It is a national system, of course, and there should be some central authority and central power responsible for it. The purpose of the bill is to create centralized authority, with complete management of the corporation or system.

Mr. ECCLES. With the board, which would be charged with responsibility for the monetary policy, working with and under the advice of the Governors' committee. There are many functions that would be carried out by the individual regional reserve banks, under the direction of their boards of nine directors.

Mr. WILLIAMS. But nothing that would influence the national monetary policy, without the consent of the central board?

Mr. ECCLES. That is right, except that the Governors would influence the policies of the board, as a result of their counsel and advice.

Mr. WILLIAMS. And that would be true whether they were representing the system governmentally owned or individually owned, would it not? Right in that connection the counsel that you propose of five——

Mr. ECCLES. Representing the 12 Governors.

Mr. WILLIAMS. What function does the advisory counsel now perform? Why could it not do the work proposed by the five?

Mr. ECCLES. I think it is more proper to have the executive heads of each of the 12 banks select their committee for the purpose of advising with reference to the policies, than to have the council advise. The Governors are in much closer touch with monetary problems. The members of the council are appointed, one from each Federal Reserve bank district by the Federal Reserve banks, and I think they consist entirely of commercial bankers from the Federal Reserve districts. They are in touch with the individual problems of their particular banks and their particular communities but I do not believe would be as able or as qualified——

Mr. WILLIAMS. They perform a very valuable function; that is, do they or do they not?

Mr. ECCLES. I have not been on the Federal Reserve Board except for a few months, and I have only had occasion to meet with the advisory council on two occasions. It would, therefore, be difficult for me to judge as to just how important the functions of that body have been over the life of the System.

Mr. FORD. Might I make a comment, Mr. Williams, please?

Mr. WILLIAMS. Yes.

Mr. FORD. Mr. Eccles, does not the demand for more complete control on the part of the Government indicate that the heretofore private control has not proved satisfactory to the Congress or the country?

Mr. ECCLES. I would not say that we had had private control. I think one of the principal difficulties of the money system has been that we had not placed the responsibility definitely upon any one body and given it the power and authority to carry out the responsibility that was imposed upon it.

Mr. FORD. It is too wide-spread, and they have been forced to operate and do what the Board wanted to do——

Mr. ECCLES. We did not have a statutory open-market committee until the Banking Act of 1933 created one of 12 Governors, and charged that body with responsibility for the initiation of the open-market operations and gave to the Board the power of approving or disapproving the recommendations of the Governors. But even then if the Board approved of recommendations of the Governors, one or all of the 12 banks could refuse to participate in the operation.

Mr. WILLIAMS. Has not the Board had that open-market policy through the years?

Mr. ECCLES. The Board was not charged by law with the duty of formulating an open-market policy.

Mr. WILLIAMS. None at all? Have they not intended to control, in any way, the expansion and contraction of money through open-market operation, through their advice and instruction to the member banks, and through their own operations?

Mr. ECCLES. The Board has acted in all these matters, but without a clear mandate of law.

Mr. WILLIAMS. They made no effort—do I understand that the Board itself has never made any effort at all along that line until the open-market committee of 1933?

Mr. ECCLES. The Board has attempted to influence the money market through changes in discount rates—that is, its right to approve of the discount rates—and it has even changed discount rates on its own motion. The need of the open-market operation was recognized in 1922, and a voluntary committee of governors was organized to carry out the open-market policy or program.

Mr. WILLIAMS. They had that policy then?

Mr. ECCLES. The open-market committee of the governors had the responsibility for that program. The Board itself has not been charged specifically with the responsibility for the open-market policy.

Mr. WILLIAMS. I understand, as a matter of law, but they have actually adopted the policy, have they not?

Mr. ECCLES. To what extent I cannot say. I am not as familiar possibly as I should be with the detailed history of the operation of the Board.

Mr. CROSS. May I ask a question just on that?

Mr. WILLIAMS. Yes.

Mr. CROSS. Now, is it not a fact that the Board, in April 1923 or May 1924, brought its pressure on the open-market committee and had them to buy $510,000,000 of Government securities and reduced the rediscount rate from 4½ percent to 3 percent, and, as a result, put the wholesale commodity price level up to 11 percent, and the agricultural products up to 20 percent, and this action was repeated a number of times, and brought about the beneficial effect when they did it?

Mr. ECCLES. I do not know to what extent the open-market purchases and reductions in the rediscount rates had an effect upon the price level. It is true, I think, that, under certain conditions, to reduce the interest rates and increase the supply of money would be effective in increasing business activity, just as to increase the interest rates and reduce the quantity of money would tend to restrict business activities, and slow up borrowing, and possibly start a process of liquidation.

I do not believe that anyone can say to what extent open-market policy can be responsible for recovery or for depression.

The Swedish money management is one of the most interesting, I think, that we have in the world today and possibly has been as successful, or looked upon as being as successful as that of any other country, and the governors of the Swedish bank, in February 1932, made this statement:

It follows that when forming its policy in view of fluctuations in the price level the Riksbank cannot but take into account the causes of such changes in prices. For it is essential to determine whether price movements are caused, e. g., by increased tariffs, altered exchange rates, or a tendency to inflation on the domestic market which may be looked upon as primary in relation to exchange rates. In any such analysis of price conditions, naturally other price indexes besides the Riksbank's own index of consumers' prices will also be taken into consideration. Obviously, in their endeavor to create as stable economic conditions as possible, the governors are also taking into account other factors than mere changes in the price level, particularly conditions affecting productivity and stocks in various industries.

The CHAIRMAN. Gentlemen, it is evident that we cannot continue much longer, in view of the business in the House. I am going to suggest that we adjourn until tomorrow morning at 10:30, and resume with Governor Eccles.

(Thereupon a recess was taken in the hearing until 10:30 a. m., Tuesday, March 12, 1935.)

# BANKING ACT OF 1935

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**TUESDAY, MARCH 12, 1935**

House of Representatives,
Committee on Banking and Currency.
*Washington, D. C.*

The committee met at 10:45 a. m., pursuant to adjournment, Hon. Henry B. Steagall (chairman) presiding.

The Chairman. The committee will please come to order.

Mr. Eccles, you may proceed now. Mr. Williams, do you have further questions?

Mr. Williams. I think not, Mr. Chairman.

The Chairman. All right, Mr. Cross.

## STATEMENT OF MARRINER S. ECCLES, GOVERNOR OF FEDERAL RESERVE BOARD—Continued

Mr. Cross. Governor, you agree with the proposition that it is the duty of Congress to regulate the value of money, don't you; that is, Congress, acting through its agency which it sets up, shall do it? Of course, Congress itself does not do it.

Governor Eccles. I think that is a sovereign power given to Congress.

Mr. Cross. In the Constitution.

Governor Eccles. In the Constitution.

Mr. Cross. Now if that is the duty of Congress through its agency which it sets up, which of course, is the Federal Reserve System, don't you think that that agency ought to be independent of any outside influence or interests?

Governor Eccles. The agency should represent the Nation as a whole and should not be under the domination or control of any group or groups.

Mr. Cross. Should not the agency they set up, they being responsible and having the duty to perform, which they have delegated to that agency, should not that agency be independent of any outside agencies that come in with a different purpose in view?

Governor Eccles. It is my view that the Federal Reserve Board should be as independent as it is possible to create a body of that sort, charged with the responsibility of monetary policy in the public interest.

Mr. Cross. Now, Governor, isn't it a fact that the member banks of the Federal Reserve System are constantly wanting to go out in an opposite direction to what a wise policy would dictate, and that they are constantly wanting to inflate when they should not, and constantly wanting to deflate when they should not?

Governor ECCLES. Well, of course, there are a good many thousands of member banks, and I don't believe there is any uniformity of opinion. Inflation is brought about by creating a condition of easy money, expressed in low rates and excessive reserves, in a period when there is great business activity and hence a willingness to borrow.

Mr. CROSS. Yes. But now the point I am driving at is this, isn't it a fact that the member banks, and I am asking this just to get your reaction on this, are inflating when they should not be, and are deflating when they should be inflating? Here is what Governor Harrison of the New York Federal Reserve Bank said in the hearing in 1932, page 53:

It is almost inevitable that the Federal Reserve System, or any central bank, will always have to go contrary to what the banks are doing. When they are deflating, we have to put pressure on them, and when they are deflating we have to boost things up. I think that is what we should do.

Isn't it a fact that the member banks, when they are trying to make money for their stockholders, in times when prices are high, they want, of course, to keep extending credit, credit, credit, and inflating, and naturally their class A directors—and class B directors, who are largely under the control of class A directors—wish to keep going forward and expanding, and don't you think that is a conflicting interest contrary to what the Federal Reserve System is intended to do?

Governor ECCLES. Of course, all I have is the record. From 1926 up to 1930, there was a very small variation in the supply of money. There was no inflation in the volume or the quantity of money from 1926 to——

Mr. CROSS. You refer there to all money—credit money?

Governor ECCLES. That is right; I refer to all money. I include in that demand deposits of member banks and of nonmember banks, and the currency outside the banks, in a word the entire circulating medium.

Mr. CROSS. That is over what period?

Governor ECCLES. That covers the period from 1926 to 1930.

Mr. CROSS. Will you please answer for me this question: There was a vast difference in velocity in those years?

Governor ECCLES. Yes; that is correct.

Mr. CROSS. And the Federal Reserve System can step in and control velocity, can it not?

Governor ECCLES. I don't think that the system has as much influence or velocity as it has on volume of money. I think the velocity of money is influenced more by the tax system than by monetary policy. Velocity slows up as business activity declines, or as deflation develops.

With the national income in 1929 estimated at beyond 82 billions, with the money volume at that time 264 billions, there was a velocity of 3.12; that is, each dollar on the average turned over 3.12 times in the course of the year in the process of making up the income of the community.

Whereas, in 1933, with the national income diminished from 82 billions to 46 billions, and the volume of money reduced from 26.4

billions to 19.9 billions, income velocity had declined in that period to two and a third.

Mr. Cross. Yes; I understand, that Governor.

Now Governor, isn't it a fact that in order to control the situation you must still have a fixed policy and step in in time? "A stitch in time is worth nine", as one of the governors explained here in his testimony.

In 1929, Governor Harrison was insisting that something be done to stop the inflation, but it delayed too long, until the crash came, and of course then when that happened it was almost impossible to do anything. But it is shown by the record before that they would go out, putting out more securities, putting out more credit, more money, when the commodity prices rose, and then when they would stop that and sell, the reverse was true, because when you sell you take from the member banks their reserves, and that of necessity causes them to rediscount which they don't like to do, and that has the effect, of course, of steadying things, and slowing matters up—keeping them from rediscounting so much.

In order that I may get your reaction on some of these things, I will quote from the testimony of Dr. Sprague who appeared before the committee, I believe, in 1923:

> There would be, I think, an advantage from the passage of the bill. I probably agree with you that the defects in the operation of the Federal Reserve System are not so much errors of judgment they have made, but rather in the hesitating manner in which at times policies have been decided upon and then executed.

Without a goal to go to, and the boards come and go, the present Board may be gone in a short while, and with no goal to go to, the individuals differ and hesitate, and don't you think that is one of the great troubles, not having any goal to go to?

Governor Eccles. You mean without a specific provision or objective required?

Mr. Cross. Yes.

Governor Eccles. You mean required as a part of the law?

Mr. Cross. Yes; for Congress to set down the purpose, and have it the purpose of Congress, rather than to just turn the Board loose and let them go ahead as they did in 1928, as my recollection of the testimony shows, or 1924, when the Presidential election was coming on and they determined they should have prosperity. So, therefore, they got out and they bought Government securities, $510,000,000, shooting the price level up 11 percent, the farm products 20 percent, and built up commodity prices. Then, after that, they reversed the process, but no election was then coming on.

Now if you have a goal to go to, so they can't just shoot things up and down for some ulterior motive, they are fastened to an anchor, and don't you think it would be wise to have such a provision in the law?

Mr. Williams. You mean a price level, do you, Mr. Cross?

Mr. Cross. Yes.

Governor Eccles. I don't think there should be a mandatory provision to reach a certain price level. It may be of interest in that connection to consider the preamble of the recent law creating the Bank of Canada. It is short and might be considered as a basis for our own. It doesn't definitely fix a price level, but it does fix an objective:

> Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit, and to mitigate by its influence fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion.

Mr. CROSS. They will all say that, of course. Everybody agrees to that, but isn't it a fact that our system is such, as I suggested, we go out and do a thing when a Presidential election is coming on, without any guide as to what the purchasing power of a dollar should be, no relation to the commodity-price level, and then turn them loose? They not only hesitate, but when they do jump, they will jump because of some purpose that is actuating them like a Presidential election.

For instance, let us take Dr. Sprague, who said in his testimony, "I have reached the conclusion that a stabilization amendment might prove serviceable."

Now, that was his testimony during that same time, in 1928.

Don't you think experience has shown those people that they couldn't have a stable policy under those conditions?

Now, I want to get your reaction on some more of his testimony.

Now, Dr. Miller, in the hearings in the Senate, in 1931, said:

> It was my opinion expressed several times, in discussions at Federal Reserve meetings in the opening months of the year 1929, that the Federal Reserve System was drifting, that it was in the midst of a perilous situation without a policy--

and won't that, in your opinion, continue to be the case unless you have got a goal to go to?

Governor ECCLES. I think there should be a goal, but the goal shouldn't be a fixed-price level. I think the goal should be stable business conditions because if you have a goal of——

Mr. CROSS. Who is to determine what stable business conditions are? The Board? They differ here.

Governor ECCLES. Yes; it has got to be left up to the Board, which should not be considered a political body. The law makes the Board a nonpartisan body, on which political parties as such are not represented and appointments to which are for periods of 12 years.

Mr. CROSS. That is true, but you know human nature doesn't change, and it is just like the *Dred Scott case* in the Supreme Court. People don't change. And what we want to do, it is my idea that we get something here where they are anchored to something.

For instance, now, here is the testimony of Governor Harding:

> The American monetary system is a good deal like a ship at sea without adequate equipment of rudders and compass to guide it.

Don't you think they need something to guide them, something to go to?

Governor ECCLES. I don't believe that a fixed-price level is a guide that we should have. We might have a stable price level on the basis of some index, and yet have a great deal of unemployment.

Nobody would be satisfied if you reached a 1926 price level and continued to have a national income of 50 billion dollars instead of 80, and 10 million people unemployed.

Mr. CROSS. Yes, but Governor, the question of unemployment depends upon profits, doesn't it?

Governor ECCLES. Not altogether——

Mr. CROSS. I won't run my factory unless I make a profit, will I?

Governor ECCLES. That is true.

Mr. CROSS. If I make profits, I employ people.

Governor ECCLES. That is right.

Mr. CROSS. And when I employ people that increases purchasing power.

Governor ECCLES. That is right.

Mr. CROSS. And when they have that increased purchasing power they are going to buy, and I will continue to produce, but if you let matters run wide open and I keep expanding, then there is bound to be a reaction, and I throw a lot of people out of employment and I destroy purchasing power.

Don't you think it is better to have a stable purchasing power in relation to a wholesale price level?

Governor ECCLES. This is an interesting chart here that Dr. Goldenweiser gives me. It shows that the price level in England was very stable from 1931 to 1934, but the amount of their unemployment fluctuated considerably.

Mr. CROSS. Yes; I have seen some of the charts.

Governor ECCLES. But I mean——

Mr. CROSS. But, now, Governor, in reference to England, did you read the book by Sir Charles Morgan Webb, in which he in substance says that they regulated gold from 1823 on down to 1914 because they were the only creditor nation of the world and they were carrying the commerce of the world, and that it benefited them as a creditor nation? Did you read that work?

Governor ECCLES. No; I didn't. It seems to me that the Federal Reserve System can control to quite a large extent, not entirely, however, the volume of money, by its power over discount rates and its open-market policy.

Changes in the volume of money in the hands of the people, however, depend also upon the willingness of people to borrow and the willingness of banks to lend.

Mr. CROSS. Yes, Governor; but what I am trying to get at now is to try to show you how confused the Federal Reserve Board has been in the past. Now, for instance, here Dr. Miller testified in 1928, and he says:

> It is my opinion that the Federal Reserve mind at the present time is more perplexed than it has been since the troublesome period of 1920 to 1924; that it is in a state of mental confusion.

Why was that and what is there to keep it from remaining in a state of mental confusion unless you have some goal to go to?

Governor ECCLES. I think there should be a goal, but I don't think the question of prices——

Mr. CROSS. Well, name the goal you think is the proper one.

Governor ECCLES. The goal is stable business conditions and full employment.

Mr. CROSS. All right, they had that all the time, didn't they? It is just the same as the goal in the law now, isn't it?

Governor ECCLES. In the existing law the Federal Reserve Board is not charged with the responsibility of creating a condition either of stable prices or of full employment.

As I understand it, the responsibility of the Federal Reserve System is to supply the credit needs of commerce, agriculture, and industry.

Mr. CROSS. All right, now let us go back to Congress. It is the duty of Congress under the Constitution to furnish money, adequate money, a medium of exchange, and regulate its value.

Governor ECCLES. That is right.

Mr. CROSS. How can Congress regulate that value unless it fixes the price level?

Governor ECCLES. I don't say that prices are not part of the consideration. I think that every effort should be made to maintain stable prices, but stable prices should not be the sole and paramount objective, so that the Board would be directed to maintain stable prices and not to consider total production and employment at all.

Mr. CROSS. Yes; but you take the wholesale index of prices in the market, which are arrived at by taking the mean price, where some may go way up and some way below, but you hold a mean level of prices. Now, if you don't use that, you have got no measure of value, have you? Unless you use that, what other measure of value could you figure for money?

Governor ECCLES. I am not sure that I can say. Gold, of course, hasn't proven to be a very satisfactory measure of value and the buying power of money, measured in goods and services, of course, is the value that the people are interested in.

Mr. CROSS. Governor, I want to ask you this question, You don't think we are helpless in the midst of plenty to feed and clothe, with man power to produce—that we are helpless and these things come on and then there is no help for it? Do you think that?

Governor ECCLES. I stated the other day that I don't believe that any monetary policy alone will result in stable business. Simply dealing with the volume of money, so far as it is possible to influence or affect the volume of money through the controls that the Reserve System has, cannot give you full prosperity. This is because distribution of wealth production——

Mr. CROSS. Yes.

Governor ECCLES. Is a very important element, and that gets back to the problem of the tax system. The banking system can influence the volume of money——

Mr. CROSS. Now, Governor, I understand that.

Governor ECCLES. And the tax system, it seems to me, must influence the velocity of money.

Mr. CROSS. Well, now, Governor, let me get this. Of course, I don't think the tax system is so important that we are ever going to get anywhere with it except to stop enormous fortunes by higher taxes in the upper brakets. But now suppose you have got a small community such as they had in the early days, when people would come in to the fairs and exchange their products, their things; and they followed the law of supply and demand perfectly, did they not?

Governor ECCLES. Yes.

Mr. CROSS. Now, the dollar or the monetary unit of a country is supposed to reflect as a mirror the workings in that country of the law of supply and demand for things; so if the country has plenty of everything, if that law of supply and demand were followed just like they would come together and exchange what they have, everybody would have plenty and would not be hungry and distressed and ruined and broke. Now, don't you think the monetary unit ought to perform that function?

Governor ECCLES. The monetary unit ought to; but the monetary unit can't be made to perform that function simply through monetary policy. Placing the means of payment in the hands of people who will spend is the thing that determines employment, business activity, and price levels.

The ownership of the money is an important element in the use of the means of payment. If there are corporations, owning large unused balances of funds, which cannot find a profitable place to use or invest those funds, those funds don't go into circulation.

Mr. CROSS. That is true, but if you had prices at the point where they could invest and make some profits——

Governor ECCLES. But the——

Mr. CROSS (continuing). They would invest.

Governor ECCLES. The prices would not induce them to invest. It is the profit opportunity that induces them to invest, and where you already have a great unutilized capacity because the people as a whole lack the buying power to purchase the goods produced, there is no incentive to invest in further capital goods.

Mr. CROSS. Governor, don't you think the whole theory is that we are helpless—and so far as the Federal Board is concerned we needn't look to that for relief, not for much relief—that there are all kinds of things out yonder that you can't reach and touch, and therefore we just have to follow along?

Governor ECCLES. No; I think that the monetary factor is 1 of the 3—1 of the 3 important control measures of our capitalistic system. The volume of money can largely be controlled through a banking system.

The distribution of funds which is a factor in their velocity must be controlled through the income-tax system, and employment must be regulated through a public-works system.

When the volume of money is adequate to support a certain price level for a given volume of production, and unemployment begins to develop, and as a result prices begin to decline, it is likely to be because productive facilities are out of balance with the consumers' buying power, and velocity of money is declining.

Mr. CROSS. Yes; but you don't want to let it get to where that happens. If you are going to let contractions take place, and as a result all over the country where bonds have been issued for school districts, road districts, municipalities—and you say that the dollar today or next month will double in purchasing power, so that that individual must pay twice in real value because there is no value in money so far as keeping and clothing is concerned—he must pay twice as much in real value to pay the taxes and to pay the interest on his mortgage if he has one—it becomes an impossibility. It means a general liquidation and discontent and trouble and threatened bankruptcy.

Governor ECCLES. It does, if you let the national income decline. The purpose of our tax system and the public-works system is to keep up production when private business fails to keep up full employment. The loss to the Nation, when the national income declines through unemployment, is a loss we cannot afford.

Mr. CROSS. And your idea is to do it through public works, public enterprises?

Governor ECCLES. That is right.

Mr. CROSS. Each time you do that you borrow a good many billions of dollars, don't you?

Governor ECCLES. You wouldn't have very much to do if you did it at the right time, before you allowed deflation to proceed very far. The amount that it would require at the beginning——

Mr. CROSS. That is, more or less, just a guess, isn't it? If you keep on running these billions up, who is paying that tax but the public? And if you get 50 billions and a hundred billions, the fellow who pays it has got to collect it back off the people. There are bonds which they have got to collect off the people in taxes.

Governor ECCLES. Who pays the difference between the 85 billion of national income and the less than 50 billions of national income—who pays that 35 billions?

Mr. CROSS. The fellow who has got the loans on his land. The people who have the loans foreclose the mortgages and get the land, and they keep it until they can resell it to these fellows again, those who can buy. They have to take that loss. But my idea is to get a stable purchasing power in your monetary unit, so that it can't happen that if a man goes out and puts up a factory and has to borrow money, and he borrows this money and builds the factory and expands it, and the first thing he knows the purchasing power of that dollar doubles and trebles, and he is sunk.

Governor ECCLES. You may fix a stable purchasing power as a requirement of the monetary policy of the Federal Reserve Board, or any other Board, but I don't know what methods they could use to maintain or to reach that objective.

Mr. CROSS. Don't you think it could be kept by using the rediscount rates? In other words, using the reserves—the reserves in the banks—couldn't you use the open-market operations?

Governor ECCLES. No monetary policy alone by simply attempting to regulate the volume of money will maintain a stable national income or——

Mr. CROSS. I don't say "volume" alone. I mean volume and velocity. Can't you control it through the rates, loaning of the reserves, and rediscount rates and open-market operations—wouldn't that have an effect on the velocity as well as the volume?

Governor ECCLES. To the extent that a reduction of rates and an increase in the supply of money would tend to stimulate velocity; yes. But so long as there is an inequitable distribution of wealth production which results in excessive saving we will have depressions.

Only by pulling back that part of our savings that we cannot profitably use in new capital goods and using those funds to give employment to those who become unemployed can we maintain a balance.

The Government must be the compensatory agent in our economy through the money system, through the tax system, and through a public works system.

Mr. REILLY. I think the committee will have to go now. The committee will adjourn now.

(Whereupon, at 11:25 a. m., an adjournment was taken until Wednesday, Mar. 13, 1935, at 10:30 a. m.)

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# BANKING ACT OF 1935

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**WEDNESDAY, MARCH 13, 1935**

House of Representatives,
Committee on Banking and Currency,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. The committee will come to order. Mr. Cross, you may continue with your examination of Governor Eccles.

## STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Continued

Mr. Cross. Governor, you may have thought, from my questions, that I am in a critical mood. I want to say I think this bill provides for a tremendous improvement over what we have, and I think you are a big improvement over governors we have had heretofore; so do not think I am criticizing you.

Check money, for all practical purposes, performs the functions of legal tender money, does it not?

Governor Eccles. Yes; it does.

Mr. Cross. The easier credit is, the greater the volume of credit, and the greater the number of check dollars, the less the dollar will buy; is not that so? When credit is easy there are plenty of check dollars, check money, and that means prices are up, does it not, and therefore the purchasing power of the dollar is down, is it not?

Governor Eccles. That would be expected to follow. The easy money——

Mr. Cross (interposing). That is almost axiomatic, is it not?

Governor Eccles. Easy money, through the banking system, by creating low interest rates——

Mr. Cross (interposing). That is a fact, is it not, that it is axiomatic; that when credit is easy there is a large volume of credit, and that inevitably means that times are good and prices are up, and profits are up, and people are borrowing, and there is a supply of check money like there was in 1928 and 1929?

Governor Eccles. Of course, your general prices go up when means of payment in the hands of people who will spend increase faster than production.

Mr. Cross. Is the proposition I put to you true or not?

Governor Eccles. I think that is generally the case, but it certainly is not always so. Witness the present situation.

Mr. Cross. Then the tighter credit is, the less credit there is, the fewer number of check dollars there are; that is true, is it not?

Governor ECCLES. Yes; I think that is true.

Mr. CROSS. That being the case, then the more the dollar will buy, will it not?

In other words, as credit dries up, check money, the purchasing power of the dollar increases, does it not?

Governor ECCLES. Not always.

Mr. CROSS. Now, Governor, do you not think the velocity theory of money is more or less a meaningless fiction?

Governor ECCLES. No.

Mr. CROSS. Now, along in 1928 and 1929 we had a situation where our credit money, our check money did about 90 percent of the traffic duty of the country, did it not?

Governor ECCLES. I think those were the estimated figures. I do not know how accurate they are, but that would be approximately correct.

Mr. CROSS. That is what they put it at, about 90 percent?

Governor ECCLES. Yes.

Mr. CROSS. Now, if all of that check money had vanished or dried up, 90 percent of the money had dried up, the traffic of the country had vanished, had it not?

Governor ECCLES. Unless the deposits were drawn out in currency.

Mr. CROSS. If you have 5½ billion in currency, we will say, and we are talking about the check part of it, and practically 90 percent of it was gone, then you had left your legal-tender money, which was about 5 billion, we will say?

Governor ECCLES. Yes.

Mr. CROSS. Now, if nine-tenths of that money was check money; that is, 90 percent, and you had 45 billions in check and 5 billions in legal-tender money, and the 45 billion had vanished, it is not to be assumed that it did not all go out?

Governor ECCLES. I do not know that I understand your point.

Mr. CROSS. If your check money had vanished like the mist—it is a kind of phatom money, but it does the work of the country in all its functions. Say that 90 percent of the traffic was done through check money, and we will say that is nine-tenths of the total, and one-tenth of the business was done, we will say, with legal-tender money, there being nine times as much check money as legal-tender money, and the check money disappears, and you have only left your legal-tender money, of course, then 45 billion in check money would have vanished, would it not?

Governor ECCLES. If it disappeared, that would be the case.

Mr. CROSS. If your credit dried up like the mist, then it would disappear, would it not?

Governor ECCLES. Yes.

Mr. CROSS. And if you then had 5 billion in legal-tender money, and then that 5 billion had kept on performing the duty of transferring the property and the goods of the country at the same speed at which it was traveling when you had your 45 billion of credit money, it would have been doing only one-tenth of the amount of traffic duty that was being done by the whole amount of credit money plus the currency or legal-tender money, would it not?

Governor ECCLES. If the total amount of money is reduced by nine-tenths, then that one-tenth or the remaining money would be doing——

Mr. CROSS (interposing). Traveling as fast as it always had been, it would have been one-tenth, would it not?

Governor ECCLES. I do not know whether it would have been traveling that fast.

Mr. CROSS. Assuming that it would be traveling as fast as it was in 1928 and 1929, with the 45 billion gone, it was doing only one-tenth of the work; if it was doing the same amount of work after the crash as before the crash, is not that true?

Governor ECCLES. If the velocity of the funds does not change, if the volume is reduced nine times, of course, your volume times your velocity would be one-tenth of what it was.

Mr. CROSS. Surely; that is simple mathematics.

Governor ECCLES. Yes.

Mr. CROSS. Now, is it not a fact that in figuring velocity you give credit to the work being done by the credit money when times are good, and the legal-tender money, in fact, is not going any faster than afterward, except that the credit money vanishes and you no longer can figure what the credit money is doing to the legal-tender money? In other words, you give credit to the legal-tender money, and when times are good you say the currency amounted to 5 billions, and it was going at such and such a speed; but you are giving credit to the legal-tender money for all that is being done by 45 billions of credit money, are you not? Is not that the way you count velocity?

Governor ECCLES. No; it is not.

Mr. CROSS. How do you count it? You cannot tell how often it swaps hands.

Governor ECCLES. The national income is the number of times that your volume of money——

Mr. CROSS. Of what money?

Governor ECCLES. All money.

Mr. CROSS. All right.

Governor ECCLES. There is no distinction so far as the working of the money is concerned between currency and checking accounts; they both perform the same function in the money system. I mentioned yesterday the difference in the velocity figures.

Mr. CROSS. Let me get this concretely, if I can, so I can understand it.

Take, for instance, the situation in 1929. At what velocity do you say money was traveling at that time?

Governor ECCLES. What would be termed as the income velocity; that is, the relationship of money to the national income——

Mr. CROSS (interposing). What was the velocity of money at that time? Say we had 50 billion, counting the credit money and the legal-tender money, what was the velocity at which all of the 50 billion was traveling?

Governor ECCLES. We had, in 1929, 26.4 billions——

Mr. CROSS (interposing). Of all money?

Governor ECCLES. Of all money.

Mr. CROSS. Checking——

Governor ECCLES (interposing). And currency; that is right. That eliminates, of course, your interbank deposits. These are the figures I got from the Federal Reserve statistical division.

Mr. GOLDSBOROUGH. That does not include savings money?

Governor ECCLES. No; you cannot include savings money any more than building and loan money.

Mr. CROSS. The checking accounts, plus the legal tender, amounted to 26 billions?

Governor ECCLES. That is right. The national income was 82 billions, according to the Department of Commerce figures, or, to be exact, 82 billion 300 million.

Mr. CROSS. What do you understand as the national income?

Governor ECCLES. It represents, as I understand it, the income received in the production of all goods and services.

Mr. CROSS. What do you count as goods?

Governor ECCLES. It would be capital goods as well as perishable goods, buildings, factories——

Mr. CROSS (interposing). And lands?

Governor ECCLES. Equipment; no land.

Mr. CROSS. Just buildings?

Governor ECCLES. Buildings—factories and equipment; all kinds of goods. The total volume of bank debits was estimated to be between 1,000 and 1,200 billion. In other words, the actual turnover of money was about 40 times a year, I think.

Mr. CROSS. Governor, now you say capital goods, and then you say the income was 80 billion. Where do you get the income at 80 billion? What do you mean by that?

Governor ECCLES. The money value.

Mr. CROSS. Of all capital goods, buildings, and so forth?

Governor ECCLES. The money value of what was produced in any particular year. If in the year 1929 the value of all foods, clothing, and capital equipment of all kinds produced in that year was a certain amount, that would be income, after the elimination of duplications—for instance, if you start to figure the value of wheat that is sold to the miller, then the miller sells to the wholesaler and the wholesaler sells to the retailer. When you take the total check transactions, they run between a thousand billion and twelve hundred billion, and it takes into account all of those relationships. But the national income only takes into account what is produced, and by considering it once, and not in the various transactions through the methods of production and distribution. That is the national income.

Mr. CROSS. I am getting at the question of velocity. You say you had 26 billion of all kinds of money. Upon what basis do you figure the velocity of the 26 billion?

Governor ECCLES. With that amount of money, with 26 billion, we had a national income of 82 billion, 300 million; or we had there what is termed an income velocity of 3.12. In other words, the total volume of our currency and checking account went into the total national income that year 3.12 times.

Now, we come down to 1933, when the national income was 46 billion, 800 million, and our money had diminished from 26 billion, 400 million to 19 billion, 900 million.

Mr. GOLDSBOROUGH. When was that, 1933?

Governor ECCLES. Yes.

Mr. GOLDSBOROUGH. The other year was 1928?

Governor ECCLES. The other year was 1929. There was very little difference between the 1928 and 1929 figures. And with the income of 46 billions, 800 millions and the deposits and currency in existence during that year of 19 billion 900 million, the income velocity was 2.35. We have not the figures for 1934, but that is expected to show a decrease. We know that the volume of deposit currency has been very substantially increased as the result of three factors—the budgetary deficit, gold imports, and the reduction of currency in circulation as the result of the dehoarding.

Mr. CROSS. Your gold is all stabilized, is it not?

Governor ECCLES. That is right. But the gold comes in from abroad to take care of the unfavorable trade balances of Europe and the rest of the world. The only way they have been able to take care of their unfavorable trade balances is to pay us in gold. There has been about 1 billion 300 million of gold coming into the country in 1934. Those three factors increase your deposits. There would have been a greater increase than that had there not been a shrinkage of loans and investments of banks, outside of Government bonds. As I recall the figure, it was around 6 or 7 hundred million dollars. The result was an increase in deposits and currency by about $4,000,000,000, as I recall the figures.

Mr. CROSS. You say an increase in currency?

Governor ECCLES. In deposits. I do not think there was any increase in currency.

Mr. CROSS. As to this billion dollars of gold that comes in here, do you mean to say that would make an increase of a billion dollars of back-bone or pocket money?

Governor ECCLES. An increase in bank deposits in that amount; yes, sir.

Mr. GOLDSBOROUGH. You said the amount in 1933 was forty-six billion, eight hundred million. Have you the amount in 1934?

Governor ECCLES. No; I have not. It is estimated as over fifty billion, but the ratio of the national income to deposit money will show up considerably less than it was in 1933, showing that with the increase in the volume of money there has been a decrease in the velocity of money; that the increased volume has not increased the national income in proportion.

Mr. CROSS. What is the increase for 1934 over 1933?

Governor ECCLES. I have not the exact figures.

Mr. CROSS. In the volume of money?

Governor ECCLES. It would just be an estimate. But I think it is around four billions. That is the increase of 1934 over 1933.

Mr. CROSS. What is the difference between the check money of 1929 and the check money of 1933?

Governor ECCLES. I do not know just what you mean. You mean in amount, the actual amount of check money in 1929 as compared with the check money in 1933?

Mr. CROSS. Yes.

Governor ECCLES. There was a difference of 7½ billion between 1929 and 1933.

The CHAIRMAN. Let me ask you a question right there, to make sure I understand it. Do you mean to give the total figures for the entire country? Are your figures predicated on calculations that embrace all of our banks?

Governor ECCLES. Oh, yes.

The CHAIRMAN. That is what I understood, but I wanted to make it clear.

Governor ECCLES. Yes; the member and nonmember banks.

Mr. CROSS. You do admit that the dollar as it is today, untied to any price level, is no measure of value, do you not? In other words, its purchasing power is constantly expanding and contracting?

Governor ECCLES. That has always been true.

Mr. CROSS. You have an exact measure of length, for instance, in the linear foot; and you have an exact measure of weight in the pound. You also have an exact measure of volume in a cubic foot.

But you cannot measure volume by weight. You might have two cubes of exactly the same dimensions, one made of cork and one of lead, but if you attempt to measure them by weight you would not get any idea about it at all, would you? That is a simple question, it seems to me. I am talking about the simple question of measure. You could not get any idea as to the size of those two cubes by using the measure of weight, per pound, could you?

Governor ECCLES. No.

Mr. CROSS. One would probably weigh a hundred or a thousand pounds more than the other.

Now, you attempt to measure the value by the pure unit of weight, do you not, with so many grains of gold, for instance?

Governor ECCLES. I do not think that a fixed gold content results in stable prices.

Mr. CROSS. I do not think it does either.

Governor ECCLES. It never has in the past.

Mr. CROSS. I do not think so, but we put the price at $35 an ounce, whereas it used to be $20.67.

Governor ECCLES. That is right.

Mr. CROSS. So it is no measure of value, is it?

Governor ECCLES. I do not think so.

Mr. CROSS. Now, the only way to get a measure of value is by a price level; do you not think so? Do you have any other suggestion as to a measure of value outside of a price level?

Governor ECCLES. Do you mean by some index figure?

Mr. CROSS. Yes; or some wholesale commodity price level.

Governor ECCLES. That gives you a measure of value, but it is not what you want.

Mr. CROSS. It does give a measure of value, does it not?

Governor ECCLES. Yes; it does give a measure of value.

Mr. CROSS. Now, if you would tie your monetary unit of the dollar, as we call it in this country, to the price level, you would get a measure of value, would you not?

Governor ECCLES. I do not know just how you would tie a monetary unit to the price level.

Mr. CROSS. I say, if you do do it.

Governor ECCLES. Yes; if you can.

Mr. CROSS. I am saying, if you can you would get a measure of value. As it is, you have not any measure of value. Do you know of any other method by which you could approach a measure of value?

Governor ECCLES. I think that a stable price level is a desirable objective.

Mr. CROSS. I know; we are talking about the price level. What other way is there?

Governor ECCLES. I should not say that I know of a way to get a stable price level, and at the same time get a stable business condition, which is a condition of full employment and prosperity.

Mr. CROSS. Of course, that is what we all want to do, if we can.

Let me ask you this question: As the result of this instability, fluctuation, expanding, and contracting in the purchasing power of the dollar, and consequently affecting the earning power of a dollar, credit, or credit money, or check money is very sensitive, timid, and easily affected by any economic disturbance, is it not?

Governor ECCLES. I do not think that check money is more sensitive than any other money.

Mr. CROSS. All right. Any kind of money is sensitive, is it not; any other money, like legal tender?

Governor ECCLES. Yes; that is right.

Mr. CROSS. If you can stabilize it on a price level, it will become a dependable measure of value and relieve credit from the instability and constant fear to which it is now subject, will it not?

That is, if a man knows that he will know that he will have a dollar to spend in the aggregate, and would take into consideration the figures you use in determining the wholesale commodity price level, and he knows it will hold up the purchasing power and the value, would not that tend to stabilize and give confidence?

Governor ECCLES. I think it would.

Mr. CROSS. The only method by which we know how to do that are the levers you have in this bill, rediscount and open-market operations.

Governor ECCLES. Open-market operations, yes; that is right.

Mr. CROSS. Now, with those three levers, do you not think you could approximate holding the purchasing power of the dollar stable with the price level?

Governor ECCLES. Insofar as that can be done through monetary action, I think you could accomplish that.

Mr. CROSS. We know of no other action——

Governor ECCLES. In that connection let me read a short statement I have here which seems to me to cover this question.

Professor Olin, a Swedish authority—and they have possibly had more experience in this question of managed currency——

Mr. CROSS. He has not had a long experience because this just started recently.

Governor ECCLES. That is true of the entire world. As a matter of fact, as to the problem of central banking and money management, there is plenty to learn about it. There is no country which has had any experience for any great length of time.

Mr. GOLDSBOROUGH. There is plenty to unlearn about it, is there not?

Governor ECCLES. About the question of managed money?

Mr. GOLDSBOROUGH. About the way to handle central banks. Can you answer that?

Governor ECCLES. I do not know enough about the history of central bank operations. Of course an automatic gold standard has been a guide in the operation of the world's banking system in the past, up to the time of the war.

Mr. CROSS. Controlled banking, was it not?

Governor ECCLES. Very largely.

Mr. CROSS. I wish you would read that book written by an Englishman.

Governor ECCLES. This man says, after surveying the Swedish experiment in an article in index, volume 8, that—

> A business cycle policy that aims at as full and regular a utilization of the productive forces as possible, that is a maximization of the real national income per head of the population over a long period, is bound to take many other factors into account besides the development of prices; that is to say, it can not be based on the idea of stabilizing any particular price level, especially if the latter has been brought by an immediately preceding depression, but of equilibrium with the other parts of the price system.

Mr. GOLDSBOROUGH. Which means that there are two factors: One is the factor of a scientific monetary system and the other is the factor of distribution of production. That is what he is talking about, is it not?

Governor ECCLES. That is right; I agree with that.

Mr. CROSS. My idea is that this bill is all right, except that there are two amendments we ought to have.

I think it is up to Congress to provide for the regulation of the value of money, through our agent, which is the Federal Reserve Board.

And since, as I think I showed here yesterday, the member banks are in the business of making money, and the 12 Federal Reserve banks have that idea, too, and as Governor Harrison, of the New York Federal Reserve Bank, said, the very time the Federal Reserve Board wants to hold down inflation or credit, the banks insist on expanding it, and the very time the Federal Reserve Board wants to boost credit, the banks tend to shrink and contract it. As long as they own the stock of the Federal Reserve banks, with their class A and class B directors, with all those influences working, I am afraid there will be cross-purposes, and I think they should be in a position, without any outside influence, to act for the whole people all the time. That is why I believe that the stock should be taken over and owned by the Government in those Federal Reserve banks.

Another amendment which I think should be adopted is this: I think we ought to give them a goal to work to. It is the best we have got; it might not be a perfect compass, and no doubt is not by any means; yet I think we ought to have some kind of a price level, whether you take 50 or 100 commodities, or 784, or use the economists' index, we ought to have some goal set for them to anchor on. We can try it, and if it does not work we can change it.

I notice that England has let the pound slide down, no doubt with the idea of getting constantly under our dollar, giving her the advantage. I think we ought to take 20 percent above the wholesale commodity price level of 1926. If we take that and go very little below that, I think we should do it, because if England or any other country is constantly trying to slide under us and cheapen their money to give them an advantage in the export trade, I think we should be in a position where we can follow along with them.

But I am sold on the question of tying the dollar to the price level within a certain latitude.

Then I will tell you another thing I think about this bill, at least in connection with the psychological effect. You have 40 cents on the dollar back of the Federal Reserve note, and I think if you would make it, say, 35, and provide, say, for 10 cents in silver certificates, you would be taking a wise step.

I realize if you can have stabilized and controlled currency you do not need any metal at all, except as a matter of foreign traffic. But as long as the balance of trade is in our favor we do not even need that because they have to be constantly buying money to pay for our goods.

Of course, if we become an importing nation and the balance of trade is against us, we would have to use a different currency.

Governor ECCLES. As to this question of fixing the price level in the bill, I personally would not like to see that. I would suggest that, in lieu of a fixed price level, something of this sort might be put in the bill, as indicating the direction or objective to which the Federal Reserve Board would be required to reach:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. CROSS. That is a lot better than what we have in there now.

Mr. GOLDSBOROUGH. Would you feel like including in that a statement indicating that the Board should also direct its attention toward using its power in such a manner as to absorb the unemployment? You have done that in a way, but it is not quite clear.

You know there are experts who I think are worthy of attention who claim that you can use monetary powers in such a way as to absorb unemployment to a certain point, and that when you do that you then have notice that you have raised your price level to the proper position.

I am wondering if you could put some sort of legislative direction as that in what you have said. I think myself you have done very, very well in what you just pointed out as a possible amendment.

Governor ECCLES. I am trying to avoid a rigid requirement in the law that may be impossible of accomplishment, and hence may cause embarassment. I would like to see enough flexibility in the law; because I do not believe that we can deal with our money, economic and social problems, and they are all interrelated, as an exact science. You have too many emotional factors to contend with, and when you talk about the problems of business stability, stable prices, full employment, and so forth, you have to take into account factors other than purely the mathematical or mechanical factors of money.

Mr. GOLDSBOROUGH. Will you read that proposed provision again?

Governor ECCLES. It says:

> It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. GOLDSBOROUGH. You are stating the objectives.

Governor ECCLES. That is right.

The CHAIRMAN. The present law was designed, of course, to promote sound business conditions and laid down a guiding rule of policy somewhat along the line of your suggestion, although not so comprehensive.

Under the present law the language is:

> The board of directors shall administer the affairs impartially—

And so forth—

> and extend accommodations such as may be safely and reasonably made, with due regard to the claims and demands of other banks, and to the requirements of industry, commerce, and agriculture.

It is not so comprehensive, but it is in the law, and to a certain extent it is a recognition of the ends to be desired.

Personally, my view is that you have expressed the true policy, and that is to take the general results that would be desired as the guide and standard of activities.

In connection with Mr. Cross' inquiries, what is the relation between actual currency, or Government currency, or Government money, and check money and its velocity?

Governor ECCLES. So far as their functioning and purchasing power are concerned, there is no difference. They serve the same purposes as a means of payment. Currency is used largely as a matter of convenience in meeting pay rolls, in retail buying by the man with a small income, where the checking account is too expensive, or is not wanted. Even in cases where checking accounts are used, particularly is it true now with service charges and the check tax, people will cash checks for a larger amount and pay bills with currency rather than pay all bills with small checks. The use of the check has been greatly diminished.

The CHAIRMAN. What I am undertaking to develop is the necessary part that must be played by actual money in the present scheme.

Governor ECCLES. I do not know that I quite understand you, Mr. Steagall.

The CHAIRMAN. We cannot get away entirely from the use of actual money, even though we do 90 percent of our business by the use of bank checks.

Governor ECCLES. That is right. We possibly use the bank check more than any other country.

The CHAIRMAN. As we cannot rest our banking structure entirely on air, we have to have a basis for that. What I am directing your attention to and asking you to discuss is the proper basis, and the necessity for it; how far the development of a sound bank-check currency must rest upon the use of actual currency and the opportunity to redeem the bank check in actual currency.

Governor ECCLES. Of course, a bank has to be in a position to pay its deposits in currency. At one time it was required to pay it in gold, and of course we know what trouble that got us into. The bank is required to pay the deposit in currency. We found that, while banks were closing and the great deflation was going on, that a great many people and corporations wanted their deposits in currency, to such an extent that the amount of currency outstanding passed the all-time record of the use of currency, even when business was very active. It exceeded over seven billions of dollars, at a time when our business activity was about 50 percent of what it normally is, showing that a very substantial amount of that currency was not drawn out for current or immediate use but was drawn out for fear of loss through bank failures, to be held in safekeeping. We must prevent bank failures so far as is humanly possible. When people found they could get their money if they wanted it, confidence was reestablished in the banking system, and the amount of currency outstanding greatly diminished.

The CHAIRMAN. You say we got into trouble under the system under which we had to redeem everything in gold. Just what do you mean by that?

Governor ECCLES. I mean that when people demanded payment in gold, since gold was used as a reserve for our money system, it did not take the withdrawal of very much gold to force a suspension of gold payments and to put an embargo on gold.

The CHAIRMAN. Let me ask you this question, "Were we forced to suspend gold payments?"

Governor ECCLES. Yes; I think we were, not only because of withdrawals but also because of our price and debt structure and the measures that were absolutely necessary to correct it.

Mr. CROSS. Gold was leaving the country very rapidly, was it not?

Governor ECCLES. Yes; it was leaving the country very rapidly; not only that, but it was being drawn out by corporations and individuals at a rapid rate.

The CHAIRMAN. When we suspended payment we had an unprecedented amount of gold on hand, did we not?

Governor ECCLES. At the time we suspended we had lost a great deal of gold.

The CHAIRMAN. We had lost a great deal of gold, but we still had more than half of the world's gold, did we not?

Governor ECCLES. No; we had about 40 percent of it.

The CHAIRMAN. But we had certainly something like a third—an undue proportion of the world supply.

Governor ECCLES. But at the rate at which it was being drawn out it was evident that we might soon reach a position where it would be necessary to dispense with gold payments and put an embargo on, and therefore, why permit a preference to those people and corporations who demanded payment in gold?

The CHAIRMAN. Had we not always been able, by the use of Government credit, to get our hands on all the gold we needed to redeem the outstanding gold obligations? I do not mean it was a desirable thing to do; far from it; that is not my view of it. I am simply stating the facts.

Governor ECCLES. We had panics in the past where we could not even pay in currency, up until the time we got the Federal Reserve System set-up. I remember the panic of 1907, when they suspended payment in currency and used clearing-house certificates.

The CHAIRMAN. There was not any difficulty in redeeming the currency in gold, was there? Of course, we have always had occasion when quite a number of banks could not pay out any kind of money because they could not get it. But there never was any time in those situations when there was any difficulty about exchanging currency for gold, if you wanted it?

Mr. GOLDSBOROUGH. In the panic of 1873 the gold reserve was depleted.

Mr. CROSS. And there is always a vast difference between dollars and commodities. The whole world was trying to get back, and the whole world was scrambling for it.

The CHAIRMAN. I am speaking about what did happen when Mr. Cleveland was unable to get gold.

Governor ECCLES. I think he negotiated a loan with Mr. Morgan.

The CHAIRMAN. As a matter of fact, we maintained our gold standard with $150,000,000, did we not? That leads to this question: I am not one of those who think that our gold-standard system was ideal; that is one of the things I think it might be said we had to unlearn. Whether we have learned anything or not, I will not attempt to say.

But I think it will be agreed that is one of the things we have unlearned.

But I was going to ask you this question: Why was it we could not redeem in gold? Why could we not go along with that system? Why was it not safe to continue it? That is what I am talking about.

Governor ECCLES. For the reason that——

The CHAIRMAN. Is not this the fact, Governor, that the trouble was there was not enough gold?

Governor ECCLES. Of course, there was not a fraction of enough gold in this country or in the world to meet the gold obligations.

The CHAIRMAN. We did not have enough gold.

Governor ECCLES. Not a fraction of enough to meet the obligations, but that is always the condition. It works all right so long as no questions are raised about redemption but in case of panic there is not enough gold and payments have to be suspended.

The CHAIRMAN. Let me ask you another question. Was not that the chief difficulty with the banks when they found themselves in the situation where they could not meet their obligations in currency, that the currency was too scarce?

Governor ECCLES. No; the currency was not scarce, because the banks had assets with which they could go to the Federal Reserve System and get credit, and they could have drawn down currency. There was no shortage in the amount of currency available to a bank, if the bank had assets acceptable to the Federal Reserve bank.

The CHAIRMAN. That is the point. The fact was they had deposits, as you have said, I think, amounting to 26 billion, or say 25 billion in round figures, that were in the nature of demand obligations. But they had only a trivial amount in comparison to their deposit obligations of assets upon which they could apply for and obtain actual currency; is not that right?

Governor ECCLES. That is right.

The CHAIRMAN. And the fact was, as against 25 billion dollars of demand-deposit obligations for which the banks were responsible, they had only in the country something like 5 billion dollars in which to meet that responsibility. And for all their cash obligations in the Nation they had only such a portion of actual cash that they could have paid, plus their discountable or rediscountable paper, and the amount of rediscountable paper had gotten to the point where it was trivial as compared with the amount of obligations they had.

Governor ECCLES. Oh, yes; and the amount of rediscountable paper, even in 1928 or 1929, was only a fraction of the total deposit liability.

The CHAIRMAN. As a matter of fact, the banks now owe deposit obligations that I believe you say amount to about 25 billion.

Governor ECCLES. That is, demand obligations.

The CHAIRMAN. The amount has increased from 19 billion to 25 billion of demand obligations outstanding against the banks?

Governor ECCLES. That is right.

The CHAIRMAN. And they have available today to meet those demands something like three-quarters of a billion dollars of actual money; is not that about right?

Dr. GOLDENWEISER. You mean cash in vaults?

The CHAIRMAN. Yes.

Dr. GOLDENWEISER. That is about right.

The CHAIRMAN. That is what I am talking about. That is a fair way to state that position, is it not?

Dr. GOLDENWEISER. No.

The CHAIRMAN. Of course, they have in addition to the cash available to them their privilege of obtaining currency on their assets, which is still limited to a certain quality of assets.

Governor ECCLES. Besides the cash value which they have in their vaults, they have their balances in the Reserve banks, which are the equivalent of cash, the reason being that they can draw down currency against those balances with the reserve banks, and those balances today are over 4 billion dollars.

The CHAIRMAN. Then they would be entitled to have Federal Reserve notes issued.

Governor ECCLES. That is right; against those balances.

The CHAIRMAN. That is, their excess balances?

Governor ECCLES. They are required, of course, to carry a minimum balance.

The CHAIRMAN. But they could not utilize that.

Governor ECCLES. They could draw down their currency against their excess balances, but they would be penalized if their balances were below the legal requirements.

The CHAIRMAN. Which, of course, means that the legal requirements could not be utilized, as a practical proposition.

Governor ECCLES. Yes. It could be utilized subject to the payment of a penalty for any deficiency in reserves.

The CHAIRMAN. So they would be limited to their excess balances and their cash on hand, and such paper as they would have upon which they might obtain currency.

Governor ECCLES. That is right.

The CHAIRMAN. Does it not follow that the banks found themselves in difficulties in undertaking to meet their demand obligations growing out of the scant supply of actual currency, as compared with the demand upon that supply, not alone by the banks but demands from various sources in the Nation?

Governor ECCLES. The banks found that they were unable to meet their deposit liabilities in currency because of the lack of assets which the Reserve banks would accept. That reduced the amount of currency that they were able to pay out, and the very fact that many of them were unable to meet that demand caused the whole Nation to want to convert their deposits into currency.

As soon as the people found that they could get their deposits in currency, as the result of the emergency banking act of 1933 permitting the banks, not only the member but also the nonmember banks, to get credit, and hence currency from the Reserve banks upon all of their sound assets, the people of the country did not want their deposits in currency. The reverse action developed and the currency which they had wanted when they thought they could not get it began to come back into the banks and increased the deposits of the banks by an amount of from a billion and a half to two billion dollars.

So that it seems to me that the lesson that that experience should have taught is that the Federal Reserve Board should have some discretionary power in the making of rules and regulations that will permit the Federal Reserve banks to accept the sound assets of banks and thus stop what otherwise would be a repetition of what we have had in the way of a credit contraction and the reduction of our deposit money.

The CHAIRMAN. Governor, it is unquestionably true that we have, to a large extent, restored confidence in the banks, and money in hoarding, and no doubt considerable sums that have been withdrawn for legitimate uses, because of the distrust of the banks, has been returned to the banks.

But does not that result mainly from the insurance of bank deposits?

Governor ECCLES. I think that is a very important fact.

The CHAIRMAN. Let me ask you another question.

Governor ECCLES. I think that is particularly——

The CHAIRMAN. We will not have accomplished much, no matter how fully we accomplish that, if we only succeed in restoring confidence in banks so that the public will leave its funds in banks for safekeeping.

That would be a thing to be desired, and it seems to me a thing which the public has a right to expect, but that would be a long way from accomplishing what we need in this country, to bring about a revival and recovery of normal business conditions; is not that right?

Governor ECCLES. Yes; that is right.

The CHAIRMAN. It is a fact, is it not, that we did find the banks in a condition where their demand obligations were so great that they had no way on earth, with the limited amount of cash or currency available to them, to meet their demand obligations. Even though a bank might be solvent, the practical situation was that there was no way for the bank to get enough currency to meet its demand obligations. That was the situation that existed in many cases, was it not?

Governor ECCLES. That is right.

The CHAIRMAN. That is the situation that confronts us and for which we must find a remedy if we are going to make it possible to bring about business recovery and the normal use of banking credit to support business in the United States; is not that right?

Governor ECCLES. That is right.

The CHAIRMAN. And this is also true, is it not, that the emergency plans embodied in the emergency legislation which we passed in

1932 have certainly failed to accomplish those desirable results, have they not?

Governor ECCLES. I think that is the only conclusion one could reach, from the present evidence.

The CHAIRMAN. Those provisions are so hedged about, even though under the law, under the act of 1933, as it was finally written by an amendment that extended to nonmember banks the privilege of having their sound assets treated as eligible for advances by the Federal Reserve banks, and as a basis for the issuance of currency, the rules and regulations were so hedged about, the law being a temporary measure, and being tried out as an emergency measure, was not enough to reassure the banks that they were free to go ahead and use their credit facilities freely for the support of business and to promote recovery.

Governor ECCLES. An abundance of excess credit is available in the banking system. Excess reserves are sufficient at the present time for the banking system, as a whole, to extend credit to an amount in excess of 20 billion dollars, without the banking system as a whole having to use its rediscount facilities with the Reserve System. Interest rates are at possibly an all-time low level. The discount rates of the Reserve banks have been steadily reduced until at the present time none of the banks have a rate in excess of 2 or 2½ percent.

The amount of the excess reserves held by the banks, the low discount rate, and hence the low rates that are prevailing for commercial paper, for high-grade bonds, industrial and municipal, and for Government securities, are indicative of the excess supply of money and credit in relation to the demand for it, on a basis largely of short-term credit.

In order to expand the use of money which is necessary for recovery, either those holding deposits in banks must be willing to spend their funds, which would increase the velocity of the total existing deposits, or borrowers who can command bank credit must be willing to go to the banks and borrow funds which they will spend, or a combination of both is necessary.

If, in the first instance, owners of funds spend their funds, you would get an improvement in business through an increase in the velocity of the existing deposits. If new loans are made you would then get an increase in the volume of money as well as an increase in the velocity of money. In the absence of an increase in the velocity of the funds held by the banks, or an increase in the volume of private credit extended by the banks, the Government has been required to inject into our system through using its credit an increased flow of funds. Government spending has the same effect as private spending. It is somebody's income. Every one's spending is somebody else's income.

The CHAIRMAN. Let me ask you a question right there. Do you think Government spending has the same effect as private spending? Do you think you want to adhere to that statement upon reflection?

Governor ECCLES. From the purely monetary standpoint——

The CHAIRMAN. As far as the actual transaction is concerned; but as far as the psychological effect is concerned, and the effect upon a lot of men who want the money spread into their business, it would be a different matter would it not?

Governor ECCLES. It may be. It is, of course, desirable to have private spending instead of having Government deficits.

The CHAIRMAN. In that connection, let me ask you this question: In reference to the matter of farm-land values, we have put a certain amount of support under farm-land values by the assistance that has been extended by the Government. But the average citizen who might have some idle cash and might want to invest it for his children does not know how long that policy will continue, or when that support will be withdrawn, and in such an event, what effect it would have on bank values. But if this support was given in a normal way so a citizen would expect it to be maintained and to endure, he would have a different mental attitude toward the situation, it seems to me.

Mr. CROSS. The difference, as I see it, is that money put up by the Government in enterprises that would not come in conflict with the activities of private business would cause those who receive wages from that activity with the Government to spend money with the merchants and others, but it does not affect the feeling or help the condition. Everybody feels like the Government has to quit sometime somewhere, and therefore they remain nervous.

If private enterprise should take up this unemployment people will feel as if that is natural and normal. If you could get prices to where private enterprise could make a profit, I do not see how the credit you are talking about will be used, because neither the fellow will borrow, nor would the bank be foolish enough to loan; but you have to get prices to where a man can get a loan and can sell his products and make a profit and pay it back. Of course, that means the employment of labor, and that means spending power.

I know we are in a jam, and it is hard to get out. Of course, we can dig and dig, and get right back to where we find ourselves in the mud. But I do believe if we could get prices back we will be going ahead.

Governor ECCLES. The only way you could get prices back is through increasing the means of payment in the hands of the people who will spend faster than you increase production. To get them back any other way means to get them back through an artificial restriction of production or the fixation of prices, which are not desirable ways to get prices up. In other words, to raise prices and reduce production does not add anything to the national wealth.

Mr. CROSS. We are in this situation. You have a fixed indebtedness on the people. You say that Tom, Dick, and Harry own these buildings in this city. They do not. In the courthouse you will see a paper title in their names. But there is a mortgage against it, and under present prices, with the taxes they have to pay, they do not own anything. They are mere interest-paying tenants. That is all they are, struggling like the dickens to pay their rent to the fellow who owns the mortgage.

The dollar has so increased in its purchasing power that it takes twice as much for him to get the necessities and comforts that he has than he had to pay before, and with the taxes he has to pay now he is up against. Unless we can get it to where he can pay back with the same kind of dollar that he borrowed, I do not see anything ahead but a general liquidation, and possibly a revolution.

Governor ECCLES. Of course, there are two ways out of depressions, it seems to me. One is through the process of liquidation and bankruptcy.

Mr. CROSS. Then there may be a revolution.

Governor ECCLES. The other is through an inflationary process. We went through a period of liquidation and bankruptcy as a result of allowing nature to take its course until we had extinguished a third of our deposit-money supply and until we had 15 or 16 million people out of employment, and until the quoted values of the resources of America were less than the debt. In other words, we liquidated down to a point where we had created a condition of general insolvency as measured by the ability of the people through the national income to support the debt structure.

The deflation was finally stopped because of the unrest and because of the suffering caused thereby and because it not only was affecting the debtor but the creditor was equally affected. The corner of completing the job of deflation was so hot that it could not be turned, and there was only one other course open. In order to save the system of capitalism and to maintain order, the Government was forced to step in, even under Mr. Hoover.

The first effort was made through the organization of the Reconstruction Finance Corporation, not for the purpose of directly relieving unemployment but for the purpose of using Government credit to support, through further debt, the railroad system, the banking system and the insurance structure, all of which was very necessary to support.

That action did not meet the problem of unemployment. It was an effort to support the private credit structure through the use of Government credit.

That action, plus similar actions by the Government through other credit agencies which have been set up and have not been inflationary—I mean the Home Owners' Loan Corporation, the Farm Credit organization, and the Reconstruction Finance Corporation—stopped deflation. The greatest portion of Government credit which has been used during the depression is not of an inflationary nature, because it is simply a question of transferring the debt from where it is to a Government agency.

The CHAIRMAN. And by that process it did stop deflation?

Governor ECCLES. Yes; that process stopped, or at least checked deflation. The condition of inflation has to come about through the increase in the volume and velocity of money either by Government spending or by private spending, or by a combination of both.

Mr. FORD. Would not " reflation " be a better term?

Governor ECCLES. Yes. The difficulty is that so many people, when you say " inflation ", think it is something unsound; they think of worthless money. What I mean is that a rise in the general price level, in employment, and improvement in the business situation, from wherever it is, would be inflation, no matter how small the extent.

The CHAIRMAN. Let me suggest that you just use the word politely and call it "expansion."

Mr. CROSS. They deflated until they got into this condition. Now, if you go back to where we were, would we not simply be reflating, or expanding?

Governor ECCLES. "Expanding" or "reflating"—I do not care what the term is. I think it is a question of what is meant.

Mr. CROSS. It ought to be controlled?

Governor ECCLES. Absolutely; it is very important, of course, that it be controlled, and with the private banking system, with the excess reserves now available, if the credit expansion should commence and continue with the use of the present existing reserves, you could get a business activity and a price level substantially higher, I think, than we had in 1926, 1927, 1928 or 1929. You would have an increase in your total deposit money; or, in other words, your total deposit money would be increased beyond any amount that we ever had before.

Mr. CROSS. We know that, Governor; but do you not think that by these levers that have been put in this bill, as you have it, by your control over the reserves, the rediscount rate, and so forth, you could take the situation in hand any time so that you could control it?

Then, too, is it not much easier to control inflation, to stop things from going up, than to stop deflation after it has once started? As one of the Governors who testified here before told us, whenever you attempt to stop deflation, it is the hardest problem with which you have to deal.

Governor ECCLES. I think that the control of inflation is a far less difficult problem than the control of deflation. We have had a good deal of talk for a year or two about the fear of inflation. If there was any real fear of inflation, it would be evidenced by an increase in equities. Stocks would be going up instead of down, high-grade bonds would be going down instead of up, and the interest that would be paid on long-term municipal, Government, and other securities would be increasing rather than decreasing. Likewise, real-estate values would be rapidly increasing, and rents would be going up.

In other words, if there were a fear of inflation that we hear so much talk about, money would be shifting from deposits into things, and there would soon come a demand for increased credit, because it would be profitable, with things going up, to use credit to buy things.

Mr. CROSS. Every time a statement is given out, purporting to come from the White House, that there is or will be no inflation, down drops the stock market and everything else.

If you have any influence over there, I wish you would stop them from doing that. [Laughter.]

Mr. FORD. Is not the situation that you are describing there one of fear on the one hand and cupidity on the other? In a deflationary period, everybody is shivering; and in a boom period, everybody is overconfident and wants to get more. As I said, you have cupidity on the one side and fear on the other. You step from one stage to the other, do you not?

I am not criticizing that cupidity; that is human nature; but that is what it amounts to.

Governor ECCLES. You have, of course, a lack of confidence on the part of a good many people, and a timidity; but on the other hand, if they feel sure of inflation, that these things are going up, the natural result is that they would buy things in order to make a profit.

The CHAIRMAN. It is 12:30, and I think that this would be a good time to recess.

Governor ECCLES. I would be glad to have the Federal Reserve furnish to the members of the committee mimeographed copies of the first 3 days' hearings.

The CHAIRMAN. That will be very helpful. We will appreciate it.

Governor ECCLES. And also, when I have finished here, or the hearings have been finished, I will be glad to furnish the members of the committee with a complete brief, just as I have it here, of every phase of this legislation.

The CHAIRMAN. All right.

We will meet at 10:30 tomorrow morning.

(Thereupon, at 12:30 p. m., a recess was taken until Thursday morning, Mar. 14, 1935, at 10:30 a. m.)

# BANKING ACT OF 1935

**THURSDAY, MARCH 14, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. The committee will come to order. Mr. Eccles, you may continue your statement. Mr. Cavicchia desires to ask you some questions.

## STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Continued

Mr. CAVICCHIA. Governor, I think the other day I asked you to tell me the amount of mortgages held by member banks. I understand that amount has already been inserted in the record, namely, $2,270,000,000.

Governor ECCLES. Yes; that is right.

Mr. CAVICCHIA. The bill before us, as I understand it, authorizes the national banks to lend on amortized mortgages up to 75 percent of the appraised value; am I correct?

Governor ECCLES. That is the limitation put in the bill; but I made the recommendation that the Federal Reserve Board be given the power to make rules and regulations governing mortgages to be taken by member banks, in lieu of the 75 percent and 60 percent limitations in the bill.

Mr. CAVICCHIA. What do you mean by 75 percent and 60 percent?

Governor ECCLES. Seventy-five percent of the appraised value of the property and 60 percent of the amount of the time deposits.

Mr. CAVICCHIA. One of the reasons given for the banks' inability to meet the demands of the depositors, Governor, in this crisis we have been going through in the last 5 or 6 years, was the fact that they had so much of frozen assets on hand. Do you not think that if you give authority to the banks to lend on mortgages on a higher percentage than they have been loaning on heretofore that you will make it still harder for them to meet the demands for payments in case we should have another crisis?

Governor ECCLES. I feel that the liberalization of the mortgage provision should be considered in connection with the modification of the eligibility changes in the legislation. It seems to me that unless the eligibility provision be liberalized, permitting the Federal Reserve banks to loan on sound assets in order to meet conditions of deflation, then the banks should be prohibited from loaning on

5-year 50-percent mortgages. They should be prohibited from loaning on or purchasing any bonds the maturity of which runs beyond 6 months or a year.

Mr. CAVICCHIA. You think that it is the short-term mortgages that add to a feeling of fear?

Governor ECCLES. No; what I think is this, that the banks, having only 12 percent of their loans and investments eligible in 1929, and those eligible assets not equally distributed throughout the banking system were not able to meet a substantial contraction of credit without many of them being forced to the wall and without forcing the payment of loans as they fell due.

There should be no more objection to the long-term amortized mortgage as proposed in the bill than to the 5-year straight 50-percent mortgage, which has been permitted for a period of 20 years, or to the investment in securities of all kinds without regard to maturity.

It is interesting to note as to the banks which closed throughout the country, and I understand that it has been shown by investigation, that the greater number of bank failures was in the area—and this is according to Federal Reserve districts—where the smallest amount of real-estate mortgages were held by the banks. The area where the larger percentage of real-estate mortgages was held by the banks was where the percentage of bank failures was the smallest.

It is found that the investment in securities—in bonds—has a very close relationship to bank failures.

Mr. CAVICCHIA. That leads me to ask you this question: I think you will agree with me that the decline in the value of real estate has amounted to perhaps 25 percent or more during this crisis as compared with what it was in 1923, 1924, and 1926. Do you agree with me on that?

Governor ECCLES. Yes; I think there is an average deflation of real estate of at least 25 percent.

Mr. CAVICCHIA. So that if a bank loans up to 75 percent of the appraised value on a mortgage, and then there should be a depression, that 25 percent equity would be wiped out overnight, would it not?

Governor ECCLES. It would be wiped out over the period that it took to bring about a deflation of that amount.

Mr. CAVACCHIA. It will not be as good a security as a mortgage based on 50 percent, because if there is that difference there will still be a leeway there.

Governor ECCLES. I think that is correct, with this exception: That in the case of the 50-percent straight mortgage, which is now permitted, the owner——

Mr. CAVICCHIA. What do you mean when you say "which is now permitted"?

Governor ECCLES. The law now permits a mortgage of 50 percent of the appraised value—up to 50 percent of the time funds.

Mr. CAVICCHIA. Is that in the law now?

Governor ECCLES. That is in the law now, and it has been there for 20 years.

Mr. CAVICCHIA. You say "time funds"?

Governor ECCLES. That is right.

Mr. GOLDSBOROUGH. I think you are mistaken about the 20 years. I know that Mr. Steagall and I fought the inclusion of a more liberal provision in the banking act for years and years, and I have only been on the Banking and Currency Committee for 15 years.

The CHAIRMAN. We liberalized the provision in the McFadden Act of 1927.

Governor ECCLES. You might have liberalized it, but they have been making real-estate mortgages for 20 years. I was incorrect in stating that the present provision has been there for 20 years.

Mr. GOLDSBOROUGH. They were not allowed to carry real-estate mortgages before 1926.

Governor ECCLES. There is a provision in the original Federal Reserve Act.

Here is the provision of the original Federal Reserve Act:

SEC. 24. Any national banking association not situated in a central reserve city may make loans secured by improved and unencumbered farm land, situated within its Federal Reserve district, but no such loan shall be made for a longer time than five years, nor for an amount exceeding fifty per centum of the actual value of the property offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus or to one-third of its time deposits and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

Mr. CAVICCHIA. That was confined to farm lands, as you read it.

Governor ECCLES. Yes.

The CHAIRMAN. Just a moment. This seems to be chasing niceties rather than principles. Dr. Goldenweiser, can you give us off-hand the history of this legislation?

Dr. GOLDENWEISER. I think Mr. Wyatt can answer that question.

Mr. WYATT. I cannot give you the details off-hand, but that section has been amended a number of times and all the amendments were in the direction of greater liberality. The last extension of it was in the McFadden Act of February 25, 1927.

Mr. GOLDSBOROUGH. My memory is that Mr. Steagall and I fought that for years and years and years, and finally we were steamrollered in 1927. I also know that this Congress has spent a large part of its time in the last 2 years bailing out the banks that accumulated these real-estate mortgages over our protest.

Mr. WYATT. That section was amended twice: Once by the act of September 7, 1916, which was in the direction of greater liberality, and authorized loans on city real estate as well as farm land. It was amended again by the McFadden Act of February 25, 1927 which authorized loans on city real estate for 5 years, instead of 1 year, removed the prohibition against banks in certain reserve cities making any real-estate loans, and increased the aggregate amount of real-estate loans which might be made by any national bank from one-half of its time deposits to one-third of the savings deposits.

Mr. CAVICCHIA. When we talk of 1-year mortgages, it does not mean that they will be called in at the end of 1 year. If the people will pay their interest and the property is kept up, the mortgage is permitted to run along; am I correct or not?

Governor ECCLES. I think that is true.

Mr. CAVICCHIA. That is the general practice, is it not?

Governor ECCLES. That is the general practice, in connection with most loans, whether real estate or otherwise.

Mr. CAVICCHIA. I am only cognizant of what takes place in my own State. I know of savings institutions——

Governor ECCLES. The borrower usually pays a commission, however, each time the loan is renewed, and he is always in the position of never knowing——

Mr. CAVICCHIA. That is not true in New Jersey. The savings institutions make their mortgages for 1 year. They never pay a bonus for getting the money. The mortgage is never renewed. Under our law it may continue, even though it is for a 1-year period. You will find mortgages that have been on some pieces of property for 15, 20, or 25 years. As long as the people pay their interest, they run on. They do not have to be renewed.

It does not cost them a nickle, except in the case of some mortgage companies, where some 5 or 6 years ago they got into the habit of writing short-term mortgages for 3, 4, or 5 years. When those mortgages expired, they did have to be renewed, which caused extra cost to the borrower, and sometimes a great deal of trouble in having them refinanced.

Let me ask you one more question in connection with the mortgages. I take it that the reason you are liberalizing the mortgage clause in this banking bill is that you are hoping to be able to provide mortgage money, which has been very scarce during the last 6 years. Am I correct about that?

Governor ECCLES. That is partly true. We had this in mind.

The commercial banking system has over 10 billion of time funds. Those time funds, or savings funds, in the commercial banking system are the equivalent, so far as the people are concerned, of funds held by the mutual savings banks in the New England and New York areas.

Either the banks are going to use those time funds in the long-term lending field, either long-term bonds of various kinds, or long-term mortgages, or long-term Government financing, or they are going to have to stop paying interest and give up those time funds.

If a bank is confined to its loans to eligible paper, in order to be liquid, then the only other avenue for investment of its funds would be Government bonds. That would mean at the present time that 8 percent of the total loans and investments of the banks would be commercial paper, and the 92 percent would be Government securities. This would mean that the Government, through its agencies, would be doing the lending business, furnishing long-term credit, which it is largely doing today, and the banks which hold the funds of the people would be furnishing the Government the funds by purchasing Government bonds or bonds guaranteed by the Government. That is the trend today.

As a matter of fact, 44 percent of the assets of the banks are now Government bonds, or bonds guaranteed by the Government, and I see no——

Mr. CROSS. Long-term deposits?

Governor ECCLES. Forty-four percent of the loans and discounts; that is, the investments of the banks represent Government bonds.

What I am trying to do is to put the banking sytem in a position where it can furnish long-term credit to the communities, just as the mutual savings banks and savings and loan associations do with the time-funds which they have.

If banks are not to be in a position to compete in that field for loans and investments of that sort, then it seems to me that they are put up against the problem of the use of these funds, which they hold and which are greatly needed to bring about an improvement in business conditions.

As I indicated yesterday, the income velocity of our existing funds was about two, whereas in 1926, 1927, 1928, and 1929 it was over three. Of if we had the same velocity of our deposit money that we had during that period, our national income would be at least from 20 to 25 billions more than it is.

But it is the stagnation of credit, the stagnation of funds, that continues, it seems to me, to retard business recovery. As to the extent to which an easing of credit by the use of long-term mortgages or on the amortized basis, and the liberalizing of eligibility requirements would bring about the use of that credit, nobody, I think, is in a position to say.

Mr. CAVICCHIA. I think you will agree with me when I say that whether they be national banks or State banks, or mutual savings banks, they have a lot of money on hand at the present time and are not loaning it; am I correct?

Governor ECCLES. That is right; they have excess reserves.

Mr. CAVICCHIA. The savings banks or the mutual banks which are now permitted under State laws to loan money on mortgages up to 50 percent of the appraised value are not loaning any, or very little, money at the present time.

Do you think, if this act were passed, that the national banks would do what the mutual banks are not doing now—lend money on mortgages?

Governor ECCLES. The mutual banks are lending money on mortgages in certain sections. The insurance companies are lending on mortgages, and one of the first things this act would do would be to enable the banks which now hold over 2 billion of mortgages, many of which are in excess of 50 percent of the appraised value——

Mr. CAVICCHIA. That is because of the drop in the market?

Governor ECCLES. That is right. Therefore, they are forced to collect on the mortgages, and Congress is appropriating money for the Home Owners' Loan Corporation, the Federal Farm Mortgage Corporation, and the R. F. C., to take up these mortgages.

The banks are not in a position to hold many of the mortgages that they may have for the reason that their mortgages are in excess of 50 percent, and they are due.

I would like to see the banks required to hold the mortgages they have and refund them on a long-term basis, requiring amortized payments with reduced interest. Instead of going through the process of changing the form of the obligations they hold, they have to substitute for their own loans obligations guaranteed by the Government.

Not only that, there are many State nonmember banks which, if they should come into the Federal Reserve System, would have more than 50 or 60 percent of their time funds in mortgages. In many sections the banks are permitted to loan in excess of 50 percent; and, if there is a liberalization of the mortgage feature, the bill will make it less difficult for the nonmember banks to come into the Reserve System.

If we are going to proceed on the assumption that we are going to have great cyclical booms and depressions, depressions that can extinguish 30 percent of our deposit currency and can reduce the national income by one-half, then I say that there is no way you can set up a banking system that will serve the money needs of the country and at the same time be prepared to meet that kind of a catastrophe. Liquidity in deflation can only be provided by the Federal Reserve System.

Mr. GOLDSBOROUGH. You mean as long as we are on this fractional reserve basis of 10 percent? Is that what you mean?

Governor ECCLES. Yes.

Mr. GOLDSBOROUGH. Of course, when you have an accordion and just blow the air in and out, you are right, but you do not have to have that system.

Governor ECCLES. Of course, it seems to me we do not have any alternative at this particular time without a very revolutionary change in the whole banking set-up. The 100-percent reserve idea would, of course, eliminate the 10 to 1 ratio. But that is another story.

Mr. CAVICCHIA. Governor, am I right in saying that one of the main reasons why this provision is in the law is to encourage the banks to hold onto the mortgages that they have now, because otherwise they would have to resort to foreclosure, because their mortgages are no longer on a 50-percent basis on account of the big drop in values?

Governor ECCLES. I would say that is true in some cases, and I would say that is one of the constructive effects. The other constructive effect would be that the banks are put in a position to do what the R. F. C. and other Government agencies are now doing.

There apparently is no demand for short-term commercial credit. The business of this country is largely done by concerns with an adequate working capital. But there does seem to be some demand for longer-term credit, and there is no prospect of getting any building activity without providing long-term credit at low interest.

The English have provided 30-year credit for home construction on 80 percent of the value of the property at 4½-percent interest, and that is done by the private savings institutions.

The most unsound type of mortgage credit is the straight loan that we have had in this country. It means that the borrower, the builder, will get a straight 50-percent loan from the banks and insurance companies, and then a second-mortgage loan will be financed elsewhere at ruinous rates, until the cost of the mortgage money, considering the first-mortgage cost and the second-mortgage cost, has made the financing cost of the property ruinous to the home builder and the home owner. The amortizing payments were to be made over a period of time on the second mortgage. The first mortgage became due and it was expected, of course, that the full amount would be renewed.

Mr. CAVICCHIA. Governor Eccles, I appreciate the fact that there are many definitions as to what constitutes centralized banking. One of the charges made about the bill that is before us now is that it tends to centralize banking.

Is this so, or is it merely regulatory in the sense that this bill tends to do away with the great disparity heretofore prevailing between the national and State banks?

Governor ECCLES. Which part of the bill are you referring to? Title II does not deal, it seems to me, with the problems of national and State banks, except by giving the Board the right to waive the present legal requirements for membership of nonmember State banks.

Mr. CAVICCHIA. I mean in the strict sense that centralized banking is used. This is not a bill aimed to centralize authority in the Federal Reserve Board, is it?

Governor ECCLES. It centralizes some authority in the Federal Reserve Board. The authority that is being centralized through this in the Federal Reserve Board is the authority over open-market operations.

The Board at the present time has authority over the discount rate, and subject to the approval of the President, under the emergency act, has the authority to change reserve requirements by declaring an emergency.

This bill is proposed to place in the Board, with the advice of the governors, the third function of monetary control, that of open-market operations, which, at the present time, is in the committee of governors, subject to the approval of the Board, and then subject, finally, to the decision of the twelve Federal Reserve banks as to whether or not they will participate in the program recommended by the governors and approved by the Board.

Mr. CAVICCHIA. Does that leave the different Federal Reserve banks in different districts to operate independently, if they wish?

Governor ECCLES. It leaves them to operate independently; and that is not changed. The question of extending credit to member banks is left with the credit division of each Federal Reserve bank.

It has been stated that the changing of eligibility requirements would cause the Federal Reserve banks to be loaded up with long-term mortgages. It seems to be assumed that the Reserve banks would discount these mortgages or any slow assets that they may choose to take, during the life of such assets.

In the first place, whether or not credit will be extended to a member bank, and upon what basis, will be determined by the regional Federal Reserve banks, which are responsible for the credits extended to member banks. The Board will only make the rules and regulations governing the basis upon which credit can be extended, and it is proposed here to give the Board power to liberalize the basis upon which the Reserve banks can extend credit to the member banks. The occasion for the extension of credit arises when the reserves of the banks get below the legal requirement, and they find it necessary to borrow to build up the reserves.

Mr. CAVICCHIA. The other day you showed the members of this committee a chart, showing the conditions in England. This chart seems to show that there is no relation between the price level and the increase or decrease in employment; am I correct about that?

Governor ECCLES. That is correct.

Mr. CAVICCHIA. Although we have been proceeding on the theory in this country that if the price level goes up wages will increase and unemployment will decrease; am I correct in that?

Governor ECCLES. You say we have been proceeding on that theory? I do not know what you mean by "we."

Mr. CAVICCHIA. There are certain economists; everything that this Administration has done in the past 2 years—and I am not criticizing the Administration; I do not intend to be partisan; but it has proceeded on the theory that if the price levels went up wages would go up and unemployment would decrease. But the chart showing conditions in England seems to negative that assumption.

Governor ECCLES. That is correct.

Mr. CAVICCHIA. Governor Eccles, the Canadian banks, I am told, are not permitted to make mortgage loans, and in depression times they are not met with the problem of frozen assets. Is this one of the reasons why they have had no bank failures in Canada during this depression?

Governor ECCLES. I do not accept the assumption that a mortgage is any more of a frozen asset during deflation than nearly any other asset of the bank. The assets become frozen when every banking institution wants to dispose of its assets to meet the demands of its customers for money. The only liquidity that can be provided for a banking system is through the central bank.

The Canadian banking system is a very different structure than the American banking system. In the first place, they have very few very large banks, and the creditor area—the eastern section of Canada supplies the credit to the debtors of the interior provinces of Canada. I have been told that the interior sections of Canada, had they not been tied into the creditor or eastern section of Canada, would have had the same kind of bank trouble that we have had in this country; that it was the eastern section which was really furnishing the funds to develop the interior areas that enabled the system to carry through.

The Canadian system had only a fraction of the credit contraction that we had in this country. Had our credit contraction been 13 percent, as it was in Canada, we would not have had the banking collapse that we had.

The credit contraction in the British banks during the depression was practically negligible. The total amount of deposit money and currency outstanding all during the period of the depression in Great Britain remained almost uniform. Things might have been different here also, had our Federal Reserve System been in a position to loan against sound assets. The demand for money would have ceased—that is, the demand for currency—because we know that when people were able to get their currency after the bank holiday they did not want it, and currency came back into the banks instead of continuing to go out of the banks.

Mr. HOLLISTER. You said Canada had very, very few very large banks. You mean she only has a few very large ones.

Governor ECCLES. That is right.

Mr. HOLLISTER. It sounded as if you meant there were a lot of little ones.

Governor ECCLES. I mean that they have few very large banks, but they have a large number of branch banks.

Mr. HOLLISTER. I thought you might want to clear that up.

Governor ECCLES. Yes; I thank you.

Mr. CROSS. You say that in England they did not have trouble with currency to take care of their deposits. Are the assets upon which those banks loaned money broader than ours? Can they loan upon any sound paper, where we are limited in that respect?

Governor ECCLES. Are you referring to central banks—that is, the new Canadian Bank and the Bank of England—or are you referring to the commercial banks?

Mr. CROSS. I am just referring to your statement that they could loan on sound security, and that if we had been in their position we would not have had the crash that we had. The question I am trying to get at is, Could they loan upon different assets than we loaned upon, because it is sound paper and ours is sound, but we are not under our law permitted to loan on that paper or discount that paper?

Governor ECCLES. In the first place, the Canadian banks, as I understand it—and I am not an authority by any means on that subject; it is just what I have been told and hear—that the Canadian banks and the British banks do not loan on real estate. The banking structure, as I said, is entirely different; it is differently constituted.

The savings funds in Britain are largely built up, as I understand it, in the savings and loan associations, the mutual savings and loan associations, which carry the real-estate credit.

If our banking system was a large branch banking system such as the Canadian system or the British system, it would be a much easier problem to segregate investments or savings funds from the commercial banking system. But so long as we have unit banks operated under the laws of 48 different States and the National Bank Act, these unit banks have two functions: The function of providing the check money through their deposits, and the function of investing the community's savings or investment funds.

Demand deposits representing our deposit currency should be invested in short-term paper, so far as possible, and in Government securities. But when it comes to investment funds, interest-bearing funds, it seems to me that we have another problem, and it is entirely different from the problem in Canada or the problem in Britain, or in any other country.

If we are going to avoid a banking collapse and the extinguishing of a large part of our money supply in the future, it is going to be necessary to make it possible, when contraction starts, for our Federal Reserve System, which is our central bank and bears the same relation to our banking structure as the Bank of England does to the English banks, to loan on sound assets to prevent a continuation of credit contraction and bank failures.

Mr. CAVICCHIA. You need not answer this next question if you feel that you ought not to, Governor. This is the question: In your opinion, should we have a metallic base for our money, such as gold, or is that an exploded theory?

Governor ECCLES. A "yes-or-no" answer could be misunderstood. That is a question which, in order to answer it, would need considerable explaining.

Mr. CAVICCHIA. The reason I asked it is this: Some people still hold to the theory that we should have a metallic base, and that that should be gold. Others say it has been tried and it as failed. That is why I asked the question.

It is a problem upon which many opinions are expressed; but I do not think it has been answered. The fact that the important countries of the world have been wedded to gold by experience and habit for so long a time makes it a very difficult matter to divorce money from gold.

Mr. CAVICCHIA. Governor, it is a moot question whether or not the United States is still on a gold basis just now. What do you say about this?

Governor ECCLES. Our currency and our deposits in the Federal Reserve still require the same gold reserve that they always have, of 40 and 35 percent. To the extent that gold is not being paid out, we might say that we are not on gold. To the extent that we are requiring the same gold reserves, we can say we are on gold. We permit the export of gold under license, so that internationally we are on gold.

Mr. CAVICCHIA. So far as our imports are concerned, we are on gold, are we not?

Governor ECCLES. The dollar has been fixed at a certain price at the present time in relation to gold.

Mr. HANCOCK. It has been stated that we are today on a discretionary international limping gold-reserve standard. What do you think about that?

Governor ECCLES. I would prefer not to discuss that question. I do not believe that has very much relation to title II of the banking bill.

Mr. HANCOCK. Well, it is not irrelevant.

Mr. CAVICCHIA. Under our present system, fear and confidence have a lot to do with the banking question, have they not; and is that not also true in relation to business in general?

Governor ECCLES. Not as much as I think is sometimes claimed. What is confidence with one group would be lack of confidence with another.

An effort to balance the Budget would give confidence to a group of people who feel that, if it is not balanced, their taxes are going to be higher; but it would put fear and consternation in the minds of the group of people who are dependent upon what the Government appropriates for relief.

Therefore, when we speak of confidence, it does not have an equal application to all our citizens.

Mr. GIFFORD. Governor, I question the necessity of title II. Mr. Hancock questioned you and you answered that that is really the primary feature of the bill, while the secondary feature is in reference to the reserve of banks. I want to ask you a few questions leading up to the necessity of it.

What is the total debt of the Nation, having in mind the present expenditures and authorized expenditures? In the President's message, was it 31 billion of authorized expenditure that faced us up to that moment?

Governor ECCLES. I would not be certain. As I recall, I know it is over 30 billion, but I do not remember the exact figures.

Mr. GIFFORD. It is 31 billion and some fraction, I think.

Governor ECCLES. I think that is approximately correct.

Mr. GIFFORD. Having in mind what has been done, we passed the H. O. L. C. bill, carrying one and seven-tenths billion?

Governor ECCLES. That is right.

Mr. GIFFORD. And if we pass the bonus bill that will be two and three-tenths billions additional, will it not?

Governor ECCLES. It depends on which bill passes.

Mr. GIFFORD. It is two billion three hundred million, is it not?

Governor ECCLES. It will depend on which bill passes.

Mr. GIFFORD. You are following these probable expenditures with the idea in mind of the necessity for this law?

Governor ECCLES. No; that is not correct. This law has no relationship to that. If the Government were to balance its Budget, we would propose the same law.

Mr. GIFFORD. I think my vote, so far as the necessity of this is concerned, would be guided by the actual necessity presented.

Governor ECCLES. I think there has been——

Mr. GIFFORD. If the Public Works bill now pending in the Senate, carrying $4,800,000,000 passes, and we provide for 1 billion to take care of social problems, as suggested, and if another billion should be required for farm-credit loans, we would get into the realm of a national indebtedness of 42 billion dollars, should these things transpire. You may subtract from your total, 3 billion, if you want to, and take into consideration the $1,800,000,000 profit from gold, but you would still have a debt of some 36 billion dollars. How much did you say there were in deposits in the banks?

Governor ECCLES. About 25 billion, eliminating interbank deposits. That represents the demand deposits.

Mr. GIFFORD. There are 38 billion in currency and deposits in the banks of the country. Do you recall the President's warning about the danger of the banks having to absorb the deficiencies in 1932, causing a very dangerous situation—that is, the deficiency caused by the operations of the R. F. C.?

Governor ECCLES. I do not recall that statement, but, of course, I would not feel there was any danger in that.

Mr. GIFFORD. The President spoke very strongly, and I wish you would read what he said, of the great danger of the banks having to absorb that deficiency caused before March 4, 1933, and since then we have added this large amount.

The purpose of this legislation is to control the privately owned banks, which would still be privately owned, by a Government board in Washington, so far as open-market operations are concerned?

Governor ECCLES. You mean control the investments that are made by the Reserve banks?

Mr. GIFFORD. To control open-market operations.

Governor ECCLES. Yes; to control open-market operations by the Reserve Board in Washington rather than by the banks themselves.

Mr. GIFFORD. They will still be privately owned, but they will be Government controlled.

Governor ECCLES. That is right.

Mr. GIFFORD. You mean the Government as constituted at the moment.

Governor ECCLES. I would say they are publicly controlled, rather than governmentally controlled. The control of open-market operations is proposed to be placed in the Federal Reserve Board.

Mr. GIFFORD. Exactly; and that policy will be dictated by this new board.

Governor ECCLES. It will be carried out by the Federal Reserve Board.

Mr. GIFFORD. So far as the Government as at present constituted is concerned, that means just that, does it not, inasmuch as a provision for refusal to reappoint was included in your bill?

Governor ECCLES. I do not think that has anything to do with the political relationship.

Mr. GIFFORD. Oh, no; there is nothing political in this bill.

Governor ECCLES. The fact is that the Governor has always been appointed by the President, at his pleasure.

Mr. GIFFORD. This bill specifically indicates the method by which the Governor might not be reappointed.

Governor ECCLES. That is entirely incorrect. The bill provides that the Governor shall be—that his term as a member shall expire when he no longer——

Mr. GIFFORD. I am talking about the members of this new Board.

Governor ECCLES. It is not a new Board; there is no difference——

Mr. GIFFORD. The present Federal Reserve Board——

Governor ECCLES. There is no change whatever proposed in that Board.

Mr. GIFFORD. But they retire at 70, under a pension, after a term of years, and there are many changes.

Governor ECCLES. Rertirement at 70 will be compulsory only for future appointive members.

Mr. GIFFORD. My point is, should another government come in, otherwise constituted, could they get control of this Board?

Governor ECCLES. In what way could they get control?

Mr. GIFFORD. I am asking you.

Governor ECCLES. No; they cannot, not unless their terms expire, and the President chooses to appoint some one other than a member whose term expires.

Mr. GIFFORD. By that method could not the new President get control?

Governor ECCLES. By what method?

Mr. GIFFORD. By the refusal to reappoint.

Governor ECCLES. He could, if the terms expired. But a member is appointed for a 12-year term.

Mr. GIFFORD. There is no way of getting rid of them?

Governor ECCLES. There is no way of getting rid of them except for cause. That has always been in the bill. There is no proposal to put in the bill any change in the method of appointing members of the Board, or as to their terms.

Mr. GIFFORD. That reminds me of the lady who insured her home. There was a fire, and when the agent came to the house he said he would look into the cause of the fire. Then she said, "I thought there would be a catch in it."

Governor ECCLES. That has always been in the law; we are not presenting any change.

Mr. GIFFORD. Then the banker who wrote this letter to me was misinformed when he said that nothing short of a revolution could ever change the condition that will be brought about by the enactment of this bill; is that correct?

Governor ECCLES. When the Federal Reserve Act was passed in the beginning, what did the bankers say?

Mr. GIFFORD. Getting back to the necessity of it, it is not quite as tight as the United States Supreme Court, is it? It is not quite as tight, is it, so far as the appointments are concerned? Would you be willing to provide for the appointments in that way, to have these men appointed in the same way that members of the Supreme Court are appointed?

Governor ECCLES. They are appointed in the same way, by the President of the United States, with the advice and consent of the Senate.

Mr. GIFFORD. I think that has been challenged. But you claim it is exactly the same?

Governor ECCLES. It is the same, so far as the appointment and confirmation is concerned. The term of the members is 12 years, in the case of the Federal Reserve Board, whereas the term of a Justice of the Supreme Court is for life. I believe he may be removed for cause.

Mr. GIFFORD. For what cause may a Justice be removed? What would be the cause in this case?

Governor ECCLES. I suppose for dishonesty or improper conduct.

Mr. GIFFORD. Or unwillingness to cooperate with the Government; would that be a cause?

Governor ECCLES. I am not in a position to say what the cause would be. All I know is that during the life of the Federal Reserve Board of over 20 years no member of the Board has ever been removed for cause. Their terms have expired or they have resigned voluntarily.

Mr. GIFFORD. I think if they made it hot enough for them they would get out, if they did not cooperate.

Now, coming back to the necessity for this bill: Faced with a debt of 38 billion or 42 billion, do you want to make the assets of the member banks sound assets, available for the issuing of currency; is that it?

Governor ECCLES. No; that is not the purpose of it. The law is not being drawn with that idea, of assisting in the financing of the Government.

The Government is having no difficulty with its financing. Its interest rate has been going down steadily. The desire of the banks to purchase Government bonds is so great that whereas at the end of Mr. Hoover's term the interest rate was nearly 4 percent, it is now less than 2¾ percent.

Mr. GIFFORD. Of the present indebtedness of the Nation, how much of it is in short-term loans?

Governor ECCLES. Do you remember, Dr. Goldenwesier, what the exact amount is?

Dr. GOLDENWESIER. I can look that up and let you know presently.

Mr. GIFFORD. You have not been offering many loans to the public on long-time paper, have you?

Governor ECCLES. They have been doing a good deal of refunding. They have just called one billion eight hundred million of the fourth 4½-percent Liberty loan, and they offered in exchange a 25-year bond at 2¾ percent.

Mr. GIFFORD. They did that in other countries, based partly on the ground of patriotism.

Governor ECCLES. As a matter of fact, the bonds held by the banks of this country are less in proportion than the Government bonds held by the English banks. Thirty-nine percent of the assets of the member banks are invested in Government obligations, whereas 41 percent of the assets of English banks are so held.

Mr. GIFFORD. You said this morning it was 44 percent.

Governor ECCLES. Forty-four percent of the total outstanding bonds; 44 percent of the amount of Government bonds outstanding are in the member and Reserve banks and 39 percent of the assets of the member banks are invested in Government bonds; whereas 15 percent of the total bonds outstanding in Britain are held by the London clearing banks and the Bank of England, but that represents 41 percent of the resources of the British commercial banks.

It takes 5½ percent of the national income of Great Britain to pay the interest on the British national debt.

Mr. GIFFORD. Suppose we had to have an indebtedness of $40,000,000,000, and $9,000,000,000 was to be absorbed in the next year and a half, what proportion would the banks probably hold?

Governor ECCLES. What proportion of their resources in bonds?

Mr. GIFFORD. Yes.

Governor ECCLES. Of course, if the banks took 9 billion of bonds, the banks would increase their deposits by 9 billion.

Mr. GIFFORD. The term " deposits " is a rather tricky term. I suppose if I owed you $100,000, and you should be able to discount that, you would get some more currency and loan me another $100,000, and then take my second note and discount that, and still loan me still another 100 thousand, and that process could go on indefinitely, could it not?

Governor ECCLES. As a matter of fact, the banks could extend $20,000,000,000 of credit without rediscounting anything. The trouble today is not the need of the banks to rediscount; the trouble is the banks are unable to loan the funds that they now hold.

Mr. GIFFORD. We know that is a temporary situation. Idle money is glad to get something to invest in. There have not been many long-term offerings made in these times. They are all anxious to get something. You do not consider that that condition will be regular, do you?

Governor ECCLES. I think—and this, of course, is my opinion only—that for a long time to come there are not going to be in this country short-term loans of sufficient quantity to create the money that is required to carry our business structure.

Mr. GIFFORD. Why has not the Government—knowing that this indebtedness cannot be paid off for many years—why has not the Treasury offered long-term paper or bonds?

Governor ECCLES. Why have they not?

Mr. GIFFORD. Yes.

Governor ECCLES. That is a question I would prefer you ask the Treasury. I would not want to answer that question for them.

Mr. GIFFORD. You have said money was plentiful.

Governor ECCLES. Money is extremely plentiful. But if the Treasury had offered long-term bonds a year ago or 2 years ago, they would have paid a rate of maybe a half or three-quarters of a percent more than they are paying now. So long as the Treasury can borrow at a fraction of 1 percent, and the interest rate on long-term financing is going down, would it not appear advisable to finance on the cheapest basis of short-term credit, so long as the long-term market is going down? It has been profitable up to date to defer long-term financing.

Mr. GIFFORD. If they could sell these long-term securities at $2\frac{3}{4}$ percent they would sell them, would they not?

Governor ECCLES. If they could, you say?

Mr. GIFFORD. Yes; they would offer them if they could be sold, would they not?

Governor ECCLES. I do not know whether they would or not. Personally, I think you will see less than a $2\frac{3}{4}$ percent rate on long-term financing.

Mr. GIFFORD. Then you think there will continue to be plenty of idle money and that business will not get busy and need this money?

Governor ECCLES. I cannot conceive of business using 20 billion dollars of commercial credit, when in 1929 they only used 4 billion.

Mr. GIFFORD. You do not care to answer as to why the Treasury does not now, when money is plentiful and rates are low, offer long-term paper, that must, necessarily, be refinanced, a lot of it, with short-term paper?

Governor ECCLES. If they can borrow later at 2 or $2\frac{1}{2}$ percent, would it seem advisable now to borrow at $2\frac{3}{4}$ percent?

Mr. GIFFORD. Let us put it the other way. If business recovers and needs money, and money is at a higher rate, has not that been the fear, that when these short-term securities are forced to be refinanced by long-term securities that the rate will be very high?

Governor ECCLES. That has been the fear, but it has been unjustifiable, and the reverse has been true.

Mr. GIFFORD. I hope you will prove to be a prophet, and a correct prophet, so far as the next 5 years are concerned.

You have no fear, so far as the Government using the method of issuing currency to banks with sound assets is concerned, that they will not always have plenty of money to buy the issues put out by the Government, and that this Government, under this plan of banking, could go into that practically to any amount?

Governor ECCLES. The amount of the Government debt that can be supported depends upon the national income, and a 40-billion-dollar debt here with an 80-billion income, is 6 months of the national income.

Mr. GIFFORD. We had a 90-billion-dollar income once, but what is it now?

Governor ECCLES. I think when Mr. Roosevelt came into office it was around about 38 or 40 billion. It is now some 50 billion.

Mr. GIFFORD. Our capital structure was 38 billion, that being the amount on deposit, available money and credits in the banks?

Governor ECCLES. No; it was 26 billion 400 million in 1929. That was the amount of demand deposits plus currency.

Mr. GIFFORD. There are two other questions I want to ask you, which you may be willing to answer.

You have no particular fear of a 40-billion-dollar national debt in this country?

Governor ECCLES. I have no fear of a 40-billion-dollar national debt.

Mr. GIFFORD. Your answer staggers me. I have.

Governor ECCLES. I can give you my reasons for not having it.

Mr. GIFFORD. Personally, I wish you would. With the present national income you have no dread or fear of the consequences of a 40-billion-dollar debt?

Governor ECCLES. I am concerned about the present national income, but you do not increase the present national income by diminishing Government expenditures. It is the total expenditures of the Nation that create the national income, and when the community, as individuals and corporations, do not spend, then the Government must.

Mr. GIFFORD. I am looking at it from the standpoint of my corporate interest. If I owed a hundred thousand dollars to you and you discounted my note and loaned me another hundred thousand, you could then go to the bank and discount my second note and loan me still another hundred thousand, and keep that up indefinitely. But then what happens to me, finally? How long do you think that a person, an individual, or corporation, can keep that up, and how long can the Government keep that kind of thing up? The application is the same.

Governor ECCLES. That is just where the mistake is usually made. Government credit is considered in the same way as we consider individual or corporate credit, whereas when the Nation borrows it is a question of the Nation borrowing from itself, so long as it is a creditor Nation. Therefore, when it borrows from itself, that is the——

Mr. GIFFORD. If the citizen owed enough taxes, that is sound. But the whole revenue is based on taxation, is it not?

Governor ECCLES. Taxes are the basis of the Government's income. If by Government spending you increase the national income, you increase the ability to pay taxes.

Mr. GIFFORD. Exactly. Then you have answered the question, that a 40-billion-dollar debt can only be paid by taxes.

Governor ECCLES. But the taxes will not be paid out of the present national income. I believe in the Government spending to a point that could prime the pump. If you increase that spending, in that way you increase the demands for goods.

Mr. GIFFORD. Did you ever try to prime a pump and you did not get quite enough water?

Governor ECCLES. That has just been the case.

Mr. GIFFORD. That being the case——

Governor ECCLES. It is the case today.

Mr. GIFFORD. Does anybody know the exact measure of water to be poured in before you catch?

Governor ECCLES. The measure would be when you get your unemployment problem rapidly diminishing and with private business being required to employ those who are unemployed to meet the demand for goods, by reason of increasing purchasing power and spending.

Mr. GIFFORD. Your statement about the 40-billion-dollar debt will probably be of great comfort to those who vote for the soldiers' bonus; it will probably be of great comfort to those who want social legislation, that is, your statement that you have no fear of a 40-billion-dollar debt. Do you realize the importance of that statement?

Governor ECCLES. Forty billion dollars in relation to the debt of Australia and in relation to the debt of Great Britain and other countries that we look upon as having met all the problems of the depression possibly as successfully as anybody else——

Mr. GIFFORD. So far as a comparison of our banking system is concerned it is no comparison to compare that with the system of other countries, if you can prove that our indebtedness is nothing to be worried about, in comparison with other countries.

Governor ECCLES. When we speak of a future debt of 40 billion. it seems to me it is only fair to deduct from the 40 billion the assets which the Government has taken in lieu of the debt. We cannot say that the loans which the R. F. C. has made are entirely uncollectible, and we should also take into account the balance in the Treasury in considering the net debt.

Mr. GIFFORD. And the gold profit?

Governor ECCLES. I think any other country would take the gold profit into account. It is there.

So that the debt is less than 23 billion today when you consider the Treasury balance, and without considering the gold profit, but when you consider the assets that you can use to offset the debt. That is less than 4 months of the normal national income of this country.

The indebtedness of Great Britain is 35 billion, and it takes 5½ percent of the national income to support the British debt. That is, what is considered the present national income, which is between 19 and 20 billion.

Mr. GIFFORD. You do not want us to fall into their company, do you?

Governor ECCLES. Our situation would require less than 1 percent of the normal national income to support the Federal debt.

Mr. CAVICCHIA. What percent?

Governor ECCLES. Less than 1 percent of the normal national income to support the present Federal debt.

Mr. GIFFORD. The national income?

Governor ECCLES. I said the normal national income.

Mr. GIFFORD. What is that?

Governor ECCLES. Eighty-two billion was the national income in 1929.

I am as anxious as anyone to see the Budget balanced. The Budget can only be balanced, however, out of the national income. The national income can only be increased by employment.

Mr. GIFFORD. May I say, before I go any further, Governor Eccles, I may appear to be almost brutally frank in my questions, but that is my mannerism. I am the most harmless man on the committee.

I have letters from 25 commercial bankers in my district, all fine bankers and upright men, who are opposed to this legislation, and I want to find out about their opposition.

Governor ECCLES. I appreciate the opportunity for giving my answers. I have met with the bankers, with the representatives of the American Bankers' Association, and with many other bankers, and I find that their opposition to the bill has been largely the result of a misunderstanding. They do not understand what is in the present law, and the opposition they raise to this bill is the same opposition which might be raised to the present law, in a great many instances.

Mr. GIFFORD. I am a new member of the committee, and know little about the problems.

Governor ECCLES. I have now the figures of the Government debt as of January 31, 1935, the total interest-bearing debt being $27,952,000,000; due within a year, $5,606,000,000; from 1 to 5 years, $8,792,000,000; and over 5 years, $13,554,000,000.

The CHAIRMAN. Let me suggest that in your statement you incorporate the figures showing the holdings of the Government against those obligations, in order to make the story complete.

Governor ECCLES. Yes; I will do that.

Mr. HANCOCK. You mean the credit balances in the general fund of the Treasury?

Governor ECCLES. The general fund balance is somewhere between a billion and a half and two billion. We will have to insert in the record the exact figures.

The CHAIRMAN. That is what I said, that you should do that to complete the statement, showing the holdings in the R. F. C. and other organizations inuring to the benefit of the Government.

*Public debt and net assets of the United States, Jan. 31, 1935*

[In millions of dollars]

| | |
|---|---|
| Gross public debt | 28,476 |
| Net balance in general fund (excluding balance of increment resulting from reduction in weight of the gold dollar) | 1,519 |
| Net debt | 26,955 |
| Proprietary interest of the United States in governmental corporations and credit agencies: | |
| I. Financed wholly from Government funds: | |
| Reconstruction Finance Corporation | 2,321 |
| Commercial Credit Corporation | 41 |
| Export-Import Bank | 14 |
| Public Works Administration | 269 |
| Regional Agricultural Credit Corporation | 90 |
| Products-Credit Corporation | 113 |
| All other | 506 |
| Total | 3,354 |
| II. Financed partly from Government funds | 1,120 |
| Total | 4,474 |
| Increment from reduction in weight of the gold dollar | 2,812 |

Mr. GIFFORD. We have your Treasury statement every day on our desks. I am speaking this morning of the probable billions to be added. We have that fact staring us in the face every day.

I want to bring out the fact that with this continual financing by the Government of Federal indebtedness we need this sort of protection.

Governor ECCLES. The budget of any government must be balanced over a period of time; there is not any question about that.

Mr. GIFFORD. Would you suggest a time—possibly 5 years?

Governor ECCLES. I would say it might be desirable over a 5-year period, but I do not think it necessarily need be fatal if it is only balanced over a 10-year period. A war condition could create an unbalanced budget for a considerable period of time, if sufficient taxes were not imposed to pay as it was carried on.

Mr. GIFFORD. Would you advise my creditors to carry me along for 5 years? If so, I wish you would send me a letter.

Governor ECCLES. It has been my philosophy that the amount and the rapidity with which the Government spends will reduce—that is, if the amount and the rapidity are sufficiently great—they will reduce the total amount that the Government may be required to spend. To do that we have had a 40-billion-dollar deficiency in national income and a 3-billion priming process last year; that is about what it was.

I do not consider the transfer of the existing debt from where it is to the Government as a priming process. It stops deflation, but the actual amount of the budgetary deficit as a result of the Government spending and the Government lending for new structures that increases the buying power of our people has not been sufficient to stop the process of deflation and to give the momentum necessary when you consider the size of the pump.

By that I mean that with 10 or 12 million unemployed the buying power cannot be sufficiently increased by a 3-billion-dollar spending to utilize our existing productive capacity.

Mr. GIFFORD. That is a fine statement you are making, but I am sure that the priming process must reach down far enough to give constructive money that not only feeds and clothes people, but begins to construct something out of which people can get an income.

If the Government had spent this money and it was being used by people who were constructing something which was employing labor, that would be different than simply feeding and clothing people and building beautiful roads or race tracks, and ornamental things in the country which, in the end, does not keep very many people at work bringing in an income. That does not keep many people at work for any length of time bringing in an income, does it?

Governor ECCLES. I think so. I think to spend money, or increase productive capacity when you already have an excess of productive capacity, is just the place where you do not want to spend it.

Mr. GIFFORD. In my section, they want to spend money on public works, or on race tracks and beautiful roads through the woods, and after they spend that money how much of an income will that produce?

Governor ECCLES. After all, income has to come from spending.

Mr. GIFFORD. But if that spending is simply for feeding and clothing people and putting up ornamental unnecessary things, that will not help them any in the future, so far as any income in the future is concerned.

Governor ECCLES. Of course, I do not believe that Government spending should be in a field of competition with private enterprise, where Government spending will be expected to return an income.

Mr. GIFFORD. You do not believe in the Government loaning to help private business, do you?

Governor ECCLES. I would prefer that the lending should be done by the private-credit system, but when you reach an emergency such as we had in 1932, and set up the R. F. C., it became necessary to save the credit structure and lend money.

Mr. GIFFORD. Would you prefer that the $4,800,000,000 in the bill pending in the Senate be loaned to private industry, the whole of it, rather than have it expended in the method suggested?

Governor ECCLES. I would prefer that no part of it be loaned; that every part of it be used as a grant, as leverage, so as to induce private borrowing and spending.

Mr. GIFFORD. Would it be possible to make such a grant to private industry by any such process without favoritism?

Governor ECCLES. It is possible to make grants to cities, counties, and States for noncompetitive public works, and induce leverage through that process.

It is possible, through a subsidy to home owners, to induce the construction of new homes, and the subsidy will be the difference between the cost and rents.

Mr. GIFFORD. Do you prefer non-Federal projects?

Governor ECCLES. When it is a pure Federal project there is no multiplying. If the funds are used as a leverage, as a subsidy, we will say, to cities, counties, and States, you get an increased spending or a leverage added to the spending by the home owner. We have a differential between costs and rents today which is retarding private construction.

Mr. GIFFORD. You mean, do you not, if you grant 30 percent to municipalities and the municipalities are putting up 70 percent, therefore you get three times as much work done?

Governor ECCLES. Yes.

Mr. GIFFORD. Exactly.

Governor ECCLES. But instead of the Government loaning 70 percent, let the municipalities arrange their own credit. I think 30 is possibly not sufficient.

Mr. HANCOCK. I am very much interested in the statement you made with respect to subsidizing the private home owner to induce him to build a new home. If such a program as that were carried out by the Federal Government, would it not have a tendency to stagnate every private lending institution in this country?

Governor ECCLES. It would stimulate them greatly if the subsidy represented the difference between costs and rents.

Mr. HANCOCK. Are you explaining the proposal that the newspapers carried not long ago, to the effect that you advocated or suggested a plan whereby the Government would make a grant or a gift to a prospective home owner up to, say, 20 percent of the cost of construction?

Governor ECCLES. I am not sponsoring any plan. The question was with reference to the spending of the $4,800,000,000, whether I would prefer that to be spent by the Government or used as a loan.

In answer to that I am simply making some observations here, or some suggestions as to what would be my own personal view, in order to get the most out of the proposed appropriation.

Mr. GIFFORD. I think you have answered my question sufficiently.

Mr. CROSS. It seems to me we are going far afield from this bill, and that we have taken in all of the theories of loaning, most of which have nothing whatever to do with this bill, and if we continue along that line we will never get through with this hearing.

Mr. GIFFORD. Mr. Cross went very far afield.

Mr. HANCOCK. I think the gentleman's questions have been interesting and pertinent.

Mr. GIFFORD. I will be through in 2 minutes, if you will give me 2 minutes longer. I want to make two remarks.

I believe thoroughly in non-Federal grants, where the Government itself pays only 30 percent and the municipality puts up 70.

I want to say simply in connection with this matter of priming the pump, the answer seems to be suggested to me that we have poured in the water, but the well is frozen. Lack of confidence has frozen the well, and it does not amount to very much.

(Thereupon, the committee took a recess until 3 p. m. this day.)

AFTERNOON SESSION

The CHAIRMAN. All right, gentlemen. I believe we finished with Mr. Cavicchia. Now, does anybody on this side want to interrogate Governor Eccles?

Mr. SPENCE. I want to ask him some questions.

Mr. DIRKSEN. I would like to ask some questions.

The CHAIRMAN. All right, proceed. Let us get along.

Mr. DIRKSEN. Governor, I shall try to be brief. Perhaps I ought to restate the question Mr. Gifford had in mind this morning, I think, namely, that the President has authority to designate one man to the Board as Governor of the Federal Reserve Board; is that a Presidential designation?

Governor ECCLES. That is right.

Mr. DIRKSEN. And when a man ceases to be designated by the President, he is no longer a member of the Board?

Governor ECCLES. No; he is no longer Governor, but he is a member of the Board.

Mr. DIRKSEN. He remains a member of the Board?

Governor ECCLES. Yes; unless he resigns, which is usually the case if he is no longer designated as Governor.

Mr. DIRKSEN. I got the impression from reading your observations on the bill that, when the President ceased to designate him as Governor, he automatically divorces his membership as a member of the Federal Reserve Board.

Governor ECCLES. The present Federal Reserve Act requires that the President designate a member of the Board to serve as Governor at his pleasure.

Mr. DIRKSEN. I think I see, and it will not take very long to state the question. Now, with respect to the government of the Federal Reserve bank, I think the residence requirement has been taken out of the old act, has it not? In the new provision there is a statement to the effect that the Governor no longer has to be a resident of the Federal Reserve district or Board on which he should serve.

Governor ECCLES. That is right.

Mr. DIRKSEN. I am wondering whether it would be possible, under this provision, to take a man from New York, for instance, and by virtue of the fact that the power of approval is vested in the Federal Reserve Board, insofar as the class C directors are concerned—if it would be possible to transplant such a man to the seventh Federal Reserve in Chicago, and by either the giving or withholding of the power of approval, you could make him a member of the Board? Do you think that is possible, if not probable?

Governor ECCLES. Yes; it is possible to transfer a man from any other reserve districts, and the proposal simply applies the same and class C director. At present the Governor may be chosen from other reserve districts, and the proposal simply applies the same principle to the chairman and class C director, which is necessary in combining the offices of governor, chairman, and class C director.

Mr. DIRKSEN. It would be possible then, to take somebody from another section of the country and transport him to some other place?

Governor ECCLES. Yes. The idea of that was to promote able men in the Reserve System by moving them from one bank to another bank, creating a career system. The selection of the Governor. however, must be made by the local board of the reserve bank.

Mr. DIRKSEN. However, you have the power to approve?

Governor ECCLES. That is right.

Mr. DIRKSEN. And you could approve, or you could disapprove anybody that you desired to disapprove? In other words, you could prevent a man from becoming a combination governor, chairman, and Federal Reserve agent by simply giving your disapproval to his selection?

Governor ECCLES. They would have to submit some other name.

Mr. DIRKSEN. So really you would have the power to control?

Governor ECCLES. Well, whether the power of approval is the power to control may be open to debate. It would become necessary for the board of the Reserve bank and the Board here—at least a majority of the board of the Reserve bank and the majority of the Board here to agree upon a man that would be the executive head of the bank.

Mr. DIRKSEN. I think the matter is important, for this reason, and this is not very familiar to me and may not be familiar to you, but in 1927, I think, the rediscount rate was reduced for the purpose of stimulating the investment interests and also stop the flow of gold toward Europe, and the directorate of the Chicago Federal Reserve Bank was rather opposed to it, because they saw a possibility of the flow of capital from every agricultural bank. They resisted the idea, but it was done anyway; and I am not so sure but what, in the light of hindsight, that was right, after all. So if it depends on somebody out there who is absolutely sympathetic with all of the things that are done, that might prejudice the interests of the particular area. That brings up, of course, this question: I was interested in your observations that it was seeking to make them responsive to the national interest. That was the idea I think that you enlarged upon in the course of your remarks some days ago.

Governor ECCLES. Make who responsive?

Mr. DIRKSEN. Well, your Federal Reserve Board, and I suppose your open-market committee; they would be responsive to the large public interest, rather than to the sectional or local interest.

Governor ECCLES. Yes; that is right.

Mr. DIRKSEN. That would, of course, eliminate the checks and balances that did exist between the open-market committee and the Federal Reserve Board and the directors of the respective Federal Reserve banks. In the light of that experience back in 1927 I am just wondering whether it would be wise to eliminate that check, because, in that instance it would have had a most salutary effect upon the country, if the directors of a particular Federal Reserve bank had prevailed, and that probably had been able to carry out their own policies with respect to that Reserve bank district.

Governor ECCLES. Well, of course, if each of the 12 Reserve banks is going to be permitted to operate independently of the interests of the country as a whole, with reference to their monetary policies, it seems to me you would be sure to have great confusion.

Mr. DIRKSEN. If carried to the extreme?

Governor ECCLES. So long as you have 12 banks without a Federal Reserve board, without coordination and the power to deal with the problems of national interest, I cannot imagine how you could have a monetary policy that would be effective in meeting a situation that the Nation might be confronted with. No other country, so far as I know, has a divided responsibility with reference to the monetary policy that would be comparable to a policy made by the 12 different Federal Reserve banks.

Mr. DIRKSEN. You know, section 205 of this bill, in speaking, for instance, of the open-market committee, contains this language: It says that you are to deal, instead of through the Federal Reserve Board, with the Federal Reserve banks, and then the language is, "and the Federal Reserve banks shall conform their open-market operations to the provisions hereof." So, you are going to establish, after all, complete control at a time that might be disadvantageous to the interests of a particular geographical section. For instance, I suppose in Atlanta and Dallas you have certain cotton interests, in Minneapolis you have the grain interests, in Chicago you have not only grain but industrial interests; and that very question came up in 1927, and I am not so sure that, if it had prevailed, we might not have been infinitely better off. Of course, that is a speculative thing, I admit, but that was one instance where it proved out.

Governor ECCLES. I feel that monetary policies must be dealt with on a national basis, and that for each Reserve bank to act independently with reference to open-market policy or discount rates would cause great confusion. Money is like water—it seeks a level; and to raise rates in one section would cause the funds to flow to the section where the rates were raised from the section where the rates were low, which would act to increase the excess reserves in one area substantially and, therefore, make for expansion of credit and cheap money, and have the opposite effect in another area.

Mr. DIRKSEN. But I think you will admit that was practiced in one Federal Reserve district, and we might have had a 2 percent rediscount, and in another place 2½ percent, and another place possibly 3 percent, because that seemed to fit the conditions of that Federal Reserve district at that particular time.

Governor ECCLES. I do not believe it is necessary to have a uniform discount rate at all the Reserve banks and, as a matter of fact, there has rarely been uniformity in the discount rates. The discount rate is proposed by the Reserve banks and approved by the Federal Reserve Board, as a general rule.

Mr. DIRKSEN. But, examining the maximum possibilities of the bill with respect to the open-market committee, it is quite possible that the Federal Reserve directorate in any particular district would not have anything to say about it, the System insisting that they conform to whatever regulation is laid down about it?

Governor ECCLES. That is correct. If the committee felt it was in the national interest to raise rates to prevent undue expansion and speculation, they would do so; and, if they felt on the other hand that there was an unnecessary contraction, they would want to reduce the rates and the reserve requirements in an effort to stop the deflationary process, so far as they could. It seems to me that must be done in the interests of the Nation, because we have found that every part of the country is very interdependent with every other part of the country, and that money has a very rapid flow and is movable and transferable almost instantaneously.

Mr. DIRKSEN. When Mr. Crowley was before the committee, I asked him about the section entitled I, which provides that mutual savings banks and other banks may become member banks, or insured banks, after July 1, 1937. In other word, you would have to become a member of the Federal Reserve or otherwise have no Federal Deposit Insurance. I presume you are familiar with that?

Governor ECCLES. Yes; I am.

Mr. DIRKSEN. That, in the light of section 202 entitled "II" of the bill, which provides that the Federal Reserve, in order to facilitate their entry into the System, can waive the capital requirements. You enlarged on that somewhat in your observations and said, "and any other requirements that may be necessary." Now, you are familiar with the facts, also, that in organizing many of these State banks, you had to give deferred certificates in lieu of deposits, and I think you have answered that that is a contingent liability charged against the capital and, therefore, you cannot take those banks into the System.

What would you do about those banks, particularly in cases where most of the deposit liability was made up by deferred certificates, and there may be in small banks, as much as $30,000 or $40,000 outstanding of those certificates, and it may take 10 years to earn enough money to pay them off?

Governor ECCLES. I am familiar with that rule and I do not know that I, personally, agree with it.

Mr. DIRKSEN. The rule does exist, however?

Governor ECCLES. Yes; it was the opinion of counsel at the time the question came up, that in the light of the present banking legislation, by reason of those deferred certificates which the banks had issued, although they were secondary to the depositors' claims, still the bank was unable to qualify for membership. Now, one of the reasons for this provision which you just read is, to permit the membership of the banks of the class that you referred to.

Mr. DIRKSEN. Well, now, the corollary of that is this: What will the present members of the Federal Reserve System say if by wholesale, you should take in these banks? They might object to the fact that you are cutting corners in order to get them into the System, might they not?

Governor ECCLES. I cannot see that the other members of the Reserve System could be, in any way, affected by that, except favorably. It would be to the interest of all of the member banks of the System to have all of the nonmember banks members of the System, for the purpose of uniformity in carrying out the banking practices and procedure, and so forth. Admitting those banks into the System does not, in any way, place any liability upon the present member banks.

Mr. DIRKSEN. Well, if this is a fair question, would you care to say, categorically, whether you favor all banks coming into the Federal Reserve System at this time?

Governor ECCLES. I think that it is in the interest of the banking situation as a whole, nonmember banks as well as member banks, to have all banking institutions, which have the power to create money, members of the Federal Reserve System.

I think that the period of 1937 is helpful, in that it gives to the banks an element of time in adjusting their affairs to any extent that they may desire to, before applying for membership; and I think that, if this proposed legislation is passed, permitting the Board to waive the requirements that the nonmember banks are unable to meet, and providing the eligibility features that this bill carries, it will be a great source of strength to the Federal Deposit Insurance Corporation and to the banking system as a whole, through all banks being members of the Federal Reserve System.

Mr. DIRKSEN. Well, now, Governor, if I remember the figures, I think 41 percent of all of the banks in the United States are in towns of 1,000 in population. I am just wondering what distinct advantage will accrue to a bank in a small town which is simply subserving the money and borrowing interests of that community to buy 6 percent of the stock of the Federal Reserve, on which they will get no interest and discount benefits and privileges, which they probably would not use.

Governor ECCLES. They get 6 percent on the stock which they buy, which is a very profitable investment right now. Six percent is what they get on the Federal Reserve bank stock which they buy at the present time. Furthermore, the opportunity of rediscounting or borrowing from the Reserve bank for seasonal requirements or for emergency requirements should be a great source of help to the local community and would tend to prevent bank failures which otherwise might develop.

Mr. DIRKSEN. Well, now, if all of these banks come into the Federal Reserve System, manifestly, you are first destroying the banking authority of your State, and that would be possibly, or would possibly have the effect of superseding the laws of the State with reference to branch banking, and you might have an extension and development of branch banking; is that possible?

Governor ECCLES. I have not said very much about branch banking——

Mr. DIRKSEN. Will you allow me to interpose and tell you that my interest is aroused in the matter because of Senate bill 1926, which was introduced recently by Senator Fletcher, a very short bill, and the last phrase provides that—

Any national banking association may, with the approval of the Federal Reserve Board, consolidate with or purchase the assets of, and thereafter operate as a branch or branches thereof, and national or State banks, or banks, located in the same State, with which such national bank association was on

January 1, 1935, and still is affiliated, or shares or majority of shares of which were, on January 1, 1935, and still are owned by an affiliate of such national banking institution.

Mr. GOLDSBOROUGH. I am putting the committee on notice of the fact that the bill is before us now, and there seems to be a trend toward unification of the banking system. The extent of the branch banking would be easier than it is at the present time, when you still have checks and safeguards of some State law.

Governor ECCLES. Of course, there has been a rapid development of branch banking in the last few years.

The CHAIRMAN. Since the passage of the act that was to restrict branch banking.

Governor ECCLES. The National Banking Act or the Federal Reserve Act permits State-wide branch banking in those States where branch banking is permitted by State law.

Mr. GOLDSBOROUGH. Just to give the historical fact, we let the branch-banking features slip by with the express assurance on the part of those who wanted it that they would stand by the permanent insurance plan, and as soon as the law passed they began to fight the permanent insurance plan; we have had that fight on our hands ever since. Our theory was that it would be impossible to make any branch-banking law effective, because the independent banks would be so strong under the permanent insurance plan that they could preserve themselves. That is the history of that legislation. The branch-banking features would not have passed had we not had the assurance that the permanent insurance plan would be allowed to stand.

The CHAIRMAN. Governor, in connection with what Mr. Goldsborough said, the remark I made a moment ago had reference to the McFadden bill, which dealt with the matter of branch banking.

Governor ECCLES. The development of branch banking has been brought about by the action of the various State legislatures, and I understand that at the present time about one-half of the States permit branch banking, either on a State-wide basis or in some form; and, of course, the national banks are permitted to carry on the branch-banking business to the extent that is permitted in the States in which they operate.

Now, there is nothing in this proposed legislation that in any way changes the present laws with reference to branch banking, and there is nothing that interferes, or encroaches upon, the State banking organizations. The provision that requires insured nonmember banks to become members in 1937 is not in this legislation, but in the legislation that was passed last year. So there is nothing in this legislation that is being considered now that in any way changes the relationship of the State banking authority with reference to the banking structure.

Mr. DIRKSEN. I quite agree. What I was getting at, of course, is that, if a little later, it was all set up it would be made infinitely easier to extend the branch banks.

Now, getting over to section 206, there is a section there that provides that any sound assets may be discounted, that any Federal Reserve bank may discount any commercial, agricultural, or industrial paper and may make advances to any certain member bank on its promissory notes secured by any sound assets of such member bank. I presume an asset may be sound and still be "ill-liquid" rather than liquid, can it not? In other words, it might be good security behind it, but still not liquid?

Governor ECCLES. Yes. Many of the assets which are considered to be eligible and held to be liquid were less sound than many of the assets held by banks which could not qualify for rediscount or security for borrowing from the Reserve banks.

The CHAIRMAN. Mr. Dirksen, let me ask him a question right there, please.

If you have not already stated it, what percentage of the investments of the banks, exclusive of Government securities, is eligible for rediscount with the Federal Reserve bank?

Governor ECCLES. Well, at the present time, I do not know the exact percentage, but I understand it is less than 8 percent of the total loans and investments of the banks that are eligible; and that is according to the classifications made by the banks themselves and not according to the classification made by the Reserve banks. I think, upon experience, the banks would find, if it were necessary to use all the paper which they considered eligible, that some of it would not be so considered by the Reserve banks. So that the figure given, which is as I say, less than 8 percent, is the maximum.

Mr. DIRKSEN. I see section 207 provides that guaranteed obligations of the United States may be bought and sold without regard to maturity. Those are such bonds as Home Owners' Loan Corporation——

Governor ECCLES. And Federal farm mortgages, and so on.

Mr. DIRKSEN. Well, now, I suppose that has to be considered in the light of the provision in the bill which calls for the repeal of the collateral requirements. Is there any notion of policy that something else should be substituted for 50 percent of the eligible paper and collateral in addition to the 40-percent gold reserve?

Governor ECCLES. No. You see, this is providing for the elimination of the collateral requirements against the Federal Reserve notes. The reason for the provision that you have just read is that it is felt that there should not be discrimination between Government bonds and bonds guaranteed by the Government. The fact that the Reserve banks may buy direct obligations of the Government, and the fact that they may not buy long-term guaranteed obligations of the Government is an unjustifiable discrimination between the guaranteed bonds and direct obligations.

Of course, at the time the law providing for the purchase of direct obligations was originally passed, there were no guaranteed obligations; and I feel that, had there been guaranteed obligations at that time the law would very likely have included both direct and guaranteed obligations.

Mr. DIRKSEN. Well, now, heretofore, of course, the note-issuing power was used largely commensurate with the rise and fall of business in that area; and if there had to be a 40 percent gold reserve and 60 percent of eligible paper, there had to be commercial transactions behind all of that paper. And so as there was a fixed volume of business, the chances of any demand on the Federal Reserve agent for more Federal Reserve notes, or less, depended on whether the tide of business was high or low.

Now, that collateral requirement is to be repealed and you are authorized to buy and sell in the market, and these guaranteed obligations of the Government—that is what is called elasticity, which does not mean a great deal to me—however, it is taken away, and from then on the amount of notes that will be issued will bear no definite relationship to the amount of business in the 12 Reserve districts, or it may be a very arbitrary amount.

Governor ECCLES. That was the theory upon which the collateral requirements for note issue were based, but that is proving to be inapplicable to the facts in the case. The greatest requirements for notes in any year in this country happened when the business volume was at its lowest, showing that the demand for currency does not necessarily follow the fluctuations of business. The fluctuation of bank lending on short-term eligible paper reflects to some extent the activity of business. The call for Federal Reserve notes in the United States, a country where 90 percent of the business of the country is done by check, has very little relationship to the volume of business.

As I stated a few days ago in discussing this question, the Reserve banks have two classes of liabilities: One is the deposits to the member banks and the other is the notes outstanding.

The CHAIRMAN. Will you not add to that, the capital held by the other banks?

Governor ECCLES. That is a liability to the stockholders, of course; and the surplus is a liability to the Government. In liquidation, the assets of the Reserve bank consist of the gold certificates, and the investments that the Reserve banks make in governments, and loans and discounts which they make to member banks.

I see no reason for putting up 40 percent gold certificates back of notes and then putting up eligible paper to the extent of 60 percent. As a matter of fact, it would be perfectly impossible to cover the note requirements of the banks by 60 percent of commercial paper; because the banks do not have the paper to cover that proportion of the note requirements. Therefore there would not be sufficient Federal Reserve notes to meet the requirements, if the Reserve banks were required to secure notes, as originally contemplated in the act, by 60 percent of the commercial paper.

There is no difference between note liability and deposit liability. They are both liabilities of the bank and there would seem no more occasion for the securing of notes than it would for the securing of deposits. All of the assets of the Reserve banks are back of all of the liabilities of the Reserve banks. The type of assets that the Reserve banks hold—outside of the Government bonds which they buy and the gold certificates which they hold—is determined by each Reserve bank, when that Reserve bank extends credit to member banks.

Mr. DIRKSEN. Well, Governor, if you have more than 40 percent gold reserves, that means that the Federal Reserve bank has got to issue $2.50 for every gold certificate dollar that it has; is that correct?

Governor ECCLES. What is that?

Mr. DIRKSEN. If you have that 40-percent gold reserve behind every dollar of Federal Reserve notes issued, you will have issued

$2\frac{1}{2}$ times for every gold certificate that the Federal Reserve banks may have?

Governor ECCLES. That would be right.

Mr. DIRKSEN. Then in the light of the fact that you could buy and sell without limit, virtually, all of the outstanding contingent obligations of the Government, or those that are guaranteed, you could retire most of them today if you so chose, and if that was going to be the policy, by rather copious note issue; that would be entirely possible under the bill, would it not?

Governor ECCLES. As I understand it, the bill would not change that situation, at all.

Mr. DIRKSEN. But I would think that would be possible, would it not?

Governor ECCLES. The present law permits notes to be secured by Government bonds and gold certificates. That is not in the present law, it was in the Emergency Banking Act of 1932.

Mr. DIRKSEN. You could, instead of just securing them, retire them altogether?

Governor ECCLES. What is that?

Mr. DIRKSEN. I say, instead of securing them, you could retire them altogether?

Governor ECCLES. Retire what?

Mr. DIRKSEN. Retire these bonds that had been guaranteed as to principal and interest, being nothing more than a note issue——

Governor ECCLES. You mean that the Reserve Bank, through open-market operations, could purchase all of the outstanding, or as many of the outstanding Government bonds and guaranteed bonds as they chose to do?

Mr. DIRKSEN. Yes; as far as there were gold certificates available that would be possible, would it not?

Governor ECCLES. Yes; but, of course, that would increase the reserves of the members by the amount of bonds which were purchased, and the excess reserves of the members today are something over $2,000,000,000. To extend that reserve, banks purchase additional Government bonds or bonds guaranteed by the Government—they would increase the reserves of the member banks.

Mr. DIRKSEN. I think this morning, or yesterday, you made the observation that the relationship of income to the deposit currency was as 3 to 1, or substantially so?

Governor ECCLES. In 1928, and 1929 it was 3.12. That was about the average, as I recall, of the deposits and currency to the national income. In 1933 the relationship, or what is spoken of as the income velocity, was about $2\frac{1}{3}$. At the present time, it would be substantially less than that. That increase of money, deposits plus currency, has been much more rapid than the increase in income, and hence, the velocity has been reduced.

Mr. DIRKSEN. Has that relationship of 3-to-1 between the income and deposit currency existed for a longer period than since 1929?

Governor ECCLES. No; it has been steadily going down.

Mr. DIRKSEN. It has been going down since that time, but I mean anterior to that period. I do not know where I got that figure, but——

Mr. GOLDSBOROUGH. Does income mean the same as production?

Governor ECCLES. Yes; it is spoken of as the national income. Dr. Currie says the figure was very stable from 1923 to 1929.

Mr. DIRKSEN. At 3-to-1?

Governor ECCLES. Yes.

Mr. DIRKSEN. And before that time, what was it?

Governor ECCLES. I do not have the figure on it. Of course, during the war period and during the period of depression in 1920 and 1921, I imagine there would be some changes in ratio.

Mr. HANCOCK. May I ask a question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. Governor, what do you mean by "national income?"

Governor ECCLES. What I understand to be the basis for figuring the national income is the price of all goods, whether consumer's goods or capital goods, that are produced in any one year.

Mr. HOLLISTER. For ultimate sale?

Governor ECCLES. Would that be sale?

Dr. CURRIE. It is the wages, profits, dividends, of all the money actually received by the income receivers.

Governor ECCLES. It is supposed to represent all the goods bought and sold.

Mr. HOLLISTER. That is, the ultimate sales?

Governor ECCLES. The ultimate sales, yes; otherwise you get duplication. That is right, the ultimate sales.

Mr. HOLLISTER. Dr. Townsend refers to $1,200,000,000,000, and I wanted to be sure about it.

Governor ECCLES. No, you have $900,000,000,000 to $1,000,000,000,000 of bank debits, which, based upon the amount of demand deposits would possibly give a velocity of deposit currency turn-over of over 50 times in the period of 1928 and 1929.

Mr. HANCOCK. At what rate is the national income running today?

Governor ECCLES. Well, I do not know. I do not know that there are any figures at all on it.

Mr. HANCOCK. What was the national income in 1934, as defined by you?

Governor ECCLES. Do you have the figures of the Department of Commerce?

Dr. CURRIE. No; not for 1934.

Governor ECCLES. I have heard it variously estimated from $50,000,000,000 to $50,000,000,000, but you would really have to have the complete figures for 1934.

Mr. DIRKSEN. At any event, that ratio is invariable and goes back to 1923?

Governor ECCLES. It was relatively constant.

Mr. DIRKSEN. And for any increase of $1,000,000,000 in deposit currency, you would get an increase of $3,000,000,000 in national income?

Governor ECCLES. Well, theoretically, but that has not been the case from 1929 to 1934.

Mr. DIRKSEN. But if it were invariable, there would be a great incentive then to increase the amount of deposit currency, in the hope of increasing the national income by just exactly three times that amount and all the good that we could do with that amount of money?

Governor ECCLES. It would be fine—there is no question about that—if we could do that by an increase of our volume of money, without regard to who owns the money, and thus regulate our national income. I do not believe that is possible. I do feel, as I have said before, that of course the volume of money is an important factor; and, certainly, with high interest rates and shortage of reserves today, you could expect no credit expansion, and such a situation would be very deflationary. Excess reserves, such as we have today, which bring down the rate of interest, should ultimately lead toward creating credit expansion—whether we can do that and recover time alone can tell. That is one of the factors and one of the elements that will help make for recovery, if private credit expansion can induce recovery.

Mr. DRISCOLL. Governor, I am not entirely clear in my mind as to the expression "national income"; does that mean the price of every taxable article that is produced in the United States per year?

Governor ECCLES. It is the income received from the production of all goods.

Mr. DRISCOLL. We will say all of the hay, tobacco, textiles, wool that is sold?

Governor ECCLES. No; you would get duplication then.

Mr. DRISCOLL. Not if you sell it only once?

Governor ECCLES. That is right. For instance, you would sell wheat to the miller, and the miller would sell the flour to the wholesaler and so on, and you would get, of course, a duplication, because that would be the flour sold to the consumer——

Mr. DRISCOLL. And not the wheat sold by the farmer?

Governor ECCLES. No.

Mr. SISSON. In other words, there is a great distinction between the national income and the total turnover of business.

Governor ECCLES. A very great distinction.

Mr. SISSON. Many times?

Governor ECCLES. A very great distinction, but the national income determines the actual wealth produced, which determines the well-being of the people if it is properly distributed.

Mr. FORD. Might I suggest that my interpretation of "national income", is all wages, interest, dividends, ultimate sale prices of goods. Does not that fairly well cover it?

Governor ECCLES. I think that is the rule.

Mr. SISSON. That would not include the lawyers' income, who are not productive members of society, as a part of the national income?

Governor ECCLES. Yes; it includes a lawyers' income.

Mr. WILLIAMS. How about wages?

Governor ECCLES. The same thing applies.

Mr. HOLLISTER. Would not the real test be not the national income in dollars, but the units of articles sold in respect to these other particular years? If your prices are quite different, your national income may look different, but it is the units of things that happen to be sold in a particular year, with reference to the other year?

Governor ECCLES. Yes, the production; that is right.

Mr. DRISCOLL. Governor, I see that section 209 of this bill confers upon the Reserve Board the authority by regulation to change the requirement as to the reserves to be maintained against demand or time deposits. As I understand the percentage on demand is now 13 for Chicago and New York, and 10 for other eastern cities, and 7 for the country banks, and 3 percent on time deposits?

Governor ECCLES. That is right.

Mr. DIRKSEN. Now, at one time, I think when the Federal Reserve was raising prices, it was up to 25, 18, and 15, was it not? Was it not much higher, and mounting higher when the Federal Reserve was first enacted?

Governor ECCLES. It was higher than it was in 1925; it was 18 and down below 18.

Mr. DIRKSEN. It has been reduced?

Governor ECCLES. Yes. Dr. Goldenweiser, I wonder if you know the reason for the drop in the Reserve requirements, from those higher percentages to the percentage that applies at the present time?

Dr. GOLDENWEISER. The reason requirements were reduced at the time was that it was the theory that the cash held in the bank vaults amounted to about that much. When this cash in the vaults held by the banks was excluded from the legal reserve, there was an allowance made for it.

Mr. DIRKSEN. You do not require any cash in vault now, do you?

Dr. GOLDENWEISER. No. When they would not let it count as reserves any longer they reduced the requirement.

Mr. DIRKSEN. No; actually, there is no cash in the vault at the present time, only of course these reserves against the deposits that are deposited with the Federal Reserve bank?

Governor ECCLES. There is cash in the vault, and these reserve requirements of 7, 10, and 13, as I understand Dr. Goldenweiser, were reduced because previously the cash held was considered as a part of the reserve requirements, and the cash now held by the banks is not considered a part of the reserve. There is no legal cash requirement, but banks have to hold sufficient cash to be able to meet the cash requirements of their customers, and those requirements fluctuate from day to day.

They have to ship money, from the Reserve bank to their bank and the amount of cash required by a bank that is not in a Reserve center, that is, in centers where there is no Reserve bank or branch of a Reserve bank, is relatively higher than the percentage of cash that is carried in a bank where there is a Federal Reserve branch bank or Reserve bank.

Mr. DIRKSEN. What reserves do the Bank of England and the Bank of France require, as compared to these requirements here?

Governor ECCLES. I am unable to say.

Mr. DIRKSEN. Dr. Goldenweiser, what can you say about that?

Dr. GOLDENWEISER. There are no legal requirements about the reserves of commercial banks.

Mr. DIRKSEN. In practice, what do they maintain?

Governor ECCLES. Well, in England, somewhere around 10 percent, as a rule.

Mr. DIRKSEN. Yes; both the demand and time deposits?

Dr. GOLDENWEISER. Yes; against their deposits.

Mr. DIRKSEN. Against all deposits?

Dr. GOLDENWEISER. Yes; and in France I do not know, because in France they hold so much of it in actual notes and the ratio varies, but it is not very greatly different from the English system.

Mr. DIRKSEN. Well, now Governor, section 209, of course, would confer upon the Federal Reserve Board the power to raise or lower those reserve requirements; in other words, instead of 13, 10, and 7, you could reduce them to 10, 7, and 3, and you might reduce the reserve against the time deposits to 2 percent or even 1 percent. In practice, how much of that reserve deposit do the Reserve banks, as a general thing, carry?

Governor ECCLES. You mean the member banks?

Mr. DIRKSEN. No; of the deposits that are carried by member banks in the Federal Reserve bank, do they keep all of the 13 percent or 10 percent or 7 percent on hand, or do they use it?

Governor. ECCLES. The Reserve banks.

Mr. DIRKSEN. Yes.

Governor ECCLES. The Reserve banks do not invest their money—that is, their deposit money—from the standpoint of keeping their money operating at a profit. It is their business to invest their money in open-market purchases as a regulatory measure of the monetary system.

Mr. DIRKSEN. Well, the purpose, apparently, of that section is to give greater flexibility and give the Federal Reserve Board the authority to raise or lower their reserve requirements, and——

Governor ECCLES. That provision with reference to the reserve requirement is now in the law. The Thomas amendment to the act of May 12, 1933, added to the Federal Reserve Act a provision giving the Federal Reserve Board the power, by declaring an emergency, to raise the reserve requirements, with the consent of the President. That was put in there as a supplemental monetary control to open-market operations. It is a control against inflation.

Mr. DIRKSEN. Against inflation?

Governor ECCLES. Yes; that would be the purpose of that—a control against inflation. For instance, assuming that the excess reserves of member banks greatly exceeded the amount of Government bonds which the Reserve banks held and the bills which they held, there would be no way of controlling through open-market operations an inflationary credit expansion on the part of member banks. There would be no way of reducing or wiping out their excess reserves upon which credit inflation is built. For instance, if the authority now granted to issue $3,000,000,000 of greenback currency was exercised, and if the $2,000,000,000 of gold profit now in the stabilization fund were used, $5,000,000,000 additional bank deposits would be created.

Mr. GOLDSBOROUGH. Right there, if that money were used to retire Government bonds, the deposits would not be increased but the reserves would be increased?

Governor ECCLES. That is right. In that case it would increase the reserves by that amount, but it would increase deposits to the extent that it retired Government bonds not held by the banks. If the money was used to retire Government bonds held by individuals, it would increase deposits and increase reserves; to the extent that it was used to buy Government bonds held only by the bankers, to that extent it would increase the reserves alone without increasing deposits.

It is possible with the use, we will say, of the $5,000,000,000 referred to, to increase the reserves by that amount. Additional gold may continue to come into the country, which would also tend to increase the reserves. So that the banking system could build up excess reserves from the $2,300,000,000, approximately, that they hold now to $7,300,000,000 plus any increased gold that comes in. You would have a potential agency for bank-credit inflation that would simply be terrific and no open-market operation could control it. An increase of reserve requirements would have the same effect in extinguishing the excess reserves as a sale of securities, and that is why this proposal is made.

Mr. DIRKSEN. That is the sense of the 20 percent in this bill?

Governor ECCLES. Yes.

Mr. DIRKSEN. Ultimately to extinguish the reserve requirements, if necessary?

Governor ECCLES. Yes.

Mr. DIRKSEN. I think I have only one more question, and that is with reference to section 210, dealing with real-estate loans. I was much interested in the discussion this morning, and I wondered whether, after all, we could not keep the banks on a commercial basis and keep them liquid by letting the building and loan associations handle the amortized real-estate mortgages up to 20 years, and pursue the policy of greater leniency with respect to bank loans, to such thrift agencies that now operate. I say that for this reason—the building and loan associations are equipped to handle the amortized loans, and if the banks were going to handle them in any quantity, they would have to set up separate establishments and take on additional personnel to do that.

Mr. CAVICCHIA. May I say this, Mr. Dirksen?

Mr. DIRKSEN. Yes.

Mr. CAVICCHIA. The great trouble was that many building and loan associations were running businesses in opposition to the banks. They got in the habit of going to the banks to borrow money on notes and pay, say, 5 percent on the money that they borrowed from the national bank or trust company; and they would proceed to lend it to me, or the man who wanted to buy himself a home; and they would get 3 percent or 4 percent or 5 percent bonus; and if they started to sell preferred shares to depositors and some of these companies borrowed—they did not borrow, but they took on deposit money on which they guaranteed as much as 7 percent per annum, which no bank could afford to pay. If the building and loans had not gone to that field, they would not have suffered as much as they did when the crash came in 1929.

Mr. DIRKSEN. Well, let me say there are probably 700 or 800 Federal savings and loan associations that have been established now; and, of course, their sole mission is to deal in amortized loans.

Governor ECCLES. Well, I may answer that by stating that the Federal savings and loan associations are members of the home-loan banks.

Mr. DIRKSEN. And those are rediscount institutions?

Governor ECCLES. Yes; and those institutions can borrow money from the home-loan banks at 3 percent. Therefore I do not know how commercial banks owning substantial savings funds upon which they pay 2½ percent could compete with the home-loan banks in providing funds to savings and loan associations.

Mr. DIRKSEN. It could, but for one thing, and do you know what it is? It is the bank examiners. There are lots of buildings and loans that would go to the banks and make their notes signed by all of the directors, get the money, and pour it into the development of building and construction in their communities; but I doubt very much whether the examiners would permit that at the present time.

Governor ECCLES. The only thing is that a bank, in order to pay 2½-percent interest on time funds, which it will likely have to pay to hold the funds against the competition of the 3- and 3½-percent rates paid by savings and loan associations, must lend those time funds on a basis to yield them not less than 5 percent.

A building and loan association, as a member of the home-loan bank, would not be willing and could not afford to pay the banks 5 percent for funds which they in turn would have to loan out at 8 percent; and in borrowing from the banks, they would borrow on a short-term basis and would be loaning in the community on homes on a long-term basis. Therefore I do not think it is practicable to expect the building and loan companies to borrow from the savings or time funds of commercial banks.

Mr. DIRKSEN. There is one statement in here, one proviso in the section dealing with real-estate loans, section 210, that says:

> Nothing contained in this section shall prevent any national banking association from acquiring, as additional security for loans, previously made in good faith, second or subsequent liens on real estate or shares or participations in such liens.

Those are junior liens, or they would not be second mortgages?

Governor ECCLES. That is right.

Mr. DIRKSEN. There would not be anything to prevent a bank from taking a $2,000 first mortgage on a $10,000 property, and then stepping in a little bit later and taking another junior mortgage for $1,000, and making a junior lien against the first mortgage against the property, if they so desired. I believe you stated this morning you thought that was rather poor financing to even indulge in junior liens, if it could be avoided.

Mr. ECCLES. A bank should be prohibited, in the first instance, from taking a junior lien—from making a loan secured by a junior lien; but if a bank has a loan, and even though it may be an unsecured commercial loan or a collateral secured loan, the bank is justified in taking a second lien, for additional security, if conditions develop where the loan, which was adequately and properly secured, or a loan which was made to a concern which had ample resources, gets into a position where it becomes a doubtful loan. In such cases the bank may take a second mortgage or take any other security that it can get; and banks have always done that, in fact. They have always been doing that.

Mr. DIRKSEN. The only requirement, however, in that language, is the faith of the bank, "previously made in good faith."

Governor ECCLES. I think possibly the only reason for that language there is this: The banks, we know, have always taken, and there has been no prohibition upon banks taking, for debts previously contracted, second mortgages or any other collateral.

Mr. DIRKSEN. Have they that authority now?

Governor ECCLES. Yes.

Mr. DIRKSEN. To take second mortgages?

Governor ECCLES. Yes; they have always done that.

Mr. CAVICCHIA. Is there not some confusion here, Mr. Dirksen? I think you mentioned about a bank lending their $10,000, and subsequently he wants to borrow another $1,000 on the same piece of real estate. That is perfectly legitimate, because it is considered practically one mortgage loan—is it not—whether it is made in one loan or two loans; am I correct, Governor?

Governor ECCLES. It would seem to me that it would be considered a first and second mortgage, because the first mortgage might be sold without recourse, and certainly the $1,000 mortgage would then be a second mortgage. So long as both pieces of paper are held by the same institution, they would be, for all practical purposes, the equivalent of a first mortgage.

Mr. CAVICCHIA. I had in mind the building and loan practice, where a man has $5,000 mortgage, and a year or two later wants another $1,000; in all respects, that is considered as one mortgage. Now, a second mortgage is never taken by a building and loan—by a member bank unless it wants to secure some loan that it had already made; is that correct?

Governor ECCLES. That is right.

Mr. HANCOCK. Mr. Dirksen, may I ask one question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. In addition to the fact that there is such a small amount of eligible commercial paper available for rediscount, did I understand you to say the other day that one of the reasons why you were suggesting that 20-year amortized real-estate mortgages should be made eligible for borrowing was the fact that unless the banks did handle this type of paper, these loans would continue to gravitate to the home-building and thrift institutions?

Governor ECCLES. We are not proposing that 20-year mortgages, as such, be eligible for rediscount. The proposal is that the banks be permitted to make amortized real-estate loans on improved property up to the maximum period of 20 years, up to a certain percentage of their time funds.

Mr. HANCOCK. Sixty percent, is it not?

Governor ECCLES. Yes. Now, with reference to the question of eligibility, there is nothing said at all about the right to rediscount those mortgages. The wording of the eligibility provision is to the effect that the Federal Reserve Act would be amended to authorize the Federal Reserve banks, subject to regulations of the Board, to discount for member banks any commercial, agricultural, or industrial paper, and to make advances to member banks on promissory notes, secured by any sound asset.

Mr. HANCOCK. I understand. This is something that was recognized in the Emergency Banking Act, that the member banks be permitted, on their bills payable or promissory notes, secured by sound assets, to borrow from a Reserve bank, and the credit department of each Reserve bank would determine the terms upon which the member bank could borrow.

Let us see if we understand each other right there for a minute. Under that provision, would the member bank be able to endorse, without recourse, a first-mortgage note to a Federal Reserve bank?

Governor ECCLES. A member bank now cannot endorse without recourse any paper to a Reserve bank. All borrowing from the Federal Reserve bank is done on eligible paper, on the discount basis, with recourse, and all the bill does is to broaden the borrowing privilege so as to give to the Reserve banks the power to lend to member banks on the member bank's note for a period of 3, 6, or 9 months, according to the regulations that the Board may make, those notes to be secured by bonds, mortgages, or loans secured by collateral, with such margin as the Reserve banks may consider adequate to make the loans safe and sound to the Reserve bank.

Mr. HANCOCK. I think I understand that now; you see if I do. In other words, the member banks, under this provision, would not be able to rediscount a 20-year amortized mortgage with the Federal Reserve System, but use the mortgage as collateral for a loan.

Governor ECCLES. That's correct.

Mr. HANCOCK. But it could give its own note, secured by the 20-year amortized mortgage, and secure a loan from the Federal Reserve bank, if that was a sound asset?

Governor ECCLES. The Reserve bank would determine what margin might be required, and would also determine whether the loan would be made for 3 months or 6 months, or a longer period.

Mr. HANCOCK. But that would enable the member bank to be in a position, in time of emergency, to take that paper and use it for the purpose of liquidity?

Governor ECCLES. The same as it could with eligible paper; that is right.

Mr. HANCOCK. In other words, you mean put real-estate mortgages on parity, as they should always have been, so far as eligibility is concerned, with bonds?

Governor ECCLES. Government bonds, you mean?

Mr. HANCOCK. Yes; Government bonds?

Governor ECCLES. Yes; so far as being able to borrow money from the Reserve bank is concerned.

Mr. CAVICCHIA. Is this inflation, Governor?

Governor ECCLES. This is not inflation, because no member bank is going to borrow from the Reserve bank as long as it has excess reserves. Now, when the borrowings of member banks reach the point where you can get credit inflation, just as we have had in this country in the past, it was said to be the duty of the Reserve Board and the Reserve banks to raise the discount rates and to discourage future credit expansion.

Inflation can only be brought about by the willingness of the people and corporations to borrow money, and that is one thing we are trying to get; we are trying to induce the borrowing and lending of money upon which recovery is based. We are talking about the fear of inflation or reflation, when, as a matter of fact, that is what we want.

Mr. DIRKSEN. Governor, I have one more question, and that is predicated on the question asked by the chairman of the committee last week, when, off the record, he observed something about the condition of one of the Federal Reserve banks. Was that early in 1933?

The CHAIRMAN. I am not sure that I remember the remark you refer to.

Mr. DIRKSEN. Well, I got the impression at that time that it was the Federal Reserve banks that had lost their liquidity; is that possible?

Governor ECCLES. The Reserve bank lose its liquidity?

Mr. DIRKSEN. Yes.

Governor ECCLES. I never heard of that.

Mr. DIRKSEN. I got that impression at the time, but that is neither here nor there. I am just wondering if, carried to its logical conclusion, there is plenty of demand for this money; and, as you say, the assets can still be sound and still not be liquid, but if those were infiltrated to the Federal Reserve banks, you may have another flurry similar to the one we went through.

Governor ECCLES. An asset that may be considered sound and liquid with business activity and a high rate of employment and national income becomes frozen and unsound when the national income diminishes. Soundness is not determined only by the substance of a loan or asset at the time the asset is purchased or the loan is made; it depends upon the state of trade and business which follows, and it is up to the banking system to maintain a state of trade and business that will preserve soundness, if soundness existed when the credit was created, in so far as it is possible.

When certain foreign bonds were purchased, German bonds, prior to the war, we considered those the best in the world, and they were sound assets. When wheat was selling at $2 a bushel, it would have been considered perfectly sound, and the paper would have been eligible to have been loaned upon, and it would have been proper to have loaned upon that wheat with a 25-percent margin, on the warehouse-receipt basis. The same thing is true in any other commodity.

I remember when sugar was selling at around $21 a bag, and within a 6-month period it fell below $5 a bag. I am not arguing that a loan of 80 percent of the value of $21 sugar would have been sound.

I remember when sheep were selling at $16 a head, when within a 6-month period you could not sell them at $4 a head, yet a loan made on sheep at $16 for 9 months—that is, on the basis of 50 percent of $16—say, $8 a head for 6 months was eligible; whereas before that loan came due that security was not selling for one-half of the amount of the loan.

The point I am trying to make is that the question of liquidity and the question of soundness depends upon the state of trade and the state of business; and to the extent that forced deflation through forced credit contraction is obviated through making available the rediscount facilities of the Reserve banks—to that extent you provide liquidity. The only liquidity that really exists in a serious depression is the liquidity that is provided through the money-issuing agency, the Reserve System. Even Government bonds cease to have liquidity at the price at which corporations can sell them without going bankrupt.

The price of Government bonds in 1932 was down, the 3's, I think, to $83. A bank holding any substantial amount of those bonds—to have sold them at that market—and if any substantial amount had been sold, the market possibly would have gone to $50, and the bank would have been ruined. The banks, however, could go to the Federal Reserve banks and borrow on those Government bonds, and that was a protection to the market, and also a protection to the banks, which would not have existed if the banks had been forced to sell those bonds to get money to meet the demands, instead of going to the Reserve bank and getting the money.

Mr. HANCOCK. Mr. Dirksen, may I ask one other question?

Mr. DIRKSEN. Yes.

Mr. HANCOCK. Now, deposits you have already written off.

Mr. DIRKSEN. I think if the Governor wanted to, in the light of the fact that it was related to the bonus, he might make a further observation.

Governor ECCLES. I do not care to express an opinion on matters of that kind, because I feel it is entirely outside of my official position. I have my personal opinion, but I think it is outside of my official position.

Mr. DIRKSEN. I have just one observation to make with reference to this last section of title II, and it is this: Whether or not the time deposits will be drained off in the form of real estate amortized loans to any appreciable extent, will depend entirely upon the public demand?

Governor ECCLES. Entirely.

Mr. DIRKSEN. The public demand must necessarily be occasioned upon the purchasing power?

Governor ECCLES. There is no question about that.

Mr. DIRKSEN. If you have not got the purchasing power, they might demand until they are blue in the face, and it would not do any good; and that, in turn, is conditioned upon the state of employment in the country?

Governor ECCLES. That is correct.

Mr. DIRKSEN. The question that comes up to us is: Which is the first, the hen or the egg? And I question whether it is going to do any good.

Governor ECCLES. If you get demand for long-term credit for home construction or for other construction, and the facilities for providing it do not exist, that would be most unfortunate.

Now, I feel that, with low interest, and abundance of excess funds, that the need and desire of institutions with those funds should be to put them to work, and that may tend to create some construction. I do not believe that the demand, today, throughout the country as a whole, for long-term, amortized loans is entirely being met. What you say about the hen and the egg is true, and I am not claiming for the eligibility feature of this legislation and the real-estate feature, one of which is the corollary to the other, that it will bring about recovery; but it would create the machinery upon which recovery can be brought about.

I might say this: That the increase in private expenditures for equipment and construction await upon the increased demands for products of industry. The increased demand depends upon the increased incomes, as a whole. Increased incomes await upon increased expenditures in construction. There is your circle.

Now, the impasse can be broken in the first instance, I believe, only by the various Government activities, and if the impasse is broken, then you have created here the machinery with which to help carry forward, just as you are creating in the case of the Home Owners' Loan Act and providing funds for your home-loan banks to loan to the members of the home-loan banks. That is the agency that will help in the mortgage field as well.

Mr. HANCOCK. That is what you said in 1933, is it not?

Governor ECCLES. Something like that.

Mr. DIRKSEN. That is all I have to ask, Mr. Chairman.

The CHAIRMAN. All right. Mr. Wolcott, have you any questions?

Mr. HANCOCK. Let us adjourn now until in the morning, Mr. Chairman.

Mr. FORD. May I make one observation before we adjourn?

The CHAIRMAN. Pardon me just a minute. Let this be off the record.

(Here follows discussion off the record.)

Mr. SISSON. As I understand it, this bill makes no change in the law with respect to the liability of the banks that are members of the permanent insurance fund for assessment; that is, in other words, the assessment is still based upon the total amount of the deposits; that is correct, is it not, whether insured or not?

The CHAIRMAN. That will be the situation under the new law, but it is not the basis on which the assessments are made under the law as is stands now.

Mr. SISSON. I know, but it was contemplated as a permanent fund?

The CHAIRMAN. Well, under the permanent plan, there would be an assessment of one-fourth of 1 percent, to be repeated in case of necessity. The necessity depends upon whether or not the total fund on hand equals one-fourth of 1 percent of the amount of the total deposits of insured banks.

Mr. SISSON. Well, what I am getting at, Mr. Chairman, is this: You all know that was one of the points at issue last year, and that is going to be one of the points in controversy this year. We are getting some letters from certain banks to the effect that that is inequitable; that is, when the total amount of the deposits that are insured are a relatively small percentage of their total deposits, as compared with their uninsured deposits, they are making the claim that there should be a change made.

I am not taking any position. In fact, if I were to take any position now, I would be opposed to that contention.

The CHAIRMAN. I think you will find, Mr. Sisson, in Mr. Crowley's testimony, and in Mr. O'Connors' testimony that that phase of the legislation is fully covered, not only as to the changes made and the systems being employed, but all fields that enter into the calculation are covered.

Mr. HANCOCK. Mr. Chairman, may I respond to my good friend from New York?

I had occasion, today, Mr. Sisson, to go into a case affecting an institution in my own State. I received a letter recently criticizing the method proposed under title I of the new bill, whereby the proposed assessment of not more than one-twelfth of 1 percent would be levied against the total deposits in any one institution, annually. This institution that I have in mind, under the present law, insured $20,700,000 of its total deposit liability of $58,000,000, and the present cost to that institution is approximately $51,000 a year. Under the provisions of the new act, whereby the assessments apply to the total deposits of $58,000,000—on the basis of not in excess of one-twelfth of 1 percent, the cost of insurance to this institution is actually reduced $3,000, to $48,000 a year; and 13,000 institutions that are insured today would carry this insurance at a lesser amount under the new act than they do under the temporary plan at the present time.

Mr. WILLIAMS. The fact is, there is no insuring under the permanent system and——

Mr. HANCOCK. No; I say, under the temporary plan.

The CHAIRMAN. Well, gentlemen, have we decided to adjourn for the afternoon? We will meet at 10:30 in the morning, and I hope we shall finish with Governor Eccles tomorrow.

(Thereupon, a recess was taken in the hearing until 10:30 a. m., Friday, Mar. 15, 1935.)

# BANKING ACT OF 1935

**FRIDAY, MARCH 15, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committe met at 10:30 a. m., Hon. Henry C. Steagall (chairman) presiding.

The CHAIRMAN. All right, gentlemen, there is nothing in the House to interfere with our meeting today.

We will resume with Governor Eccles. Mr. Ford, have you something?

Mr. FORD. Mr. Spence is next.

The CHAIRMAN. That is all right. Mr. Spence, if you have any questions, you may proceed.

Mr. SPENCE. Governor Eccles, what will be the practical effect of waiving the collateral requirements for the issuing of Federal Reserve notes? In other words, is there any limitation, or will there be any limitation on the issuance of notes?

Governor ECCLES. There is no limitation now, for all practical purposes. What determines the use of currency is not the Federal Reserve banks, nor the member banks, but the people of the country who have claims on the deposits in the banks. They have the right to request a bank to pay them in currency. The bank, in order to be able to pay them such currency as they request, goes to the Federal Reserve bank to get the currency. The bank, in order to get the currency from the Federal Reserve, must have a balance with the Federal Reserve, just as an individual depositor with a bank must have a balance with the bank. Therefore, the only limitation upon the issuance of currency is the demand for currency by the people of the country that have bank deposits, and the collateral requirements in no way affect or change the amount of the currency.

Mr. SPENCE. What was the philosophy of the original act which so meticulously made the requirements for collateral?

Governor ECCLES. I do not know that I can say. I could only surmise what was in the minds of the framers of the act at that time. The theory apparently was that the demand for currency would fluctuate directly with the volume of activity of business, and as business increased in activity, it would increase its borrowings on eligible paper, which, together with the gold, would supply the necessary collateral for the Federal Reserve notes; and, as business activity slackened or decreased, the volume of eligible paper held by the banks would be reduced, and hence the volume of currency would be reduced.

It has been found, however, that there is nothing in the history of the Federal Reserve System to warrant such a conclusion. This is the only country where there is a central banking system, outside of Great Britain, which requires collateral to be held back of the note issue of the central bank. All of the new central banks which have been established in recent years recognize that, in essentially a check-using country, there is no necessary relationship between the use of currency and the volume of business.

We heard a great deal of talk about issuing currency with the idea that, if that currency is issued in greater quantity than is now outstanding, it would improve or help business. The direct spending by the Government of currency, from the standpoint of the actual money in circulation, and the business activity created thereby, would be no different than the same amount of money spent by the Government as the result of its present method of financing; because you cannot keep out in circulation more currency than is required by the country to meet its convenience in doing business. The currency comes right back to the banks and from the banks goes to the Federal Reserve banks and is destroyed. We have noticed that, from the time of the bank holiday up until the present time, the amount of currency in circulation has been reduced by about $2,000,000,000.

Mr. SPENCE. What is the total amount of gold held by the Federal Reserve, Governor?

Governor ECCLES. I do not recall the figures. Do you have that, Dr. Goldenweiser?

Dr. GOLDENWEISER. Gold certificates held by the Reserve banks amount to $5,400,000,000.

Mr. FORD. $7,866,000,000 in 1934.

Governor ECCLES. That would probably include the gold held by the Treasury as well. The Federal Reserve would not have that.

Mr. SPENCE. The amount of gold reserves upon which the circulation is based; what would that be?

Governor ECCLES. The law requires a 40-percent reserve against Federal Reserve notes in circulation. Those gold certificates, plus the Government bonds or commercial paper, or both, are held by the Federal Reserve agent as collateral. In the absence of commercial paper, it was necessary to accept Government bonds to make up the 60-percent difference between the 40-percent gold and the total of notes outstanding.

Mr. SPENCE. And this act is that 40 percent of the gold reserve is the sole basis of the circulation?

Governor ECCLES. Yes; 40-percent gold reserve is the only limitation. There is also a reserve required against the deposits of the Reserve banks, which is 35 percent in gold or lawful money.

Mr. SPENCE. And the circulation, based upon the gold now held, would be two and one-half times that?

Governor ECCLES. So far as gold is concerned——

Mr. SPENCE. So far as gold is concerned?

Governor ECCLES. Yes; there is almost sufficient gold now to back up the outstanding currency 100 percent.

Mr. SPENCE. As I understand, the Federal agent was the agent of the Federal Reserve Board in its dealings with the Federal Reserve banks?

Governor ECCLES. The Federal Reserve agent is the chairman of the board of directors, and is appointed by the Federal Reserve Board and not by the banks, and he is the person at the bank through whom the Federal Reserve Board deals.

Mr. SPENCE. He, in a sense, represents the Federal Reserve Board in dealings with the Federal Reserve bank; is not that the philosophy of it?

Governor ECCLES. That is right.

Mr. SPENCE. And he saw that the Federal Reserve banks complied with the requirements of the Federal Reserve Board. How will those functions be performed now?

Governor ECCLES. Through the Governor and the chairman, who will be one and the same. Instead of having a dual organization, which creates cleavage and which is bad administration, it is proposed to combine the two offices. That is one proposal in the bill to which there has been practically no opposition from any source. The bill will save, in the operation of the Federal Reserve System, about $400,000 a year.

Mr. SPENCE. But the functions that were performed by the Federal Reserve agent are still being performed, but the Board will select the person to perform them?

Governor ECCLES. One of the principal functions of the agent was to hold the collateral as a sort of trustee against the notes which were issued. He was responsible at all times to see to it that these gold certificates and these Government bonds or commercial paper were deposited with him in sufficient amount to meet the legal requirements for the issue of notes.

Mr. SPENCE. Under the law, one Federal Reserve bank may rediscount—it says under the orders of the Board and regulations prescribed by the Board, may rediscount its paper in other Federal Reserve banks. To what extent has that been taken advantage of?

Mr. ECCLES. I could not tell you just to what extent. I understand, however, that in 1920 and 1921 there was some of that done, when the reserves of the Reserve banks got down to practically the legal limit and they were unable to extend further accommodations and, at the same time, have sufficient gold to meet the legal requirements for deposit and note-coverage. Do you remember to what extent that was, Dr. Goldenweiser?

Dr. GOLDENWEISER. In 1920, from memory, about $250,000,000.

Mr. ECCLES. How many banks were involved in the rediscount?

Dr. GOLDENWEISER. There were 11.

Mr. SPENCE. That provision, really, in effect, makes the Federal Reserve bank a central bank, does it not?

Governor ECCLES. It does so only to the extent of making the resources of the system available for the benefit of all the member banks, and that is all.

Mr. SPENCE. There is one other thing: I believe you said that you thought that some policy ought to be prescribed with reference to the administration of the bill, and you made a suggestion, or you suggested an amendment. Will you tell us what that amendment was, again?

Governor ECCLES. I suggested that I thought that fixing the price level as an objective would not be desirable, and as an alternative

I suggested that something like this might be better as a definition of objective:

It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate, by its influence, unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

That is better, I feel.

Mr. WILLIAMS. That would be their duty even if you did not put it in there, would it not?

Governor ECCLES. The present law does not give them such a duty, at all. The present law only provides for——

Mr. WILLIAMS. Ought it not to be their duty?

Governor ECCLES. I do not know. The law has looked upon the Federal Reserve banks as agencies to provide credit for agriculture, commerce, and industry. The original act never contemplated the Federal Reserve bank as a monetary factor, as I understand it.

Mr. CROSS. May I interject right there, that the testimony of the members of the Reserve Board and some of the governors—they testified that it was not their duty and they did not consider they had anything to do with it.

Governor ECCLES. I think it was thought that, if credit was provided for commerce, agriculture, and industry, that is all that could be done toward creating business stability.

Mr. WILLIAMS. You think they made no effort along that line, at all?

Governor ECCLES. What is that?

Mr. WILLIAMS. You think they have paid no attention to the objective that you set out there, heretofore?

Governor ECCLES. I would not say that. Of course, the powers of the Board have been limited, their authority and their duties——

Mr. WILLIAMS. And they made no effort, at all, to stabilize business conditions and mitigate the evil effect of fluctuating prices and unemployment, and things of that kind?

Governor ECCLES. I have only been on the Board, as you know, for a very short time, and what the Board may have done is a matter of record, and it would appear in the record, from the condition of unemployment, the fluctuations of business activity, that whatever may have been done was a long way from creating stable conditions. Whether a condition of business stability can be brought about by monetary policy, only time can determine; and, as I stated the other day, monetary action has its limitations and has to be considered in connection with the tax program and Government expenditures.

Mr. WILLIAMS. I do not mean to be understood to be opposed to the suggestion you made here. I had had the impression that was their duty all right, and I still think, if it has not been their duty, we ought to make it their duty.

Governor ECCLES. I do not believe that under the existing law they are required to carry out or to perform that function.

The CHAIRMAN. Well, the fact is, is it not, Governor Eccles, that there was an attempt to incorporate specific directions of that type in the original Federal Reserve Act, and finally, it was left out of the bill.

Mr. FARLEY. Mr. Chairman, may I have an opportunity——

The CHAIRMAN. Mr. Spence, will you yield to Mr. Farley?

Mr. SPENCE. I just want to ask a question. Governor Eccles, do you consider that this bill, if passed, will be an attempt by the Congress to exercise its constitutional legislative function to regulate the value of money?

Mr. ECCLES. I should say that it would be a case of Congress delegating to a body that power and that responsibility, as defined in this statement that I just read. We often think of regulating the value of money as having reference to gold.

Mr. SPENCE. Well, as a corollary to that, that would be regulating the price levels, too, would it not?

Governor ECCLES. It would be an attempt to regulate the price level. If these instructions or requirements are prescribed for the Federal Reserve Board the price level will be one of the objectives, but not the only objective. Others will be stable production and employment.

Mr. SPENCE. Well, how far do you think you could go in obtaining some definite objective as to the regulation of price levels?

Governor ECCLES. The controlling of production and the fixation of prices can tend to create whatever price level is desired.

By the operation of the National Recovery Act and the Agricultural Adjustment Administration you can restrict production and bring about a rise in prices; but it seems to me that the thing that we are most interested in is to get a maximum of production in the country as a whole and a maximum of consumption. That is far more important than the price level.

In order to be able to get a maximum of production, it is necessary to get a proper distribution, and the question of price naturally has to enter into the problem. I do not know that I could add anything to what I said when Mr. Cross was examining me with reference to the problem of prices.

Mr. CROSS. May I ask a question?

Mr. SPENCE. Go right ahead.

Mr. CROSS. Governor, you said that three factors come in there: The question of price and production and employment. If you check the price level when the country was prosperous and when its indebtedness was created, much of it fixed by bonds and taxes, and the cheap dollar compared to the present dollar that existed—if you get a price level that is comparable to the price level then in that period, is not that the very thing upon which depends both production and employment? In other words, to get employment you have got to get the price to where the producer makes a profit—a probable profit, because not everybody makes a profit, of course, but under good management, he can make a profit, and when he can do that, he employs labor and in turn labor is given a purchasing power and the country can function as a result of that, and you get rid of your unemployment and you keep a stable product and you keep a stable price level on the standard you take of some prosperous year.

Governor ECCLES. You know, from 1923 up to about 1929, we had a fairly stable price level. Now, why was it that that stable price level became an unstable price level and we got into the depression we did?

Mr. CROSS. If you will let me answer that, if you put that as a question——

Governor ECCLES. I think maybe asking a question is the best way for me to answer it.

Mr. CROSS. I would say the Federal Reserve Board fell down in its duty, or fell down under the law as it existed—I could not say it was a duty. But in addition to that, we did not have then the securities act to control the wild speculative gambling that took place throughout the country on the stock exchanges. Now, we have controlled it largely through the laws enacted in the Seventy-second Congress.

Governor ECCLES. You assume that, if the volume of money in relation to total production is kept at a certain ratio, you would thereby maintain a uniform or fixed price.

Mr. CROSS. Not a fixed price of anything?

Governor ECCLES. No, I know; I mean a fixed index, uniform prices according to some index. And you overlook, it seems to me, the income velocity, which is an element as important in our economy as is the quantity of money. As I indicated the other day in reading the quotations from the Brookings Institution report on our capacity to consume, there must be a more equitable distribution of income than existed in 1928 and 1929, in order to keep up income velocity and to prevent production capacity getting all out of balance or relationship with consumer buying power.

Mr. FORD. In other words, Governor, if you have a national income of $100,000,000,000, but if it was confined to a small percentage of the people in the country, it would not accomplish the result of wide-spread purchasing power, would it?

Governor ECCLES. It would only so long as those receiving this income continued to spend or invest those funds, but you reach a point where——

Mr. FORD. A saturation point, in other words?

Governor ECCLES. They no longer invest.

Mr. FARLEY. Mr. Chairman, may I ask the Governor a few questions about the bill itself?

Mr. SPENCE. When I get through; yes.

The CHAIRMAN. When Mr. Spence gets through, I will recognize you immediately, Mr. Farley.

Mr. SPENCE. Governor, the maintenance of a stable dollar is something that is very greatly to be desired, is it not, because if the dollar would raise 10 percent in value and buying power, the wealth of the Nation would be raised that much. For instance, if there was $400,000,000,000 of wealth in the Nation and the dollar raised its buying power, or was increased 10 percent, that would reduce the money value of the wealth of the Nation $40,000,000,000, would it not?

Governor ECCLES. A stable price level is very desirable. If I knew of some way to maintain stable prices, and at the same time maximum production, naturally I would be very much in favor of pursuing that method. But prices are influenced by so many factors, crop failures, for instance, prices of imported goods as they are influenced by the variation in the exchanges—those are two factors that we may have very little or no control over, and they all enter into the price structure.

Mr. SPENCE. Now, in this bill we state a new policy, or new standards, or new criterions, or new objectives to be attained. The provision here in regard to the open-market committee says it shall set forth policies that, in the judgment of the committee, should be followed with respect to the open-market operation of the Federal Reserve bank. Now, if this is a delegation of constituted legislative power to regulate money, would it not be necessary for the Congress, in making that delegation to state some objective to be attained?

I have not gone into that, but I want to read a paragraph from a decision of the Supreme Court in *Panama Refining Company et al.* v. *Ryan et al.*—one of the "hot-oil" cases:

The Constitution provides that "all legislative powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives" (art. I, sec. 1). And the Congress is empowered "to make all laws which shall be necessary and proper to carry into execution" it general powers art. I, sec. 8, par. 18). The Congress manifestly is not permited to abdicate, or to transfer to others, the essential legislative functions with which it is thus vested. Undoubtedly legislation must often be adapted to complex conditions involving a host of details with which the national legislative cannot deal directly. The Constitution has never been regarded as denying to the Congress the necessary resources of flexibility and practicality, which will enable it to perform its function in laying down policies and establishing standards, while leaving to selected instrumentalities the making of subordinate rules within prescribed limits and the determination of facts to which the policy as declared by the legislature is to apply. Without capacity to give authorizations of that sort we should have the anomaly of a legislative power when in many circumstances calling for its exertion would be but a futility. But the constant recognition of the necessity and validity of such provisions, and the wide range of administrative authority which has been developed by means of them, cannot be allowed to obscure the limitations of the authority to delegate, if our constitutional system is to be maintained.

I have not gone into that question, but do you not think there ought to be some objective, definite objective placed in the law?

Governor ECCLES. You mean as to price?

Mr. SPENCE. As to price level, the purchasing power of the dollar?

Governor ECCLES. By purchasing power of the dollar you mean the price level?

Mr. SPENCE. The price level; yes.

Governor ECCLES. If the price level is placed in the law as an objective for the Board to reach as a result of monetary action, and the other factors are left out, we may get the result of having a stable price level and not getting any of the other factors which we want. I believe that the price level is less important than employment. I think the most important element, after all, is total production, because that is the real measure of wealth. I do not know what monetary policy could possibly be pursued to bring about a fixed price level and maintain it; I do not know how that would be possible.

Mr. SPENCE. Well, the price level does have a very great relation to the production, does it not?

Governor ECCLES. It may or may not. The thing that, after all, has relation to production is the buying power of the people of the country as a whole. When the national income is increasing faster than production, prices rise and production is stimulated thereby; and when the national income is diminishing, prices decline, and production is diminished thereby.

Therefore, it seems to me that the problem of the national income is a determining factor with reference to prices and production. So, rather than an arbitrary fixation of prices, if we could get an increase in the national income, we would get an increase in production and an increase in prices; and that is why in 1929, after we had had a period from 1923 to 1929 of stable prices—because we had had reasonably full employment during that period—and then our national income started to diminish and we got into a cyclical depression, prices went down and production went down.

Mr. SPENCE. Do you think the changing price level comes from conditions over which we have no control?

Governor ECCLES. Over which we do not have anything like complete control. We possibly can exercise some control through monetary action; but I do not think that we can exercise absolute control, unless we undertake to fix prices, by legislation, and attempt to regulate production accordingly. Even then, I doubt that we could maintain stability of the price structure as a whole.

Mr. SPENCE. The power given to the Congress, in the Constitution, to regulate the value of money is a power you do not think can be exercised?

Governor ECCLES. I do not think it can be exercised to the extent of maintaining a uniform price level, and at the same time keeping up maximum production.

Mr. SPENCE. Well, a good many of our ills have resulted from changing the value of the dollar and the fluctuating price level.

Governor ECCLES. Oh, yes; but the changing value, as I say, has been brought about primarily through the decrease in the national income, which was brought about through the inequitable distribution of income. That is where the trouble commenced very largely.

Mr. SPENCE. How far do you think legislation can go to stabilize the value of the dollar? Suppose we set the objective that we might not hit, but could we come anywhere near it?

Governor ECCLES. I do not know how. Certainly, interest rates could not be very much lower than they are now. The volume of money that is not in use is very great, and to increase it, it seems to me, would accomplish nothing toward either price raising or increasing business activity.

We have a potential increase of $20,000,000,000 in the supply of money. The excess reserves provide that. True, if Government spending were greatly increased, you would get an increase in the price level, because you would get an increase in the national income, and you would get an inflationary or reflationary effect as the result of that increased spending.

Mr. SPENCE. That would be an artificial condition?

Governor ECCLES. It would bring about the same result as an equal volume of spending by our people of their own funds, or their being willing to borrow and spend a like amount. That would inject into the circulation an increased amount of money and increase the velocity of money and raise the price level, and the buying power of the people would increase through that spending, and production would then have to increase to meet the increased buying power, and with the general increases, prices should tend upward.

Mr. CROSS. May I ask a question?

The CHAIRMAN. Mr. Farley is next.

Mr. SPENCE. There is one question more. I have gotten so many letters from State banks—there is a provision in the law that you can waive the capital requirements of the State banks and then give them such additional time to conform to the requirements as the Board may, by regulations, prescribe. A good many of them feel that they ought to know just how long they have to comply with these requirements, when they become members of the Federal Reserve System, with the ultimate purpose of remaining in.

Governor ECCLES. I suggested an amendment to that the other day that would give the Board the power not only to waive the capital requirements, but all other requirements, and also to permit banks to continue with less than $50,000 capital, if it is adequate in relation to their liabilities. So there would be no time limit if a bank with $25,000 capital did not need a greater capital in relation to its deposit liability.

Mr. SPENCE. Well, I suppose it works both ways.

Governor ECCLES. That was the suggested amendment to liberalize that section.

The CHAIRMAN. All right, Mr. Farley.

Mr. FARLEY. That is right in line, gentlemen, with what I had in mind. In section 202 you provide——

Governor ECCLES. Where?

Mr. FARLEY. Section 202, that the time in which this shall become effective is July 1, 1937. But why is there any objection to writing into the law 1940, for instance?

Governor ECCLES. That is not in the banking bill of 1935. As I understand it, that is in the banking act which was passed in 1933. Personally, I see no reason for an extension of time in lieu of the provisions that are being made, in order to make it possible to admit all the State nonmember banks which are insured. I believe that it would be in the interest of those banks and the System as a whole to be members of the Federal Reserve System, if this legislation broadening the eligibility features is passed.

Mr. FARLEY. I wanted to ask this, because in the State of Indiana we have, in round numbers, 420 banks, and only six now are in the Federal Reserve, and I have the fear that, if they are compelled to qualify by July 1, 1937, there will be many of them left out. Do you not think that, if the insurance feature is withdrawn from these banks, because they have not qualified, it is just the same as closing the banks?

Governor ECCLES. Why do you think they cannot qualify?

Mr. FARLEY. Well, they might be able to qualify in a little additional time, but if the rules governing the examination of these banks continue as rigid as they have been for some months past, they probably would not be able to qualify, because they have a lot of frozen assets yet.

Governor ECCLES. I am sure that, so far as the present Federal Reserve Board is concerned, they realize fully that situation, and it is their expectation to take into the System all, or practically all, banks which are insured. It is for that reason that we are proposing this amendment to the Federal Reserve Act.

It is true that, as a condition of admission to membership, the Federal Reserve Board has rather rigid regulations, which are not requirements of law. They require banks to charge off all paper that is classified as a loss, by the reserve examiners, and all depreciation on bonds except those in the four highest classifications. However, the Federal Reserve Board, under this provision, would be expected to give the same consideration to the bond accounts of these banks that is now given to the bond accounts of existing member banks both by the Reserve Board and by the Comptroller's office.

Mr. FARLEY. Well, the inference, then, is that you mean to undertake to liberalize them; and I do not mind saying that, from the impression I have of you and your public work, I should not be much afraid that would not be done.

Why object to writing it into the law and making it 1940? I have in mind a case where I tried, a year and a half ago, to get a bank into the Federal Reserve System, and they were declined, because they had something like $360,000 of what they counted doubtful paper. Now, even in these hard times, that bank has been able to reduce that now over $200,000, and collect——

Governor ECCLES. When was that, you say?

Mr. FARLEY. About a year and a half ago.

Governor ECCLES. With the guaranteeing of bank deposits by the Federal Deposit Insurance Corporation and with help from the Reconstruction Finance Corporation, with reference to capital structures, providing funds at 3½ percent for preferred stock, the banking problem is very different than it was. As a practical matter, it seems to me that the banks which are insured by the Deposit Insurance Corporation should be admitted to membership in the Reserve System. There would be no point in making requirements upon those banks which would exclude them from the Reserve System, and thus exclude them from the benefits of the Deposit Insurance Corporation, and possibly close them. That would be a foolhardy thing to do.

So long as the depositor is protected by the Federal Deposit Insurance, there should be an effort made to get all of the banks into the System, so as to have unification of the banking system and thus be able more effectively to carry out a monetary policy; and by that means, also, greatly to assist in dealing with deflation as well as inflation.

It is true that by far the greatest decline, both as to the percentages of deposits and as to total deposits, was in nonmember State banks, practically twice as great as it was in the member banks.

Mr. GOLDSBOROUGH. I did not catch that.

Governor ECCLES. I said the shrinkage in deposits of nonmember banks, the deflation in nonmembers banks from the peak of their highest deposits down to their lowest deposits—in other words, the deflation of nonmember State banks—was almost twice as great as the deflation in the deposits of member banks.

That was a very great hardship on the communities which those banks served, and the bank failures were far greater in the case of nonmember State banks than in the case of member banks, both State and national, and that of course——

Mr. GOLDSBOROUGH. I would like to inject that that was not the condition in the State of Maryland; it was the failure of the large member banks in the important cities which carried the reserves of the country banks which burst the nonmember country banks.

Governor ECCLES. I think there are exceptions all over the United States; but what I am speaking of is the United States as a whole. I am taking the entire country.

The CHAIRMAN. Somebody in the Senate, Governor Eccles, and I believe it was Senator Norbeck—I never ran it down like I should possibly have done—gave the figures, as I remember, for the year 1931, which show that the deposits, the casting up of accounts, showed that there were as many deposits tied up in the failed national banks as there were in the State banks; that I think the figures would show that, in 1931, there were more deposits tied up in failed national banks in the State of New York and in the State of Pennsylvania than there were in the State banks. I would not say that I could not be mistaken in those figures, because I am not an authority, but that is my recollection.

But let me ask you this question: What happened was that the failures first took place among the smaller banks; and of course that involved, at least in number, the State banks more than the national banks, and the nonmember banks probably more than the member banks; but when the fire spread from the back alleys and side streets to the mansion on the front and to the important centers, and began to involve the large banks, they were not helpless; they did not stand by and let the fire ruin them, but they came to Congress and had us open the Treasury of the United States to them.

So that it seems to me that an appraisal of that situation should be taken in the light of the fact that the processes were started by resort to the Federal Treasury, and never allowed to reach that end. So we do not know what the complete picture might have shown.

Mr. GOLDSBOROUGH. I think it ought to be stated here, as well as any other time, that another direct cause of the failure of the small banks was the fact that the large national member banks in the great centers, through the years immediately preceding 1929, unloaded securities on those banks, practically all of which securities afterward were shown to be sour.

Governor ECCLES. I have pointed out the effect of the bond acount when I was upholding the real-estate loan provision.

With reference to the chairman's remarks, I am not here making any odious comparisons between member and nonmember banks, for the purpose of putting the nonmember banks to any disadvantage. I am only trying to argue for the need of all banks to be members of the Reserve System and have available to them borrowing and rediscount facilities of that System, as well as of deposit insurance, so that we may avoid fires starting in the back alleys, et cetera; because, after all, the net result of the conflagration of the bank failures is finally to burn down the System, if it is not stopped; and in the process it is not only the bankers and the stockholders of the banks that we are directly or particularly interested in, but it seems to me we are interested in this problem as the duty of Congress and as the duty of officials who are responsible for our money situation.

Mr. GOLDSBOROUGH. Mr. Eccles, right there. Yesterday, I think, you stated that the stockholders in the Federal Reserve System receive 6 percent on their investments?

Governor ECCLES. That is right.

Mr. GOLDSBOROUGH. But the Federal Reserve System, in turn does not redeposit those funds in those little country banks; so that, in case of an investment which they make in the Federal Reserve System, they only get interest once; whereas on the ordinary investment, where they get a redeposit, they may lend the same money 10 times. Is not that the reason why they object to coming into the Federal Reserve System, because they do not get the benefit of the deposits which they can reloan?

Governor ECCLES. As I understand it, most State laws provide that State banks—whether members or nonmembers they are subject to State laws—are required to maintain reserves, either in money or in balances with other banks, or both, of a certain percentage of their deposits. Now, I know the requirement for State banks in two of the Western States that I am familiar with is 15 percent of demand deposits and 10 percent of time deposits, which must be carried in cash or with other banks.

Mr. GOLDSBOROUGH. Yes; but that does not answer my question. I do not know whether you want to direct your attention to my question, but what I asked was, whether or not, as a matter of fact, when one of these small country banks enters the Federal Reserve System and gets its 6 percent, that is all the interest it gets on that particular investment. The investment is not redeposited with them so they can loan it over again, as the ordinary investment is which they make.

For instance, if they loan me $5,000, they expect me to simply take a bank book from them, so they can reloan that same money.

Governor ECCLES. When you buy a Government bond, the proceeds are not reinvested, or when they buy other bonds that are marketable, we will say, or listed on the New York Exchange, or when they buy Canadian bonds or other bonds, those funds are not redeposited with them.

Mr. GOLDSBOROUGH. They are not redeposited with the country bank, but they are redeposited with some bank?

Governor ECCLES. That is correct.

Mr. GOLDSBOROUGH. But the small banks are not loaded up with Government bonds.

Governor ECCLES. Their percentage of Government bonds is pretty high; it is much higher than it was, because there was no other place——

Mr. GOLDSBOROUGH. When one of these national banks buys $100,000 worth of bonds, all the Government gets is an entry by some $25-a-week clerk to the effect that the Government has deposited or has a deposit in that bank of $100,000. That is what happens.

The CHAIRMAN. Just one moment, in connection with what has been said, I think it might be well to call attention to the situation: It means more to the small bank, the bank of small capital, to tie up 6 percent of its stock in the Federal Reserve bank than it does for the large institution to carry that burden, it would seem to me. The little banks, under the old order, were permitted to carry their reserves in a correspondent bank, upon which they were accustomed to draw interest, which was no little thing to small banks. That operated in this way: In the South, for instance, or in the West, the demand for credit is seasonal. When marketing time came and collections came in, the bank had a plan by which it could use its surplus funds, to put them to earning, by carrying them to the city bank; and that, in turn, gave them a large borrowing privilege during seasons when the demand for loans was accentuated. So that was an advantage that they enjoyed.

In addition to that, the small banks, members of the system, had to surrender their right to charge for the services rendered in remitting checks, and that is, of course, a big item to any small bank where the problem of overhead is great, and where the volume of business is small, and, of course, that requirement kept many banks from joining the Federal Reserve System. And those banks that were automatically taken into the Federal Reserve System—the national banks—conducted a war against the efforts of the Federal Reserve Board to take away such earnings, as long as they were able to carry on the fight. They finally lost through legislative action and processes that I will not take the time now to review, but which were not altogether justifiable, in my view of the matter.

You may resume, Mr. Spence.

Mr. SPENCE. I want to address——

Mr. FARLEY. There is one other question I want to ask, in connection with your statement of the wide difference between the assets of the nonmember banks and the member banks. Was that arrived at by the same committee's examination?

Governor ECCLES. I do not just understand your question.

Mr. FARLEY. You said, a few moments ago, that the nonmember banks had a much larger amount of worthless assets than the member banks. Did the same group examine the nonmember banks, or arrive at the same conclusion?

Governor ECCLES. You must have misunderstood me. I did not make a comparison between the assets of the member and nonmember banks.

Mr. FARLEY. Then I misunderstood you.

Mr. ECCLES. I made no comparison between the assets, because I am not familiar with the condition of the assets of the nonmember banks.

Mr. FARLEY. I thought you said that the losses were greater in the nonmember banks than in the member banks, or their portfolios were not so good.

Governor ECCLES. No; what I said was, that the shrinkage in deposits and the liquidation at nonmember banks was far greater than that at member banks; that the deposit deflation, as the result of bank closings and credit contraction in the nonmember banks——

Mr. FARLEY. I get the idea.

Governor ECCLES. Was about twice as great as that in the member banks, in proportion to the total deposits of each group of banks.

Mr. FARLEY. I have a letter in which the Indiana Bankers' Association makes this very emphatic statement:

> The Indiana Bankers' Association is unalterably opposed to central banking in any form, and especially to a central banking system in which credit granting and management will be vested in any political body.

That gets back to the question of control. You thought, the other day, there was no danger of anything of that kind happening.

Governor ECCLES. I see no reason to expect the Federal Reserve System, under this bill, to be any more subject to political control than has been the case in the past under existing legislation.

Mr. FARLEY. I remember your answer. There is another item I would like to get a little information on. I have read your speech at Columbus over several times, and it is a very excellent presentation of the subject.

I personally think you never can have a price level until you control all products of every kind and description, from the farmer to the market, or to the consumer. I do not ask you to say whether you do or not concur in that suggestion. But now, about this provision by which you are going out and loan on all types of real estate, making provision for the rediscount of those securities at the Federal Reserve bank, and then permit the Federal Reserve itself to issue currency against all securities. It seems to me that the wildest inflationist in the world could not have had a better term than that. When you take on anything and issue securities—and issue currency against those securities, it seems to me it is just like Germany did at the end of the war. Is there anything in that?

Governor ECCLES. I though I had answered that point. That question has been asked a number of times. I will try to answer it very briefly and cover the subject. Three phases of this legislation have a bearing on this matter: Changing eligibility requirements, permitting long-term real-estate loans, and eliminating collateral requirements for Federal Reserve notes.

In the first place, I think that you will probably agree that the amount of Federal Reserve notes that go into circulation has no relationship to the collateral requirements. I attempted this morning, and yesterday, and I think the day before yesterday, to explain why that is the case.

Mr. FARLEY. If that is already in the record, Governor, it is not necessary to repeat it.

Governor ECCLES. With reference to the question of eligibility, what we are proposing is to permit the banks, subject to rules and regulations by the Board, not only to discount eligible paper, but also to make advances to member banks on notes of the member banks, secured by any of their sound assets. That does not mean that the Reserve bank would have the power to discount a 20-year mortgage. What it does mean is this: That the Board could, by regulation, permit the Reserve banks to loan to member banks on bills payable of the member banks, for such——

Mr. GOLDSBOROUGH. A promissory note; that is what you mean?

Governor ECCLES. That is right, a promissory note, secured by bonds, mortgages, collateral loans, on a basis to be determined by each Reserve bank to be a sound basis for the loan.

Those loans would be made for periods of 90 days or 6 months, according to the regulations that the Reserve Board may make with reference to maturities. The member banks in the aggregate do not borrow for the purpose of reloaning. What is usually done is that the banks borrow to meet a shrinkage of deposits, the shifting of funds back and forth, which always happens seasonally under normal conditions, and it is usually seasonal borrowing.

If an emergency situation developed, the only way that the fire of deflation and bank closing can be stopped is by the banks being able to meet the demands of their depositors, and when they are able to do that, the depositors do not want their money. But when the depositors find banks are unable to meet the demands and banks start to close, it is a progressive condition of deflation that develops; and, therefore, this eligibility feature becomes effective.

By the way, I believe that the governors of the Federal Reserve banks and most of the member banks favor that requirement and recognize the advantage of it in protecting the banking system. The banking system, as a whole, would have to expand its credit by $20,000,000,000 before there would be any occasion to do any borrowing from the Reserve System, on the basis of present excess reserves.

The amount of real-estate loans to be made is not determined by the member bank's ability to borrow from the Federal Reserve bank, but by the percentage of time deposits, which, in itself, puts a limitation upon the expansion of real-estate loans.

I do not know that I answered your question——

Mr. FARLEY. Well, I have 2 or 3 other little questions I want to get a little light on. Does the practice still prevail of buying foreign bonds?

Governor ECCLES. I do not know to what extent. I would think, however, that if experience is any teacher, there would not be any great traffic today in foreign bonds. There are, however, certain foreign bonds, such as the Canadian issues, if that could be considered foreign, and Australian issues, and British bonds, and I think the bonds of Finland, and Poland, and Scandinavian bonds, which maintain their strength, their marketability, and have a very much better record than many domestic bonds of our cities, and counties, and States.

Generally speaking, foreign bond accounts of banks have been disastrous to them, particularly some of the South American issues and some of the European issues.

Mr. FARLEY. Would you care to state whether they need the Postal Savings System now, Governor?

Governor ECCLES. You mean is it a necessity?

Mr. FARLEY. Well, is it a good business proposition?

Governor ECCLES. For the Government?

Mr. FARLEY. Yes; for the Government?

Governor ECCLES. It is a good business proposition to the extent that they have been able to get money for 2 percent. I do not think that it is necessary for the Government for its own interests. I think the Postal Savings System has operated for the convenience and benefit and security of citizens who prefer to deposit up to $2,500 with the Government through the Postal System.

Mr. FARLEY. Well, would the guaranteed bank-deposit proposition——

Mr. ECCLES. It is less needed.

Mr. FARLEY. I think it is obsolete and ought to be put in the place where the interest that would be collected would be so low that nobody would even try it.

Governor ECCLES. I know that bankers, generally speaking, feel that there is a competitive relationship, and I think many of them would like to see the Postal Savings System eliminated, and feel that it is unnecessary in view of the Federal Deposit Insurance Corporation insuring $5,000 accounts. I do not believe it is very important, however, because the total funds in the Postal Savings System I think are somewhere around $1,000,000,000, and that is a comparatively small percentage of the total deposits of the banking system.

Mr. FARLEY. On page 69 of this act, in paragraph (g), we wrote into the law in 1933 that bank directors could not borrow from their own banks. Has any good purpose been served by that act? In other words, do you not think that it is time that we liberalized that?

Governor ECCLES. It is not bank directors, it is bank officers.

Mr. FARLEY. Well, bank officers.

Mr. ECCLES. Yes. I think it is a very constructive piece of legislation. There is not any question that, in principle, officers of a bank should not be in position to loan to themselves funds of the bank. It may be very difficult for an officer to be impartial in dealing with himself.

However, to the extent that officers of banks have loans in banks, which were made prior to the passage of the legislation, those loans should be treated, it seems to me, with due regard to the ability of the borrower to meet the obligations. There is a time limitation provided in the law, which I think is July 1935.

Mr. FARLEY. June 16, 1935.

Governor ECCLES. June 16, 1935, and, of course, there are many officers' loans in banks that it has been impossible, during this period of depression, shrinkage of values, and lack of market for securities to meet by June 16, and it is proposed in section 3 of this bill that that time be extended for 3 years.

Mr. FARLEY. Three years from June 16, 1935?

Governor ECCLES. Yes.

Mr. FARLEY. Now, would it not be infinitesimally better to prohibit bank officers from borrowing outside of their own bank, and thus compel an officer to do his borrowing from the bank with which he is connected, and if desirable and with the approval of the majority of the board, to the end that his board may be able at all times to know what he is doing, and also place some responsibility on the board. Is not there this danger, that to permit the executive officers to borrow outside of their own banks could prove very dangerous? There is nothing to prevent an officer from an inland bank to borrow excessively from a large and distant city bank, for which he may furnish proper security, but which might involve him beyond the point where his directors would consider it safe for him to go?

Governor ECCLES. There is in the law a provision that requires officers who borrow outside of their own banks to report those loans to the chairman of the board, or the president of the bank; and if it happens to be the president or chairman himself, he is required to report to the board of directors.

I feel that officers should be prohibited from borrowing from their own banks, and I feel that they should also be required, if they borrow outside, to report their borrowings, as now provided in the law.

Bank officers in the past have always been required to report their loans within their own bank to the board of directors, because it is the duty of the board of directors of a bank to approve all loans, and, therefore, officers' loans in their own banks have been reported to the boards of directors; but we have found that not only officers' loans but many loans to directors have, in instances, created real banking difficulties, and I cannot help but feel that, in view of the record of the past, the prohibition now imposed should be continued, with the extension of 3 years for those officers' loans which cannot be paid at the expiration of the period on June 16 of this year.

Mr. FARLEY. Have you already put in the record whether you think we have money enough in circulation or not?

Governor ECCLES. If I have not, I am willing to.

Mr. FARLEY. In your speech at Columbus, you stated there were $24,000,000,000 in circulation. Do you think it would be a good thing if we increased that circulation?

Governor ECCLES. How is it possible to increase it?

Mr. FARLEY. Why do we not use the authority we gave the executive department to issue $3,000,000,000, to take up some of these bonds bearing interest?

Governor ECCLES. How would that increase circulation?

Mr. FARLEY. Well, it would give these banks the actual cash instead of bonds.

Governor ECCLES. What would they do with the cash? They would immediately send it back to the Federal Reserve bank and it would be in the Reserve banks as their excess reserves, and actual circulation would not change. The banks would have, in lieu of Government bonds, $3,000,000,000 additional excess reserves.

Mr. FARLEY. I was in a bank not so long ago and the banker made this statement, and he said he wanted to sell $50,000 worth of bonds, and he could get immediate credit without any trouble if he called Chicago and New York, but he could not dispose of them. He wanted the money on the bonds he had in his safe——

Governor ECCLES. You mean Government bonds?

Mr. FARLEY. Yes.

Governor ECCLES. You mean he could not sell Government bonds?

Mr. FARLEY. That is the statement that he made—that is, without a little sacrifice at that time.

Governor ECCLES. He is misaken. He could have gone to the Federal Reserve bank and borrowed par on those bonds and possibly at a discount rate of 2 percent. If they were 3-percent bonds he would have gotton more than the interest on his loan. He could have borrowed the funds at par from the Reserve bank.

Mr. FARLEY. In your judgment, we do not need any more circulating medium right now?

Governor ECCLES. In my judgment, you cannot possibly force out and keep in circulation more currency than you have now. You may substitute——

Mr. CROSS. Right there, may I ask a question?

Governor, if that be true that this money would go right back—if that be true—and if you were to take the $3,000,000,000 that he refers to and buys bonds with it and you could not keep that money in circulation, it would go right back out of circulation?

Governor ECCLES. That is right.

Mr. CROSS. That is unquestionably true, is it?

Governor ECCLES. There is no question about it.

Mr. CROSS. Why not pay off all of the Government bonds and get rid of paying any interest—because that would be inflation itself?

Governor ECCLES. Here is what would happen: We have outstanding some twenty-odd billions of dollars and Mr. Cross asked the question, why do we not do that, and I think I should explain that such action would simply increase the reserves of the banking system by the amount of Government bonds which were purchased with currency. The currency would go out, if it was $10,000,000,000 or $20,000,000,000 or $3,000,000,000, whatever amount the Government paid out in currency to retire its bonds; but the currency would immediately go into the banks and from the banks into the Federal Reserve banks and be destroyed, and you would just have additional reserves, additional excess reserves.

The CHAIRMAN. Do you not think this bill rests upon the theory that it is necessary to control the excess reserves, because of the fact that it would have a bearing on the circulation?

Governor ECCLES. Yes. You get to the point of increasing the reserve requirements a sufficient amount to extinguish the excess reserves created by the amount of the Government bonds retired.

Mr. GOLDSBOROUGH. That is when the banks really begin to fight, is it not?

Governor ECCLES. Now, let me follow that point through and see what the situation would be. In the first place——

Mr. GOLDSBOROUGH. Can I just carry out the question so you can answer this too? Have we not actually given the banks over $13,000,000,000, and if we undertake to pay the bonds off in the way indicated by Mr. Cross we would simply be taking away from them what we have already given them?

Governor ECCLES. The thought is that you are giving the banks an interest payment that is unnecessary and is therefore a subsidy; and that, by the Government paying its bonds in currency and thus increasing the reserves of the banks by the amount of Government bonds retired, it would be necessary to increase the reserve requirements by that amount in order to extinguish the reserves; otherwise this operation could carry possibility of credit inflation to almost unknown heights.

The CHAIRMAN. You mean by that that the release of that currency would tend to bring about inflation, but there would be under this bill the power in the Board to control that tendency or defeat it?

Governor ECCLES. It would have to get started first. Of course, the $2,000,000,000 that we now have in the excess reserves should tend to do that, and it has not done it. But following out the extinguishing of these reserves, that would close thousands of banks for this reason: About 39 percent of the total loans and investments of banks is represented by Government bonds. Therefore, if the bonds, we will say, which are held by the banks are retired, it would mean that the reserve requirements would be increased by the amount of Government bonds that are retired. Some banks have only 10 percent, and that is particularly true of nonmember State banks; and, of course, if this only applied to the member banks, you would destroy the Reserve System, because they would all leave it and become nonmember State banks. That is one thing that it would do.

If all the banks were members of the Reserve System, and the principle of increasing the reserve requirements by the amount of total bonds that were retired through currency were put into effect, a bank that had 10 percent of its assets in Government bonds would be required to increase its reserve requirements, we will say, by 39 percent. That would mean that that bank would have to liquidate the difference between the 39 percent and its Government bonds, unless you simply would say to the bank that its reserve requirement increases only by the amount of the Government bonds taken up with currency; in that case the bank that had the largest amount of Government bonds would suffer the greatest loss of earning assets and would have the largest increase in reserve requirements. This would be thoroughly unworkable.

For the time being, it does not seem to me that is the alternative at all, because it would create a condition that would do anything but make for recovery. It would create a condition that would be terribly deflationary. It would put the banking system in the position that you do not want to put it in. After all, whether we like the system or not, we have it today; and to make a change of this sort would be so revolutionary that it would bring about, as I said, a condition of great deflation.

Mr. HOLLISTER. Would it not, incidentally, scare every sound business man to death?

Governor ECCLES. I say, without question, that it would bring about a condition that would be almost as bad as the bank holiday.

Mr. HOLLISTER. Which would be reflected immediately in decreasing employment, would it not?

Governor ECCLES. It would close up thousands of banks, because there is not any question that you cannot take away from the banking system 39 percent of its present investments, when we all know that they are not operating today very profitably——

Mr. CROSS. Governor, if that should happen——

Mr. HOLLISTER. Let him finish, please.

Governor ECCLES. We have not taken a most important feature into account, and that is the service which the bank renders. If a bank has to carry reserves equal to its demand deposits, why on earth would a bank take demand deposits and become the bookkeeper for the community funds, for every individual that carries an account, and act as a collection agency for the purpose of clearing and facilitating individual business transactions from all over the Nation, unless that institution made up by service charges, what it lost through having to carry increased reserves by the amount of Government bonds retired with currency? This would be anything but popular with the people of this country.

Mr. GOLDSBOROUGH. The service charge would be assumed by society, of course. The Government would assume the service charge?

Governor ECCLES. Of course, and that is exactly what is being done today through the Government paying this interest on its bonds. That means that the service charge is being assumed by society.

Mr. GOLDSBOROUGH. In other words, you agree that bonds—it is not necessary for the Government to issue bonds; in other words, to borrow money, it is just the same as the Government issuing a circulation medium, is it not?

Governor ECCLES. As a mechanical proposition, yes. But after all, we have established a method of financing, not only in this country, but in every other country—Russia is the only exception——

Mr. GOLDSBOROUGH. Well, we do not have to do things that are wrong simply because somebody else does it.

Governor ECCLES. Whether it is wrong or not, is a question. I am pointing out what are the customs, what are the practices, and to make a change, as proposed, which is revolutionary, would destroy confidence and so delay and retard recovery that I do not think it is desirable, and I do not believe that there are any particular advantages or arguments for the retirement of Government bonds by the issuing of currency.

It may be interesting to see just what the Government is paying the banks. There have been some very exaggerated statements made with reference to this subject, and it has been claimed that the banks were getting as much as $1,000,000,000 a year subsidy in the form of bond interest.

Mr. GOLDSBOROUGH. You are the only one that ever has called that by its true name, subsidy. We have never heard that before. You cannot find a metropolitan daily in the country that has the guts to call it a subsidy. You are the only one who has ever had nerve enough to call it by its right name.

Governor ECCLES. Society, then, is paying the banking system for a service—and you admitted that it was necessary that society should pay for the service which the banking system renders the people and communities——

Mr. GOLDSBOROUGH. Yes; but they should pay it directly and not by the banking system. That is the bunk, and if the public understood what the banking system was, if the public knew that the banks were allowed to loan the same money 10 times, they would not exist 24 hours, because Congress would be forced to change the law.

Governor ECCLES. I do not know that the banking business has been the most desirable or profitable, even with all of the subsidies and privileges you claim it gets.

Mr. GOLDSBOROUGH. Your reasoning is that, when deflation starts there is no way on earth to stop it?

Governor ECCLES. I would not go that far.

Mr. GOLDSBOROUGH. If you are on a 100-percent basis, you could not have deflation, because the money would always be in existence.

Governor ECCLES. I think that, mechanically, inflation is far more easy to control than is deflation.

Mr. GOLDSBOROUGH. You cannot control deflation under our system, and you cannot do it for this reason: That the creation of money amounts simply to the extension of credit, and whenever the banks start—when the banking system starts to collect its debts, it immediately decreases the circulation medium, it immediately causes a fall in all values, and it immediately causes the calling in of other debts. You just cannot stop it when you once start it under our system of fractional reserves.

Can I illustrate that in this way? In 1920 a very distinguished Member of this House, who is now on one of the boards down town, came to speak for me in my district. He said he had just had a talk with Mr. W. P. G. Harding, who was then Governor of the Federal Reserve Board. Cotton was then 30 cents a pound. He said Harding had told him they were going to bring the price of cotton down to 25 cents and stabilize it. I said, "My God! If you ever start that, you can't stop it." And cotton did not stop until it got down to 5 cents a pound. That is what happened.

Mr. FORD. Mr. Chairman, the Governor was going to read something that I am very much interested in——

The CHAIRMAN. Yes; we are all interested in that.

Governor ECCLES. I had a memorandum on this subject, because I had anticipated that that question might be discussed. With reference to the general opinion that banks are being paid $1,000,000,000 a year by the Government in interest, that is a greatly exaggerated statement. The total interest paid on the national debt during the calendar year 1934 was $817,000,000. Now, the banks, under the most generous estimate that you can figure, taking the bonds that they had, received about $260,000,000. And these are member banks. Figuring all banks, $320,000,000 is the maximum.

If the refunding operations of the Government continued until the holdings of the banks were converted into securities, bearing the current average yields, the interest received would fall to $180,000,000.

Now, it must be remembered that there are expenses in connection with the issuance of currency and keeping it in circulation; and it may be interesting to note that the cost of keeping the greenbacks and notes of the United States in circulation today is more per annum than the present rate that the Government is paying on its 180-day bills.

Mr. GOLDSBOROUGH. If they are entitled to some further consideration, do you not think it is a shame that we are refunding and giving them less interest?

Governor ECCLES. I am not arguing for consideration. I am pointing out the difficulties with no advantages of making the adjustments which you propose and which would be revolutionary, of the whole banking and monetary system, and I think, at this time, it would be disastrous.

Mr. HANCOCK. Will the cost of keeping the greenbacks out compare with the cost of issuing the 180-day bills?

Governor ECCLES. It is estimated here about fifteen-hundredths of 1 percent per annum on the greenbacks, and the 180-day bills were on the basis of eleven-hundredths of 1 percent, about one-tenth of 1 percent, which is less than the cost of keeping the greenbacks out.

Mr. HANCOCK. Where is the cost in keeping the greenbacks out?

Governor ECCLES. The destruction is rather rapid and they have to be reprinted, and the cost of shipping them out and shipping them back is something. Then there are insurance charges and express charges and there is personnel accounting, and other expenses.

Mr. HANCOCK. Does that same cost ratio apply to the Federal Reserve notes?

Governor ECCLES. I do not know what that cost ratio is. Do you, Doctor?

Mr. GOLDENWEISER. It is less than that, because of the fact that the denominations are large. In the Federal Reserve notes there are no $1 bills.

Mr. FARLEY. Mr. Chairman, I read into the record a while ago a rather emphatic protest from the State Bankers Association of Indiana, and just for the Governor's benefit I want to read just a little paragraph from the second largest national bank in the State of Indiana, and which, by your grace, survived all of the storms and is still a wonderful institution:

We might say we have given the whole bill very careful consideration. In fact, we discussed it for nearly 2 hours in our directors' meeting yesterday, and we believe that the bill, on the whole, is pretty good and meets the present needs.

That is a national bank's attitude.

Governor ECCLES. I am interested, of course, to get that reaction, and I have found, whenever I have had an opportunity to sit down and meet the arguments and questions with reference to the legislation, invariably the bankers feel that this bill is not what it has been reported to be by many of our financial writers and economists. Most of the criticism directed at the bill could be directed toward the act that we have been operating under for the last 20 years.

The CHAIRMAN. Mr. Williams, did you say you have a question to ask?

Mr. WILLIAMS. Yes. Governor, in connection with the interest that is being paid by the Government to the banks—there has been a good deal said about the interest that has been paid on bonds in the national banks and Federal Reserve System, and keeping or using those same bonds as the basis for issuing and lending out money which they get on account of that issue, and getting interest on it. Of course, in other words, that would be double interest, interest on the bonds which they deposit, or which they sell for the purpose of securing the issue, and the currency which they lend out, so they would get double interest on it, would they not?

Governor ECCLES. You are speaking of national bank notes?

Mr. WILLIAMS. National and Federal Reserve notes.

Governor ECCLES. The Federal Reserve member banks, of course, do not deposit bonds and issue Federal Reserve notes, but the national banks have the privilege of issuing national bank notes, which right has now been eliminated.

Mr. WILLIAMS. Here is the question. How much, in number of bonds, is used as the basis of the currency issue?

Governor ECCLES. There is about $800,000,000 of national-bank notes outstanding. They are the only cases where the bonds are used by banks for the purpose of issuing currency.

Mr. WILLIAMS. What about the Federal Reserve bank notes?

Governor ECCLES. The Federal Reserve banks have paid off their liability on Federal Reserve bank notes.

Mr. WILLIAMS. That is right recently, is it not?

Governor ECCLES. Yes; recently. There was never more than about $150,000,000 issued, and that was issued right after the bank holiday; and those Federal Reserve bank notes were put out on the basis of sound assets other than Government bonds and other than gold.

Mr. WILLIAMS. Well, now, I see a statement that the Treasury proposes also to retire bonds upon which the national banks issue notes.

Governor ECCLES. That is right.

Mr. WILLIAMS. When that is done, that activity will be removed from the picture?

Governor ECCLES. That is right.

Mr. WILLIAMS. In other words, there will be no cost of Government interest upon its bonds?

Mr. ECCLES. There are greenbacks which, of course, have been out for a good many years, about $300,000,000——

Dr. GOLDENWEISER. $346,000,000.

Governor ECCLES. $346,000,000, with a certain amount of gold held back of those greenbacks.

Mr. WILLIAMS. And there is the argument that is being made by a great many people, that the Government has favored the banks by permitting them to deposit bonds——

Governor ECCLES. And issuing currency.

Mr. WILLIAMS. And issuing currency, receiving currency, and lending it out and securing interest on it, and at the same time securing interest on the bonds which they deposit for that purpose. Now, as I understand, that is a thing of the past?

Governor ECCLES. The Treasury last Monday announced that they were calling the 2-percent consols and 2-percent Panama's as of July 1, approximately $675,000,000 in total, and on July 1 the circulation privilege which was given to other Government bonds expires.

Mr. WILLIAMS. Have there been none of them used for the purpose of Federal Reserve note issue?

Governor ECCLES. No; not used by the Reserve banks. The Federal Reserve banks are required to deposit with the Federal Reserve agent gold equivalent to 40 percent of the notes outstanding, and the balance of 60 percent may be made up of eligible paper or Government bonds.

Mr. WILLIAMS. That is what I am getting at. Those bonds have been deposited, have they?

Governor ECCLES. Only by the Federal Reserve banks, from one department of the bank to another. In other words, the bank has been required to deposit with the Federal Reserve agent, who is the chairman, gold certificates and bonds, or gold certificates, bonds, and eligible paper.

We are proposing to eliminate the collateral requirement for the Federal Reserve notes; because it serves no purpose, it only adds additional expense, and has no relationship to the amount of currency in circulation, and is not required in any other central bank that has been recently set up anywhere in the world.

Mr. WILLIAMS. In other words, you propose to abolish the principle that has heretofore been followed of issuing currency based upon Government bonds?

Governor ECCLES. Yes.

Mr. SPENCE. Have all of the banks that had that privilege that availed themselves of it been national banks?

Governor ECCLES. Yes; no other banks had that privilege.

The CHAIRMAN. They are using about $150,000,000 extended under the relief act and——

Dr. GOLDENWEISER. That was in the Home Loan Act of 1932.

Mr. SPENCE. What proportion of them have not availed themselves of the privilege? Have you any figures on that subject, Governor?

Governor ECCLES. Mr. Smead could get that. What percentage of the national banks have not availed themselves of that privilege?

Mr. SMEAD. Of the 5,422 reporting licensed national banks on June 30, 1934, there were 4,600 banks issuing circulating notes, and 822 banks which did not exercise the circulation privilege.

The CHAIRMAN. Well, there will be no more notes issued by the national banks, based upon Government bonds?

Governor ECCLES. That is right.

Mr. CROSS. Governor, I want to go back to where we were awhile ago, when I asked you about the $3,000,000,000. As I understood your first statement, it was that if you were to take that $3,000,000,000 and buy bonds with it, call it in or buy that much bonds, it would not cause any inflation to come back; but, as a secondary proposition, there would be inflation through the banks, because they would have more business; is that correct?

Governor ECCLES. There would be a possibility of inflation through the banks, by reason of the increased reserves from——

Mr. CROSS. The $3,000,000,000?

Governor ECCLES. You have a potential inflation, but you would have to use the existing $2,000,000,000 of excess reserves before the $3,000,000,000 would have any effect.

Mr. CROSS. Now, we realize one thing, and this is what is disturbing me: As I get your attitude, we cannot get a measure of value—that is, we cannot make the dollar the measure of value, and I do not know why the atmosphere seems to be so surcharged with the idea of expanding the currency. Everybody is talking about inflation, yet we have inflation until we are as flat as a flounder in the mud.

Now, we certainly cannot come back until we reflate, and I should say that, if we started reflating, we can get back to the normal situation; that we are helpless, or we must go ahead and start on a wild spree of inflation until we explode and plunge back and down into the mud again.

Governor ECCLES. I do not think that is necessary.

Mr. CROSS. That is what I am contending, that it is not necessary. My idea is that, with the levers you have, you ought to be able to agree on a price level that would give you a measure of value in dollars, but if we have these things recurring and are helpless, that is a tremendous indictment of our intelligence.

My idea is that we should certainly be able to get a measure of value. In other words, just to illustrate the proposition, that A borrows from B a certain amount of money, and the present price of the dollar, we will say, is money covering one particle of all of the things that are necessary to feed and clothe and supply the comforts and luxuries of life. Now, the next year, when he wishes to pay it off, because there is no value in the dollar, he has got to pay back two particles of that commodity that will buy the necessities and comforts of life, and it appears to me it is just as much within the law robbing the poor devil as if I had loaned you $100 and I met you on the street next year, when it was due, and took out a 6-shooter and said, "Give me that $200 you have in your pocket", because I am taking it from you, and it will supply me with twice the things that the $100 I let you have would supply me with. In other words, if $1 will take care of me all of my life, I do not need but $1.

Governor ECCLES. Yes; what you say is true, that it is an injustice for a debtor to have to pay back debts in goods and services that have substantially less value when he pays his loan than it had when he received it.

Assuming that a dollar a bushel is fixed for the price of wheat, and the total wheat production at $1 is 400,000,000 bushels, are the farmers, as a whole, any better off than they would be with 800,000,000 bushels of wheat selling at 75 cents a bushel? In one case the income from the wheat would probably be $600,000,000 and in the other case it would be $400,000,000.

Mr. CROSS. I do not think you can take any one commodity.

Governor ECCLES. The point I am making is, it is production we are interested in. No one can pay his debts in terms of the price level. Higher prices do not help a business that only has one-half of the volume of business with which to pay its debts. You need to maintain not only the price level but also production.

Mr. CROSS. I understand. You said that a number of times; but do you think it is possible to get a measure of value or have the dollar come to where it would be the true measure of value?

Governor ECCLES. I do not think that is possible.

Mr. CROSS. Then we are helpless.

Governor ECCLES. No; I do not think we are helpless.

Mr. SPENCE. The Federal Reserve can exercise their power to regulate the rate of interest paid by banks to depositors on time deposits and savings deposits?

Governor ECCLES. That is right.

Mr. SPENCE. I think that is a very beneficial thing, because they have been the victims of competition or of the depression. Now, there is no authority in any national agency to regulate the rates paid by State banks, is there, at this time?

Governor ECCLES. Nonmember?

Mr. SPENCE. Yes.

Governor ECCLES. There is no authority, unless the Federal Deposit Insurance Corporation has it.

Mr. SPENCE. I do not think the Federal Deposit Insurance Corporation ought to have that power.

Governor ECCLES. That is taken care of in the Banking Act of 1935.

Mr. SPENCE. I think that would be welcomed by the banks, because they are the victims of their own competition.

Governor ECCLES. It is absolutely essential that member banks should not be subject to competition of nonmember banks by a limitation of the maximum interest that the member banks can pay and have the nonmember banks benefited and protected by the Deposit Insurance, and at the same time permitted to pay any rate of interest, whether it is a sound rate or not, that they wish to pay.

Mr. SPENCE. It would be very much better, if they could all do that and——

Governor ECCLES. The Banking Act of 1935 provides for that in section 323 (c), page 67, lines 1 to 7.

Mr. SPENCE. Have they exercised that power?

Governor ECCLES. The act has not been passed.

Mr. SPENCE. This act, you mean?

Governor ECCLES. Yes.

Mr. FORD. Let me make an observation there. The banks are fixing the amount of interest that they can pay for deposits, are they not?

Governor ECCLES. We fix the maximum only. There are a great many cases where they pay much less.

Mr. FORD. Would there not be a good deal—there is no attempt made to fix the maximum interest they might charge when they loan that money?

Governor ECCLES. Most States have usury laws.

Mr. FORD. I understand, but they are pretty liberal. We make the price, we will say, to the miller, of wheat at $1 a bushel, but he can charge $10 a barrel for the flour, if he can get it, and that is a competitive matter and I do not think can be fixed. You could not say any maximum rate of interest that the bank would charge, because it was getting money from its depositors at 2 percent, because the demand for that money and the volume of it would determine what rate it would get?

Governor ECCLES. It will bring the rates down, and it is bringing the rates down.

Mr. FORD. But it is a fixed thing, is it not?

Governor ECCLES. Fixing the maximum rate of interest on deposits tends to bring down the rate on loans. That is the effect.

Mr. WILLIAMS. Governor, in order that we might have this clear, did I understand you to say that there is in the proposed law a provision which authorizes the Insurance Corporation to fix rates that could be paid by any member bank?

Governor ECCLES. Requires them to fix the rate? It is fixed by the Reserve Board for the member banks.

Mr. WILLIAMS. Where is that?

Governor ECCLES. Pages 66 and 67. We have not gone into that, because that is in title III of the bill. That is in title III.

Mr. FORD. What page?

Governor ECCLES. Pages 66 and 67.

Mr. WILLIAMS. Does that apply to the nonmember banks?

Governor ECCLES. Yes, that is what it does apply to.

The CHAIRMAN. The purpose of that is to prevent one bank inside of the Federal Deposit Insurance Corporation fighting against another bank?

Governor ECCLES. That is right.

The CHAIRMAN. And taking an undue advantage of it?

Governor ECCLES. That is right.

The CHAIRMAN. Gentlemen, may we not quit until 3 o'clock? I think we had better adjourn until 3 o'clock.

(Thereupon, a recess was taken in the hearing until 3 p. m.)

## AFTERNOON SESSION

The CHAIRMAN. Governor Eccles, I believe Mr. Ford desires to make some inquiries.

Mr. FORD. Governor, I am not going to take you into the back-alley finance in my statement. I am just simply going to say, in a very short statement, that it is my reasoned conviction that the present bill, while not perfect as to all of its details, and undoubtedly requiring some minor technical amendments, seeks, on the whole, to accomplish the following desirable results:

First, by broadening the eligibility requirements of the Federal Reserve bank discounts, to uncover a great reservoir of potential credit, which will be made available. Is that true?

Governor ECCLES. There is ample credit today, but, without change in the eligibility features, there will be great hesitancy on the part of the banks to loan on other than short-term commercial paper or Government bonds.

Mr. FORD. All right. We will change that to make it "available so far as the borrower is concerned."

Governor ECCLES. It makes it available, not because they need to borrow funds to do it, but it makes it available because they would be willing to loan existing funds, if they could get borrowers, on longer time loans, that, otherwise, they would feel unsafe in making.

Mr. FORD. My second point is that, by placing in the hands of the Federal Reserve Board the authority to initiate open-market operations, we give them the power to regulate in a material degree or to stabilize in a material degree business operations. Would it do that?

Governor ECCLES. The three powers of monetary control—open market, discount rate, and reserve requirements—put into the hands of the Federal Reserve Board a power to control inflation. And they also put into their hands the power to prevent deflation, so far as can be done by the creation of excess reserves and by the reduction of interest rates.

There is no action that the Board itself can take that will induce people to borrow, induce corporations to borrow, the excess funds which the banks may have as a result of the Board's action in creating excess funds.

Mr. FORD. But it is an effective check on the impulse for inflation, on the one hand, and credit deflation, on the other hand, is it not?

Governor ECCLES. I think so. I think the eligibility changes and the control over the supply of money would certainly tend toward a prevention of deflation.

Mr. FORD. In addition to that, in the third place, does it not add two other desirable things: By broadening the eligibility requirements of the Federal Reserve Board, each member bank with sound but long-term paper could, under emergency conditions, take this paper to the Federal Reserve bank and get currency and thus better serve the needs of its community or meet a sudden emergency? Would that be a clear statement?

Governor ECCLES. The Reserve banks will have the power to loan to member banks on sound assets, which would enable the member banks to meet the demands of their depositors.

Mr. FORD. Certainly.

Governor ECCLES. Which otherwise they might be able to meet only by forcing a contraction of credit or by selling securities; or it might be that they would be unable to meet the demand and thus be forced to close.

Mr. FORD. Now, if I understood you correctly when you were making your various statements, you said that the Federal Reserve banks today had at least $10,000,000,000 that seeks profitable investment.

Governor ECCLES. No, sir. I said that the commercial banks had $10,000,000,000 of time deposits.

Mr. FORD. I mean the member banks of the banking system had excess funds.

Governor ECCLES. No. The banking system has excess funds seeking investment of over $2,000,000,000.

Mr. FORD. What was that 10-billion-dollar figure that you used:

Governor ECCLES. I said that the time funds or saving funds held by the commercial banks amounted to more than $10,000,000,000.

Mr. FORD. But that would be seeking profitable investment, would it not?

Governor ECCLES. A good deal of those funds are loaned already in various types of loans. A great deal of those funds are no doubt invested in Government bonds and other securities and bonds guaranteed by the Government. The excess reserves of the banks, which are in excess of $2,000,000,000, are sufficient in amount to enable the banking system as a whole to extend new loans or to purchase additional bonds to the extent of more than $20,000,000,000 without the banking system as a whole being required to borrow from the Federal Reserve System.

The banking system creates money through its loans and investments. A bank making a loan of $1,000 to a customer creates $1,000 of deposits. However, for every $1,000 increase in the deposits of the bank the excess reserve decreases by 10 percent of the amount of that deposit increase, so that a loan of $1,000 increases the assets of the bank by $1,000 and the liabilities, in the form of deposits, by a thousand, and the reserve requirement by $100, approximately. You see, this increase in deposits would increase reserve requirements by 10 percent of that amount.

Therefore, 2 billion dollars of reserves in the System as a whole are a sufficient amount to enable the banks, on the basis of 10 for 1, to extend credit to the extent of 20 billion dollars, without having to go to the Reserve banks and discount or borrow money.

Excess reserve can be increased or decreased by open-market operations or by a change of reserve requirements? That is where you get your monetary control.

Mr. FORD. Now, then, at the present time we have a potential credit reservoir of about 20 billion dollars.

Governor ECCLES. That is right.

Mr. FORD. If paper eligible for rediscount came along, the banks would be free to make those loans, wouldn't they, knowing that they could take that paper, in an emergency, to the Federal Reserve banks, if they got into trouble?

Governor ECCLES. They would be. It would be very profitable to make those loans if they were available.

Mr. FORD. In comparison with the 2⅞ percent to the banks on long-term Government bonds, you are holding out an inducement to the banks, through this bill, to exercise their functions as banks and make every possible loan that they can——

Governor ECCLES (interposing). With safety.

Mr. FORD. I did not mean that they should go out and go crazy. But, when people come in wanting money, they would be in a position to loan it to them.

That is a thing that has always bothered me. I do not know whether I have got the explanation of it or not.

Now, I note that since 1922 the volume of commercial paper in the United States—the normal commercial paper, under the old law, the 90-day paper, has been greatly diminished. Now, my understanding or my belief is that the reason for that diminution in that commercial paper was that many corporations, both large and small, instead of going, as they used to do, to their banks and getting their short-term requirements, have found that, through the investment bankers, they could issue securities and get that money all in a lump. And in many cases much of that money, after they had gotten it, did not go to their own bank, but went to New York, to be used for other loans, for speculation. Is not that true?

Governor Eccles. Partly. It seems to me that the transition that has taken place in our business and banking systems during the life of the Federal Reserve System has been that our business system has become more concentrated, into larger and larger units; and that there is today a greater concentration of corporate operations in the country, in fewer companies, than we have ever had before. The trend is in that direction, as evidenced by the chain-store development and the developments in almost every field of manufacturing activity.

Mr. Ford. Steel and all others.

Governor Eccles. We see a drift toward consolidation and mergers, making for bigness and a greater concentration of control.

That has tended to concentrate commercial deposits to a greater extent than formerly in the centers where the headquarters of the various companies are located; and it has also, in cases where there has been borrowing, largely concentrated all borrowing, at very low rates, on the commercial-paper basis, in the money market; so that the average small bank, or the banks in the towns of 10,000 people or even 25,000 people, and less, have not had the demand, and have not had even during the period of our great activity, in the twenties, the commercial loans to their local business concerns that they had prior to the developments to which I have referred.

It is true that many of the consolidations and mergers were brought about through flotations of securities, bonds, and stocks, and the effect of those flotations was that the banks that formerly carried commercial loans and short-term loans for the carrying on of business transactions, furnished the money through the purchase of bonds, or through loaning to customers, who purchased bonds or stock. So that there was a substitution, to, no doubt, quite an extent, of bonds and collateral loans in banks; whereas, formerly, particularly before the war, commercial paper was used to a far greater extent.

And, of course, in the case of farmer financing, that has been taken away from the local banks to quite an extent through the Production Credit Corporation. The Production Credit Corporations, which are a part of the Farm Credit Administration, get most of their funds by the sale of 6-month and 9-month debentures, outside of their capital, which has been furnished to them by the Government.

These debentures are sold in the market and the present rate is somewhere on the basis of 1½ percent per annum. The big banks, in the centers, with the surplus funds, are the purchasers, largely, of these debentures, thus providing the funds to the Production Credit Corporation, and the Production Credit Corporation supplies the funds to the farmers, through the local communities. So, it means that the banks in the centers, through the Production Credit Corporation, are financing agricultural production; and that, of course, takes away from the banks in the agricultural areas the eligible agricultural paper.

Mr. FORD. I note that in 1929 the commercial paper; that is, the commercial loans made by banks, were only $4,396,000,000, and that was at the peak of our so-called " prosperity ", and that in 1934 that sum had dropped to $2,144,000,000; so that there has been a gradual diminution or gradual disappearance of commercial paper as a source of business to these banks, and there is very little likelihood of any substantial increase in that.

Governor ECCLES. For the reason that, if you will examine the statements of most of our business concerns, it will be found that they have an excessive working capital. One of the difficulties today is that they are the owners of huge pools of deposit money now in the banking system, which they are not using and are not able to utilize; so that, even with an improvement of business the most that could be expected from many of our business concerns would be that they would put into use the funds that they now have, and under no circumstance would they be required to borrow.

Now, I am speaking of our business concerns in very general terms. In number there may be, and no doubt are, a great many business concerns that would be required to borrow; but, measured in the volume of the business which they do, which, of course, is the important element, there would be a small percentage.

Mr. FORD. Well now, that being the case, if the reason for the existence of our banks is continued, then we have got to afford them some additional opportunity, where their funds can be employed; and it seems to me that the long-term real-estate loan is about the only outlet that appears on the horizon at the present time to any great volume.

Is that an admissible statement?

Governor ECCLES. There is no prohibition now against banks making collateral loans which are not eligible; and there is no prohibition against banks buying long-term bonds. So long, then, as there is no prohibition now against the banks investing depositors' money in those fields, which are likely, in the event of depression, to be just as frozen as real-estate loans, there should be some liberalization with reference to the power of the member banks to make long-term real-estate loans. To what extent that will be utilized by borrowers it is impossible to say.

Mr. FORD. Oh, I realize that. But we all know, if we read our correspondence, and I know from my particular experience, that it is almost impossible, or it has been up to quite recently, to get a real-estate loan from any bank. Now, the reason the banks gave for that was that that was an unliquid paper, and if they put their money in there it would stay there, and they would have no way of getting it out if they had a call.

Governor ECCLES. They had been made to feel that a real-estate loan is a slow and an undesirable asset to have. And inasmuch as the banks have most of the loanable funds, and mortgage companies and the savings and loan associations, as a whole, have very little, and in most of the communities have no funds to loan, but are in the process of reducing and bringing pressure to bear, it would seem that the situation would be helped and relieved by permitting and encouraging the banks to make long-term, sound, real-estate loans.

Mr. FORD. Not with the idea, Governor Eccles, of making the loan today and taking it to the bank tomorrow and getting a discount, getting the money and coming back to make another loan; but with the idea of making a loan that was a profitable loan—and in our country the rate is 7 percent, which is quite different from 2⅞ percent—they could put that money into that market. Then, should there be a sudden demand on them for more money, they could always take those securities to the Federal Reserve bank and get the money for them, could they not, under this law?

Governor ECCLES. The Federal Reserve banks would have the power legally to loan to member banks on the notes of the member banks, secured by mortgages or other collateral, with such margin as they thought was advisable to make the loan sound. Certainly member banks would not loan money on mortgages and then borrow from the Reserve banks so long as the member banks had excess funds to loan. It could be expected that the member banks would be willing to pay interest on borrowed money from the Federal Reserve banks only when a condition was reached by any member bank that made it necessary for it to borrow to meet its shrinking deposits.

It has never been a policy of the Federal Reserve System to permit its member banks to borrow continuously or to borrow for the purpose of reloaning because there was a profit between the discount rate at the Reserve banks and the loaning rate of the member banks.

Mr. FORD. They were only there for the purpose of the bank getting the money when it actually had to have it and for a proper purpose?

Governor ECCLES. To meet the current demand.

Mr. FORD. Now, Governor Eccles, there is just one other observation I want to make.

There seems to be some apprehension in the minds of some of my correspondents as to this bill being an inflationary measure. We have had that out here before, but I just want to make an observation on it. We discussed this morning the question of fixing a price level.

Now, my conception of the possibilities lying dormant in this bill, and which can be developed if it is passed, for credit, is this: It will make available—and when I say available I do not mean that it does not now exist—but it will make it a little easier and more attractive for the banks to go into the business of loaning money, for the purpose of bringing our production up to a maximum. If we could do that we would bring our unemployment down to a minimum. The result would be a large pool of money poured out over the country and that would give purchasing power to the consumers of the country generally, and that would tend not only to stabilize business but to bring a gradual increase in the price level, up to some point where there might be an attempt made to peg it, within certain limits. Would not that be one of the ways of doing it?

Governor ECCLES. I do not know that I understand what you mean when you say, "Would not that be one of the ways of doing it"? Do you mean the bill as now drawn?

Mr. FORD. I am talking about bringing our production up to a maximum.

At every meeting that this committee has had there have been people who said, "Now, industry cannot get money; and, when industry cannot get money, it cannot produce; and the reason it cannot get money is that the banks are afraid to loan."

Now, the loaning of money of real estate might conceivably have a tremendous influence on industry, because it would put men to work. Now, if you could create conditions so that money could be easily gotten by industry, with a prospect of getting it back and getting a profit, that would immediately create a wage pool, and it would give an increase of income to the country and, with the increase of income to the country—and the wide-spread of the purchasing power that goes to the men that do the work is one of the factors—it would naturally put purchasing power in the country, and, with an increased demand for goods, the price level of all goods would come up, would it not?

Governor ECCLES. Yes.

Mr. FORD. And if there was a tendency on the part of prices to go up wildly, could not the Reserve Board, under this bill, put an appreciable brake or check on that?

Governor ECCLES. Yes; a general increase means an inflation; and that can be, in my opinion, controlled through the powers that this bill provides to be given to the Federal Reserve Board.

Mr. FORD. Well now, taking the questions that I have asked and the picture that I have painted, I ask if this bill tends to make that possible? Do you think it does?

Governor ECCLES. I do.

Mr. FORD. All right. That is why I say in the beginning, that I believe this is the measure that the country needs and that I am going to feel very comfortable in supporting this bill in the House.

The CHAIRMAN. All right.

Does anybody else on this side have any questions?

Mr. CLARK. It will take only a minute for my questions, Mr. Chairman.

I do not think that Mr. Cross, Governor, is very much satisfied with our helplessness in this situation.

In the amendment that you have proposed three objectives are tentatively stated: First, stable business conditions; second, full employment; and, third, a more or less stable price level.

I believe that you stated that, if this bill were passed, it would give the Federal Reserve Board a control over the volume of money. That is right, is it not?

Governor ECCLES. I think it gives the Board a control of the volume of money on the up side. It does not give it such a complete control of the volume of money on the down side.

Mr. CLARK. No; but it tends to give the Board a more nearly complete control of the volume of money than it has had heretofore.

Governor ECCLES. Oh, yes; through monetary control plus the eligibility features.

Mr. CLARK. But you stated, however, that in order to achieve these desirable results—stable business conditions, full employment, and a more or less stable price level—that in addition to the control of the volume of money, there would necessarily have to be more control of the velocity of money—by the velocity of money meaning the ratio between the volume and the national income.

That is right, is it not?

Governor ECCLES. That is right.

Mr. CLARK. And you stated—I believe this is of fair inference from your testimony—that monetary action alone could control only remotely the velocity of the money; that is, by making the money available?

Governor ECCLES. That is, to the extent that low interest rates and abundant supply will induce its use; only to that extent.

Mr. CLARK. Then that is where Mr. Cross, I believe, stopped; that is to say, that is where the matter was let drop. However, I believe that, earlier in your testimony, you stated that there were two other factors which, if added to the control of the volume of money, might tend, in your opinion, to have a control over the velocity of money, namely, a tax system and a program of Government spending. Am I correct in that?

Governor ECCLES. Those are the other two elements which, it seems to me, in our capitalistic economy, must be taken into account to bring about a sufficiently equitable distribution of the national income, to keep up a full employment, full production, and keep the productive facilities adjusted in relationship to the buying power of the Nation.

Mr. CLARK. Yes; that is right. In other words, we have got, in your opinion, a three-legged stool; and this bill is one leg of the stool.

Governor ECCLES. That is right.

Mr. CLARK. This bill is designed to give control over the volume of money.

Governor ECCLES. That is right.

Mr. CLARK. Now, in order to make our stool stand up and in order to get out of that helpless condition in which Mr. Cross assumed we are—as we are—it is desirable, in your judgment, not only to pass a bill of this kind, or something of this kind, in order to build up this leg, but we should do more. Let us take the second leg of the stool—and I do not want to lead you astray, Governor Eccles, but it ties in. We are going to try to get somewhere and we want to get to a stable basis. Mr. Cross thinks it is an indictment of the human intelligence if we do not get somewhere, and I agree with him.

You say we need a tax system, and by that, I assume, you mean regulation of income taxes to the extent that when times are getting better and the price level is increasing and the full employment is reached the income taxes would be raised, as, I believe, you said they should have been raised in 1928, instead of having been lowered. So that is the second leg of the stool.

And then your third leg is a fixed national policy of Government spending, which would be controllable as conditions fluctuated.

By using those three things: first, monetary control, as proposed by this bill; secondly, shifting the income-tax rates; and, thirdly, increasing and diminishing the Government expenditures, not as an emergency proposition only, but as a fixed national policy; those factors would tend, in your opinion, to achieve this desirable state of stable business conditions, full employment, and reasonably stable prices, within limits.

Does that state it thoroughly?

Governor Eccles. You have stated the case, I think, very completely.

Capitalism, sooner or later, has got to pay whatever it may cost, through the tax bill, to provide employment for people who are employable, and to provide an adequate, decent living for those who are unemployable, when the private employer fails to give employment on a sufficient scale to utilize our available labor.

That is the cost that we have to pay for capitalism; and the sooner we begin to recognize it when unemployment develops, the less the cost will be.

We have never questioned the duty of the Government to protect its citizens, no matter what the cost, against the encroachment of a foreign enemy. We have no more reason to question the obligation of the Government to protect the citizens, through insuring them employment, when private capitalism fails to insure that.

Mr. Ford. That is it.

Mr. Clark. I think that is all. I really wanted to get that picture, because this is the first step along those lines.

Mr. Sisson. By Government spending, Governor Eccles, the third leg of the stool of which Mr. Clark spoke, am I right in assuming that what you mean is what might be called and what has been termed a long-range or long-term plan of public works, to be carried on when employment shows signs of becoming slack; and that kind of public work or that kind of Government spending to be carried on largely——

Governor Eccles (interposing). To keep up the national income.

Mr. Sisson. Yes; and such as will least come into competition with private industry, with private business.

Governor Eccles. I believe that, under capitalism, Government cannot compete with private business without the socialization of whatever field of private business it undertakes to compete in; and that Government spending should be in the fields of socially beneficial, public, noncompetitive activities, either directly or through grants to cities, counties, and States, for use in the same field.

I have no brief to offer against Government entering those fields which may be better handled in the public interest if owned and operated by the Government than if operated privately. But I do believe that when the Government steps in beyond the exercise of its regulatory powers, as a competitor, the natural effect is that all investment in that field, all private investment, stops; and that the field then must be absorbed and monopolized, sooner or later, by the Government.

Does that answer your question?

Mr. Sisson. Yes.

Mr. Hancock. Governor Eccles, is there any way of intelligently estimating what percent of short-time paper is usually renewed?

Governor Eccles. You mean commercial or business paper held by the banks?

Mr. Hancock. Yes.

Governor ECCLES. I think it would be practically impossible to do that.

The loan is paid in one bank out of the proceeds of a loan gotten in another bank. That is the way commercial paper is usually handled.

We will take, for instance, a concern is borrowing $10,000,000 on 90-day commercial paper. A number of banks buy that paper and, at the expiration of the 90-day period, the loans are paid. You will find that the borrower on that paper has possibly only reduced the amount outstanding, or may even have increased it, by borrowing, by offering paper in the market, and another group of banks, or the same banks, will purchase their 90-day bills, just as the Government now does in its short-time financing. It is offering 182-day bills; and the purchasers of that paper have short-time paper; but it is only paid by a refunding operation for 182 days, or for two hundred-and-some-odd days by selling new bills—maybe not to the same institutions, but in the market.

Mr. HANCOCK. Well, the reason that is permitted, and the bankers up to now have been seeking short-term paper, has been due to the fact that, if it ran beyond a certain period, it would not be eligible for rediscount.

Governor ECCLES. Under the law, it would not be eligible except as 90-day commercial paper or 9-month agricultural or livestock paper.

Mr. HANCOCK. But, under this bill, there is no time limit with respect to the eligible paper?

Governor ECCLES. You mean there is no time limit as to maturity of the paper that is used to secure advances?

Mr. HANCOCK. Yes.

Governor ECCLES. No; there is no time limit.

Mr. HANCOCK. That would be left to the rules and regulations of the Federal Reserve Board or to the rules and regulations of the individual Federal Reserve banks?

Governor ECCLES. It would be left to the rules and regulations of the Reserve Board, yes, sir; as to the terms upon which advances could be made by Reserve banks to members on sound assets.

Mr. HANCOCK. Governor, there is no limit to the maturity of the paper that could be discounted, is there, under the bill?

Governor ECCLES. What?

Mr. HANCOCK. There is no limit as to the maturity paper which could be rediscounted, is there?

Governor ECCLES. Except as the Board may make rules and regulations.

Mr. HANCOCK. I mean under the proposed law.

Governor ECCLES. No.

Mr. HANCOCK. Is it not a fact, Governor Eccles, that the banks have usually made most of their profits and earnings on so-called "slow paper"?

Governor ECCLES. I think that, without question, the greatest part of the banks' income would be on paper that is not eligible, because over 80 percent of all the paper of the banks, even in 1929, was not eligible.

Mr. HANCOCK. Now, Governor, just one or two other questions.

This morning, you made a comparison as to the cost, between keeping greenbacks out and the cost on 182-day paper. With respect to the 182-daybills, is there any actual money passed in that transaction? Is it not just a sheer bookkeeping transaction? Is it not as I asked just a matter of bookkeeping? No real money is passed or put out.

Governor ECCLES. That is true of any loan, any loan a bank makes. It is a bookkeeping entry, and the money does not pass until the borrower wants to draw it out in currency or check against it; and the check has the same effect as currency. The money is passed then as the account is checked against or as currency is drawn out and used. And the same is true with the Government borrowing. The banks take the bills or bonds and they credit the account of the Treasury and they debit the assets account of their loans and investments; and the Treasury draws against those funds as and when it desires to, just like any other depositor.

Mr. HANCOCK. How much money does the Government carry on deposit with the banks today?

Governor ECCLES. I do not know exactly. I would say around a billion and a half.

Mr. HANCOCK. And what interest do they receive on those deposits?

Governor ECCLES. They do not receive any.

Mr. HANCOCK. No interest return whatever?

Governor ECCLES. No, sir.

Mr. HANCOCK. Of course, the banks that carry those large deposits would naturally buy this short-term paper at a very low rate of interest. Its really the Government's money they are lending to the owner.

Governor ECCLES. The deposits that they have are of absolutely no value to them, because they carry those deposits to the Federal Reserve at no interest. So there is really a loss in the handling of them under the present circumstances.

As a matter of fact the Government deposits of a billion and a half, upon which the banks pay no interest to the Government, and which the banks must secure by Government bonds, are not profitable for the banks at this time when they have large excess reserves.

Taking the banking system as a whole, it carries with the Federal Reserve banks more deposits in excess of what is required than the Government carries with the banks. Therefore, the entire Government deposits could be moved to the Reserve banks; and thereby the excess reserves of the member banks would be reduced from something over $2,000,000,000—whatever it is today—by the amount of the transfer of those Government funds. For that reason, so long as the banks have excess reserves larger than their Government deposits, the Government deposits are of no value; there is no profit to the banks.

Mr. HANCOCK. Governor, let me get this straight in my mind. Did I understand you to say this morning that the policy of this administration and the Government from now on would be not to issue any more currency against Government bonds?

Governor ECCLES. I have no way of knowing what the future policy may be. All I know is that the action which was taken by the Treasury to call, as of July 1, the bonds which were used to secure circulation, means that it eliminates from the national banks the right to issue national bank notes. Now, unless legislation is passed which again permits the national banks to issue currency against bonds which they deposit with the Treasury, that privilege will not exist.

Mr. HANCOCK. I may be misinformed about it; but I was under the impression that, under the present act, the President had the right to extend the time within which that process could be carried on; and that he had recently extended that time for another 2-year period.

Governor ECCLES. No. It may be that you are referring to the extension of the right of the Federal Reserve banks to issue Federal Reserve notes, secured by Government bonds, in lieu of commercial paper.

Mr. HANCOCK. I was probably confused about that. That right still exists?

Governor ECCLES. That was extended a short time ago.

Mr. HANCOCK. Were any other bonds originally issued to the national banks to support their circulation other than the Consols and Panamas?

Governor ECCLES. All of the bonds yielding 3⅜ percent or less. That right expires some time in July, and it cannot be extended without legislation, which means that any currency of the national banks that has been issued on a basis of the 3⅜-percent bonds, or bonds yielding a lesser amount, will have to be taken up.

Mr. HANCOCK. Well, I am glad to get that information from you, because I had wondered, in my own mind, why the Treasury was calling in the 2-percent Consols and 2-percent Panamas while leaving out the 3⅜-percent bonds if the purpose was to lighten the interest burden on the people.

Governor ECCLES. They are not calling in the bonds, but the bonds lose their circulation privilege, which was conferred upon them for 3 years——

Mr. HANCOCK (interposing). The circulating privilege?

Governor ECCLES. The circulation privilege, which will make it necessary for the banks which have used that circulation privilege to pay to the Treasury the amount of money representing the notes which they have used.

Mr. WOLCOTT. Governor Eccles, I have a very few questions to ask. I think all the questions that I had have been quite fully covered, with the exception of one or two.

There has been a feeling on the part of many economists that there should be very little affiliation between the currency of the country and the national debt. I presume that they have in mind that if we are called upon to manipulate the currency as our national debt increases or decreases, that that tends to an unstable currency.

In reading this bill I can see some affiliation between the action of the Federal Reserve Board and the national debt, inasmuch as they have the right, in the open-market operations, to help the Government in maintaining its credit, by at least retiring that part of the national debt which matures within the current year. Do you think that is rather a dangerous practice?

Governor ECCLES. It seems to me that the Government spends only those funds which the Congress appropriates. The Congress that has the power to appropriate money also has the power to create a means of providing that money, if it is not done through the existing banking system. Therefore, I do not feel that to make it impossible for the Government to finance the appropriations which Congress makes is necessarily going to defer what the Government spends, but it is likely to jeopardize the existing banking and credit structure. For that reason, it is desirable and necessary that there should be a relationship existing between the banking system and the Government in the interest, it seems to me, of the preservation of the existing banking system.

Mr. WOLCOTT. And would you say, also, the maintenance of the national credit by the use of the banking system of the country?

Governor ECCLES. The national credit is not dependent upon the willingness of the banks to supply it.

Mr. WOLCOTT. Now, in that connection, I assume that those open-market operations—that the Federal Reserve Board can, by adopting a policy which I understand to be mandatory in its operations upon the member banks, compel the member banks to invest in Government securities, so that, if we came to a time when, as I understand now, a great deal of our Government indebtedness is in the form of short-term paper?

Governor ECCLES. About $13,000,000,000.

Mr. WOLCOTT. About half of our national debt is in the form of short-term paper?

Governor ECCLES. Under 5 years.

Mr. WOLCOTT. And there was an endeavor on the part of the banks to unload that for the purpose of making more remunerative investments in industry, then, the Federal Reserve Board, through its open-market committee, could control that situation. So I see a direct relationship between the national debt and the possible amount of currency which is in circulation and the volume of currency which is in circulation.

Governor ECCLES. Do you mean by currency, deposit money as well?

Mr. WOLCOTT. I think we can confine it to Federal Reserve notes, because, if I understand this bill, together with the policy of the administration, our trend is toward a single currency.

Governor ECCLES. Yes; but I think there is absolutely no relationship between the Government debt and the amount of Federal Reserve notes in circulation. There may be absolutely no Government debt, and there still may be, and likely would be, the same amount of currency in circulation. There is no relationship between the two.

And it was interesting to note, in looking over some charts of other countries, where the debts have greatly increased—in Japan, particularly, I noticed the amount of its currency did not vary 5 percent. And the same thing would show here, that, as a matter of fact, our debt has increased during the last 2 years, and the amount of currency outstanding has come down as the debt has gone up.

Mr. WOLCOTT. Surely it has not increased in proportion to the debt?

Governor ECCLES. It has decreased.

Mr. WOLCOTT. When the debt was about $20,000,000,000, we had $4,250,000,000 of currency, or something like that, and at the present time we have $5,600,000,000.

Governor ECCLES. Something like $5,500,000,000 in currency at the present time.

Mr. WOLCOTT. When you say that it has decreased——

Governor ECCLES (interposing). Decreased in comparison with what it was 2 years ago.

Mr. WOLCOTT. It has increased about $1,000,000,000 in the last 4 years. It has not increased in the last 2 years, but in the last 4 years.

Governor ECCLES. Yes, I think that is right; and that is due to two causes largely: One is the decreased use of checking accounts, due to the service charges and check tax, and also due to reduced incomes of people, which caused many of them to carry currency instead of using the checking account. There has also been a reduction in the number of small banks throughout the country, and thus there are many small communities which formerly supported banks and which today do not and cannot possibly support banks, thus requiring the use of currency in those communities. I think that is largely responsible for the increased use of currency. There is also some hoarding, I suppose, but I do not know how much of a factor that is now.

Mr. WOLCOTT. In other words, instead of a man who owed several people an aggregate of $100, drawing as many checks as he has debtors, he would either draw one check or go to the bank and draw it out in cash, and, for that reason, there has been more demand for cash.

Governor ECCLES. That is right. There have been less checks and more currency in circulation.

Mr. WOLCOTT. So that you claim there is no relativity between the amount of the national debt and the amount of currency in circulation?

Governor ECCLES. That is right.

Mr. WOLCOTT. Getting back to the question which was asked a few minutes ago, about the use of some of this gold profit to retire these Consols, upon which the national banks based their circulation, I assume from that and from this bill that it is the policy of the Government to eventually create a situation where we have a single currency, which will be whatever silver is needed for change and the Federal Reserve bank notes.

Governor ECCLES. This action will reduce the currency to the silver certificates which, from all present indications, may be a permanent part of our currency, and the greenbacks, which are $346,000,000. Outside of those two currencies, the Federal Reserve notes will be the only other currency in use; and, of course, the Federal Reserve currency will represent the great percentage of the currency in use.

Mr. WOLCOTT. So that the Congress, in the adoption of that policy, by passing this bill, would further contribute to the criticism of the Congress as having delegated its authority to coin money. I am not criticizing that policy. I am merely asking for the information. If there has been criticism of our having delegated heretofore to the Federal Reserve banks the prerogative of Congress to regulate the currency, there is a likelihood of a further criticism of our having centered the control of the volume of money in the Federal Reserve System, is there not?

Governor ECCLES. Reaction of Congress in taking away from the national banks this right to create money does not seem to me that it should subject Congress to criticism. It has not deprived the Congress of any of its power to regulate money.

Mr. WOLCOTT. Well, it surely cannot be considered as a recapture of any of the prerogatives of Congress, which they have under the Constitution, to issue currency, can it?

Governor ECCLES. I do not think that it either takes away from or gives to the Congress any powers.

Mr. WOLCOTT. Well, I listened with a great deal of interest to a radio address by Father Coughlin, whom you have no doubt heard.

Governor ECCLES. I have not. I have never heard Father Coughlin. I have heard of him a plenty.

Mr. WOLCOTT. I will not attempt to quote him exactly, of course, but, in the course of his discussion, which was, I believe, the night that it was announced that $642,000,000 of the gold profits would be used for the purpose of retiring these consols, he at least expressed some pleasure at the fact that, at last, the administration was using some part of this fund as a base for the issuance of currency. Now, if I understand that operation correctly, we merely retired national bank currency and substituted therefor Federal Reserve notes. Is that right?

Governor ECCLES. That is right. The calling of the consols, $675,000,000, by the use of the gold profit, resulted in reducing the national debt out of the profits that were created through devaluation, to the extent of $675,000,000.

Mr. GOLDSBOROUGH. It was a deflationary gesture, too, wasn't it?

Governor ECCLES. The national-bank notes outstanding, which were secured by the consols which were called, were naturally retired.

Mr. WOLCOTT. Well, then, by retiring the consols, the Panama consols and these other consols—and there is another consol. What is the other?

Governor ECCLES. The Panamas and the consols.

Mr. WOLCOTT. By reason of having retired those consols, of course, it is necessary to retire a like amount of the currency that was started by those consols.

Governor ECCLES. That is right.

Mr. WOLCOTT. So that, unless we issued Federal Reserve notes to replace them, the volume of money we have outstanding will be $642,000,000 less, provided that was the money out against the consols?

Governor ECCLES. That is right.

Mr. WOLCOTT. So that, instead of being inflationary, instead of using any part of the gold profit for the purpose of increasing the amount of money outstanding, it takes out of circulation the national-bank currency in that amount?

Governor ECCLES. No. There is no difference in the amount of money. Federal Reserve notes will be substituted for the national-bank currency; and it will be done unconsciously, because people holding national-bank notes will use them in the course of business, just the same as they would use Federal Reserve notes or silver certificates. There is no distinction made in the use of the currency. Now, as the national-bank notes become mutilated, the banks will send in the currency, as it comes in through the deposit windows and is sorted—and, as the old notes are sent in to the Reserve banks, new Federal Reserve notes will be sent to the member banks in place of those notes, to meet the demands of the customers. The Federal Reserve banks will send in these mutilated national-bank notes to the Treasury and the Treasury will destroy them; whereas, in the past, they would issue new notes, keeping up the flow.

Now, the national-bank notes will just gradually pass out of existence as they become mutilated and, as they pass out of existence, Federal Reserve notes will take their place. It might take a year before the whole process is worked out.

Mr. Wolcott. It was on that that I predicated my previous question concerning the concentration of the circulating medium in the—or the regulation of the volume of the currency in the Federal Reserve System, taking from the national banks the money outstanding against these consols, and the Federal Reserve System issuing in place Federal Reserve notes.

Governor Eccles. That is right.

Mr. Wolcott. There are two provisions in the bill on which I have had a great deal of correspondence. I do not know whether you are acquainted with one of them, Governor; that is, the provision with respect to the examination of private banks. Now, in the bill which we passed in 1933, we provided that within 1 year after the operation of the act all private banks which were not inspected by a State examiner, must, in order to continue to receive deposits, submit to examination by either a Federal Reserve examiner or a national-bank examiner. They had their choice as to which they would elect to be examined by.

Now, I notice that in this bill the law is to be amended somewhat; and I wondered what the reason for that was. It is amended in subsection (b) of section 303, page 52 of the bill. It is an amendment to paragraph 2 of subsection (a) of section 21 of the Banking Act of 1933 and it provides that:

> The expense of the examinations required hereunder shall be assessed against and paid by, the institution subject to examination in the manner and with the same effect as provided by section 5240 of the Revised Statutes, as amended.

What would you say was the purpose of that?

Governor Eccles. That is under title III of the bill; and there are, of course, a good many phases that the Federal Reserve are interested in under title III, that have not come up or been discussed here. It was my understanding that the discussion at this time would be confined to title II of the bill.

Mr. Wolcott. Well, this directly affects the Federal Reserve System.

Governor Eccles. Well, there are quite a number of——

Mr. Wolcott (interposing). I do not quite understand it. I am not very well acquainted with this and it is something that you might not be acquainted with, because it is a matter of detail, and these are a few isolated cases.

Governor Eccles. Title III is composed largely of the legislation that was in the omnibus banking bill of the last Congress. There are some additions and some modifications and the particular section referred to is a section that is recommended by the Comptroller of the Currency. Under title III there are, I think, some 32 provisions. Thirteen of the provisions, of the total of 32, are provisions that the Federal Reserve System recommended and was interested in. The other sections were proposed by the Comptroller of the Currency and the Federal Deposit Insurance Corporation. They are largely of a technical nature.

Mr. WOLCOTT. Then, you are not in a position, as coming from the Federal Reserve Board, to say what the purpose of those was?

Governor ECCLES. No; I am not; because that was developed by the Comptroller of the Currency.

Mr. WOLCOTT. Would that be true also of the prohibition against bank officers and executives borrowing from their banks?

Governor ECCLES. That prohibition is already in the existing law.

Mr. WOLCOTT. But, there is a change. I have introduced a bill, at the suggestion of the Treasury, and Senator Copeland introduced the bill. It was suggested that I introduce it in the House; and I understand that they have used the language of it here in this bill. I wanted to ask some questions on that. This bill gives bank officers and executives 2 years in which to retire their investments.

Governor ECCLES. Three more years in which to retire loans made before the enactment of the Banking Act of 1933.

Mr. WOLCOTT. I wondered if any thought had been given to placing a limit upon the amount that they could borrow after that or at the present time.

Governor ECCLES. There was no consideration given to that by the officials of the administration who considered that particular legislation. And the Federal Reserve Board and, also, the Office of the Comptroller of the Currency have felt, as I stated here this morning, that bank officers should be prohibited from borrowing from their own institutions; and that, in cases where they have loans, they should be given an extension of 3 years.

Mr. WOLCOTT. I was interested in the matter only to the extent that several have written me about it; and it seems to me that the prohibition would work an injustice in small cities, where there is only one bank. And they think that they should be permitted to make emergency loans, up to $1,000 or $1,500, or something like that. I am not particularly interested in the section, but I am inquiring.

Governor ECCLES. We are not recommending that bank officers be permitted to borrow from their own banks under any circumstances; and it is my personal view that it would be a mistake to permit bank officials to borrow under any conditions from their own institutions.

Mr. WOLCOTT. I appreciate the purposes of this legislation. Yesterday, I think, Congressman Gifford was questioning you, and you remarked that the British national debt is only 7 percent of the national income.

Governor ECCLES. That the servicing, the interest, on the British debt is a little over 5 percent of the national income.

Mr. WOLCOTT. And that the interest on the United States national debt is about 1 percent of the national income.

Governor ECCLES. That is right.

Mr. WOLCOTT. In arriving at that conclusion did you take into consideration the internal, municipal debt of the United States?

Governor ECCLES. No; only the national debt. I think I have the figures on the other debt in my mind. The British municipal debt is, of course, much smaller in proportion than the American debt.

Mr. WOLCOTT. They have a more centralized government?

Governor ECCLES. That is right. I think that the total public debt of Great Britain, so far as the figures are available—and it is difficult to get very accurate figures—is about $48,000,000,000. That, of course, is figuring the pound on the old parity basis of $4.85, and the American debt—in considering the Federal debt, as I said yesterday, the question of what we deduct from it by way of assets which are held in the form of loans that are made by the Reconstruction Finance Corporation, or other loans that are made by other Government agencies, should be given consideration.

Mr. WOLCOTT. After those deductions were made, I believe you said it was about $25,000,000,000?

Governor ECCLES. I said it was less than $25,000,000,000, without deducting the gold profit, which now makes up the stabilization fund—say, $22,000,000,000. I think the municipal debt would be around $17,000,000,000 to $18,000,000,000.

Mr. WOLCOTT. So that our total public debt would be in the neighborhood of $40,000,000,000?

Governor ECCLES. That is right, as against the British debt of about $40,000,000,000, whereas our national income——

Mr. WOLCOTT (interposing). Governor, for my purposes, probably we can shorten this up by saying that the public debt of the United States, based upon your previous statement, is something less than 2 percent of the national income?

Governor ECCLES. No. The public debt of the United States, in total, would be about 50 percent of the annual national income—the normal national income.

Mr. WOLCOTT. I should not have said that. I should say the carrying charges—the interest—for the total public debt.

Governor ECCLES. The ratio between interest on the public debt and national income depends, of course, upon what income you figure—whether you figure on the present income or whether you figure on what you term a normal national income.

Mr. CROSS. What is a normal national income?

Mr. WOLCOTT. Based on the normal national income.

Governor ECCLES. It would be less than 2 percent of the normal national income. Our normal national income, if we can figure 1927, 1928, and 1929 as normal, was about $83,000,000,000.

Mr. WOLCOTT. Do you know what the normal national income of Great Britain has been?

Governor ECCLES. Last year it was about $18,000,000,000, and $20,000,000,000 is about as high as it has been.

Mr. WOLCOTT. Does public debt, in the sense that you are using it, include the debts of municipalities, counties, towns, and villages?

Governor ECCLES. That is right. It is between $17,000,000,000 and $18,000,000,000, in addition to the Federal public debt, making a total of around, say, $46,000,000,000 of public debt.

Mr. SISSON. Do you use the term "national debt" in the same sense?

Governor ECCLES. No.

Mr. WOLCOTT. No. At least I am distinguishing between the national debt of the United States Government itself and the internal public debt of the States, counties, cities, townships, and so forth.

And that public debt, other than the national debt, is between $17,000,000,000 and $18,000,000,000; and the national debt of the United States Government, according to the testimony, is, in round figures, $22,000,000,000.

Governor ECCLES. The national debt, as I stated, depends on what you deduct by way of the gold profit and the assets.

Mr. SISSON. The guaranteed obligations of the Home Owners' Loan Corporation was not included in the national debt?

Governor ECCLES. No.

Mr. SISSON. They are not a direct part of the debt, are they?

Governor ECCLES. No. I am not including those as a direct part of the debt.

Mr. CROSS. When you said a little less than 2 percent, you meant that the national debt, plus the other debts of the municipalities, and so forth, required a little less than 2 percent to service the interest charges?

Governor ECCLES. Yes.

Mr. CROSS. Do you include in public debts, national debts, municipal, State, and other local governmental debts?

Governor ECCLES. The questions of Congressman Wolcott called for making a comparison between the total public debt, which included the State, county, and city debts, plus the Federal debt, as between the United States and Great Britain.

Mr. CROSS. Yes; I understand that; but I wanted to get it stated in the record so that those statements would show clearly that when you said public debt you meant by that the public debts, Federal, State, county, municipal, and so forth.

Governor ECCLES. That is right.

Mr. WOLCOTT. Then, inasmuch as we have not taken into consideration the contingent debt of Great Britain, but have taken into consideration the contingent debt of the United States Government, our total national debt at the present time, without making these deductions, is $31,000,000,000, and our State, county, and municipal debts are $17,000,000,000. That would make a gross public debt of $48,000,000,000, would it not?

Governor ECCLES. That is right.

Mr. WOLCOTT. Or within $1,000,000,000 or $2,000,000,000 of the total British debt?

Governor ECCLES. I think the gross national debt now is $27,000,000,000 plus. It is not $31,000,000,000. It would be $45,000,000,000, if we included State and municipal debts without deducting the balances on hand or the advances which will be repaid, or the gold profits.

Mr. FORD. Governor, do the obligations include any of the obligations of the Reconstruction Finance Corporation?

Governor ECCLES. Yes; that is included.

Mr. FORD. That includes their obligations?

Governor ECCLES. Yes.

Mr. FORD. And from that should be deducted their assets?

Governor ECCLES. Most of the increase in the Government debt is not due to spending but to lending. For instance, $1,000,000,000 of the increase in the Government debt went to the purchase of preferred stock and debentures of the banks and $800,000,000 have gone to the receivers of closed banks as loans against their assets, in order to hasten their liquidation. There are other loans which have gone to the insurance companies, the railroad companies, the mortgage companies, and so forth. In fact, the entire Reconstruction Finance Corporation operation is a huge credit-expending operation, and the amounts will largely be recoverable.

Mr. SISSON. Are you taking into consideration at all the matter which Mr. Ford referred to? I would assume that what be meant by the assets of the Reconstruction Finance Corporation was the repayments. You cannot tell exactly what those repayments are going to be.

Governor ECCLES. That is right.

Mr. SISSON. You are not deducting, then, from the national debt the probable repayments, are you?

Governor ECCLES. Not in figuring the $27,000,000,000. There was no deduction. That was the total outstanding debt; and, from that you would have to deduct the balances on hand, which were over $1,500,000,000, as well as all of these assets; and, of course, there are also the commodity credit loans that have been made, running up to $600,000,000 or $700,000,000. There is also, as I say, the $2,000,000,000 in the stabilization fund. That is not taken into account.

Mr. SISSON. In this comparison which was made between the national debt of this country and the national debt of Great Britain, did your figures contain any comparison which would show what the debt of this country is per capita, as compared with the British debt per capita and what our income is per capita as compared with the British income per capita?

Governor ECCLES. I do not recall just what those figures are. Of course, it would be a very easy matter to get those figures.

Mr. SISSON. I remember reading them, getting them from other sources; but I thought that, before basing any conclusions on those figures, we ought to have them authoritatively. I know that our debt is very much less in proportion than the British debt and that our debt is very much less per capita than the British debt.

Governor ECCLES. Oh, yes. If the committee is willing, I think it may be well, in this connection, and I would like to insert in the record a coordinated, connected statement covering this comparison.

The CHAIRMAN. There is no objection to that. We shall be glad to have it.

STATEMENT BY GOVERNOR ECCLES ON THE PUBLIC DEBTS OF THE UNITED STATES AND THE UNITED KINGDOM

The kind of comparison most frequently made between public debts of two countries is in terms of debt per capita. The most recent authoritative figures of this kind were prepared by the Treasury for the Joint Committee on Internal Revenue Taxation. For national debt per capita—that is, the debt of the central government alone—the figures originating from that source are $850 for the United Kingdom and $215 for the United States. The debt per capita for all public bodies, including central governments, counties, municipalities, school districts, etc., is $991 in the United Kingdom and $370 in the United States, or about two and a half times as much in the United Kingdom as in the United States. Only very tentative estimates can be made of the national income in the two countries for the year 1934, but such information as we possess indicates that the national income in the United Kingdom was about $430 per capita as against $400 per capita in the United States. In all these comparisons the rate used to convert the British into the American monetary unit is $5 to the pound.

Because of the very difficult questions connected with selecting the proper rate of exchange between two currencies in making comparisons of this kind, and because the income of a country is more important than its population in considering questions as to the burden of its public debts, per capita figures of the kind just given may be misleading. For this reason the figures below on the relation of interest on public debt, public debt, and national income are presented. National income as used here means the total money incomes actually paid to all the inhabitants of a country.

Net central government debt, after deduction of Treasury balances, stabilization funds and other assets, is 38 percent of national income in the United States and 158 percent in the United Kingdom, or about four times as much of the national income in the United Kingdom as in the United States.

The debt of all public bodies—that is, the net central government debt plus the debts of all other civil divisions—is 74 percent of national income in the United States and 194 percent in the United Kingdom, or about two and one-half times as much of the national income in the United Kingdom as in the United States. In round numbers, the net debt of all public bodies in the United States is $37,000,000,000. If it was as large in relation to our national income as the British public debt, it would be $97,000,000,000.

Interest on the central government debt is 1.6 percent of the national income in the United States and 5.4 percent in the United Kingdom. Interest on the debt of all public bodies is 3.3 percent of the national income in the United States and 8 percent in the United Kingdom.

The following are the figures on which these comparisons are based:

| As of 1934 | United States | United Kingdom |
|---|---|---|
| | *Billions of dollars* | *Billions of pounds* |
| Gross central government debt | 27.9 | [1] 6.9 |
| Net central government debt (after deduction of treasury balances, stabilization funds, and other assets) | 19.4 | 6.3 |
| Debts of all other government bodies | 17.6 | 1.4 |
| Total public gross debt | 45.5 | 8.4 |
| Total public net debt | 37.0 | 7.7 |
| National income | 50.0 | 4.0 |
| | *Millions of dollars* | *Millions of pounds* |
| Interest paid by central government | 817 | 215 |
| Interest paid by all other government bodies | 844 | 105 |
| Total interest paid on public debt | 1,661 | 320 |

[1] Excluding war debt.

The CHAIRMAN. Governor Eccles, I want to suggest to you that it would be instructive if you would at some place in the record explain what eligible paper is, or what may be eligible paper under the existing law. I will not ask you to do that now. Just put it in the record.

Governor ECCLES. All right.

The CHAIRMAN. If there is no objection, the committee will meet again Monday morning at 10:30. Governor Eccles, we want you back here at that time, please.

Thereupon the committee adjourned until Monday, Mar. 18, 1935, at 10:30 a. m.)

# BANKING ACT OF 1935

**MONDAY, MARCH 18, 1935**

House of Representatives,
Committee on Banking and Currency,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The Chairman. Gentlemen, we are ready to resume the discussion with Governor Eccles. Mr. Hollister, if you wish, you may have the discussion this morning.

Mr. Hollister. Governor Eccles, I would like to ask you a few preliminary questions before going into the actual gist of the bill itself.

Would you mind telling the committee—and these questions are with respect to title II, because with respect to title I and title III, I think there will be very little discussion. Would you mind telling the committee how this title II was prepared, who wrote it chiefly, and how it was drafted?

Governor Eccles. The members of the legal, economic, and operating staff of the Federal Board, together with myself, were appointed a committee by the board, to prepare Federal Reserve legislation to be considered by what is known as the "Interdepartmental Loan Committee", which the President had asked to consider all legislation dealing with financial matters. That in general is the way the legislation was prepared. Of course, it was——

Mr. Hollister (interposing). That was initiated by the Federal Reserve Board?

Governor Eccles. What is that?

Mr. Hollister. Was that initialed by the Federal Reserve Board, did I understand you to say?

Governor Eccles. The Federal Reserve Board appointed, at my request, a committee to develop this legislation.

Mr. Hollister. And who was that committee?

Governor Eccles. The committee were members of the staff. I was the chairman of the committee. The other members of the committee were Dr. Goldenweiser, who has been with the Federal Reserve Board for about 15 years, Mr. Wyatt, general counsel, who has been with the Board for nearly 18 years, Mr. Morrill, the secretary, who has been with the Federal Reserve Board for 4 or 5 years and prior to that was with the Federal Farm Loan Board, and Dr. Currie, who is Dr. Goldenweiser's assistant. That was the immediate committee.

They were assisted, of course, by other members of the staff, such as Mr. Smead, chief of the Division of Bank Operations, and Mr

Paulger, chief of the Division of Examinations. Those men have been with the Federal Reserve Board for a good many years.

This committee worked with me in the development of legislation which was considered necessary and advisable. The proposed legislation was, in turn, cleared with a subcommittee of the Interdepartmental Loan Committee, which reviewed it and suggested modifications and changes. Mr. Morgenthau was appointed by the President as chairman of the Interdepartmental Loan Committee.

Mr. HOLLISTER. May I ask you there, was not that Interdepartmental Loan Committee appointed some time ago as a clearing house for the various departments' financial requirements?

Governor ECCLES. No; not altogether. It was appointed to clear any legislation that was coming up from certain departments. All legislation that was to come up from nine departments, including the Federal Deposit Insurance Corporation, the Federal Reserve Board, the Reconstruction Finance Corporation, the Home Owners Loan Corporation, and the Farm Credit Administration, was to be cleared through this committee or a subcommittee. That committee was to——

Mr. HOLLISTER (interposing). It was to clear legislation as well as to coordinate finance?

Governor ECCLES. Largely to clear legislation.

Mr. HOLLISTER. This draft went before a subcommittee for consideration?

Governor ECCLES. Yes, sir.

Mr. HOLLISTER. Who were the members of that subcommittee, if you remember?

Governor ECCLES. Yes. There was Mr. Coolidge, the Under Secretary of the Treasury, Mr. Oliphant, general counsel of the Treasury, Mr. Jesse H. Jones, Mr. Lynn P. Talley, who was formerly governor of the Federal Reserve Bank of Dallas and is now assistant to the directors of the Reconstruction Finance Corporation, and Mr. Leo T. Crowley. I think, Mr. J. F. T. O'Connor, Comptroller of the Currency, was in at one or two meetings, at the last. But most of the work on title II was gone over and discussed by Mr. Coolidge, Mr. Oliphant, and myself, and——

Mr. HOLLISTER (interposing). Title II, then, as it was drafted and presented in this bill, was the result of the preliminary draft which the committee appointed by the Federal Reserve Board had prepared, after it had been checked over by the subcommittee of the Interdepartmental Loan Committee?

Governor ECCLES. That is right.

Mr. HOLLISTER. Was that discussed at all with, or was the benefit of the advice received of, any of the governors or the directors or officers of any of the Federal Reserve banks?

Governor ECCLES. No; not the governors. The matter was not discussed with them.

Mr. HOLLISTER. This was a presentation, it might be said, from the point of view of the present Federal Reserve Board?

Governor ECCLES. That is right.

Mr. HOLLISTER. Was this draft, before being presented to Congress, approved by the Federal Reserve Board?

Governor ECCLES. No. The Board was not asked to approve it. The Board was kept advised of the legislation.

Mr. HOLLISTER. The Board did not give any final approval of the legislation?

Governor ECCLES. In fact, they felt that it would be better to take no official action in the matter; but they were constanly advised as to the development of the legislation, and individually they were invited to express themselves about it, which they did.

Mr. HOLLISTER. But, prior to the introduction of this bill, there was no consultation whatsoever with any of the individual bankers of the country?

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. Federal Reserve or otherwise?

Governor ECCLES. Officials of the American Bankers Association. Mr. Rudolph S. Hecht, president, Mr. Robert V. Fleming, first vice president, and Mr. Tom K. Smith, second vice president, of the American Bankers Association, were advised with—particularly Mr. Smith.

Mr. HOLLISTER. While the bill was being drafted?

Governor ECCLES. Yes; and the report in the press as to the attitude of the American Bankers Association is entirely untrue. I think that, as a matter of fact, they have been cooperative and constructive.

Mr. HOLLISTER. I do not know what that report in the press is that you refer to.

Governor ECCLES. I just saw a report that represented the American Bankers Association as being opposed to title II of the bill. I think it appeared along with an account of the Liberty League's opposition, which, of course, was not——

Mr. HOLLISTER (interposing). There was consultation, then, with some of the officers of the American Bankers Association?

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. But not with any of the governors of the Federal Reserve banks?

Governor ECCLES. Not specifically with reference to this particular bill; but I discussed banking legislation with Governor Harrison, in a general way, but not the specific provisions of this bill.

The proposal to broaden the eligibility requirements has been generally recognized by all the bankers as desirable for some time. The proposed combination of the positions of chairmen and governors is desirable to the governors. It is undesirable to the chairmen, if they are to be eliminated, or it is undesirable to the governors if they are to be eliminated. But the principle of the combination of those officers——

Mr. HOLLISTER (interposing). I do not want at the present time to go into that in detail.

Governor ECCLES. Yes.

Mr. HOLLISTER. What I was trying to get was the preliminary picture and how much consultation there was with those who were to be very substantially affected by the bill, if it were to go into effect in its present form.

Governor ECCLES. Yes.

Mr. HOLLISTER. You have submitted to us a memorandum containing some eight modifications, which you suggest.

Governor ECCLES. There is one of them which is not important, and I prefer to withdraw it. That is the one that suggested——

Mr. HOLLISTER (interposing). No. 6, you mean, the suggestion as to the authority over open-market operations being vested in the Federal Reserve Board?

Governor ECCLES. It is the one which suggested that two members on the Federal Reserve Board be selected from Federal Reserve banks, men who have had experience as officers or directors of Federal Reserve banks.

Mr. HOLLISTER. Well, I do not seem to find such a provision on this memorandum.

Governor ECCLES. Well, anyway, I don't think that is very important.

Mr. HOLLISTER. Well, these modifications that you have suggested to us, have they been checked up in the same way in which the original bill was drafted? Were they prepared by your committee of the Federal Reserve Board and checked with the Interdepartmental Loan Committee?

Governor ECCLES. No. They have been checked only with some of the individual members of the committee, not as official committee action. They were, of course, checked very thoroughly with our own committee and were also checked with the officials of the American Bankers Association.

Mr. HOLLISTER. Now, as I understand it, there is still another change suggested—that is, the withdrawal of one of these suggestions?

Governor ECCLES. Well, I do not think it is very important one way or the other. It was not mandatory but simply a suggestion that, in selecting the members of the Federal Reserve Board, the President considered the advisability of including at least two members who shall have had experience as officers of the Federal Reserve banks. The difficulty I see about that is that it is practically impossible to get any officials from a Federal Reserve bank to go on the Federal Reserve Board; because the compensation paid the officials of the Federal Reserve banks is two or three times the compensation paid the members of the Federal Reserve Board.

Mr. HOLLISTER. Is it probable that, as we go along, there will be still further suggestions made to change the draft of the bill as presented?

Governor ECCLES. You mean by me?

Mr. HOLLISTER. By you or those representing the Interdepartmental Committee or the Federal Reserve Board.

Governor ECCLES. I do not think there will be any. Of course, I cannot say. I cannot speak for others.

Mr. HOLLISTER. I realize that.

Governor ECCLES. There may be.

Mr. HOLLISTER. What I am trying to get at, of course, is to what extent the draft of the bill presented to us is a kind of rough draft, which is perhaps quite controversial at points, and how much it is the well-considered judgment, as you might say, of all the financial interests of the administration. Of course, if it is to be submitted in one form and suggestions made for changes by, perhaps, first one branch and then another branch, perhaps the committee would have a little different feeling about it than if it was in one form, which could be finally agreed upon and considered the united suggestions of all the financial branches of the administration.

Governor ECCLES. All except one of these suggested changes were very minor modifications. For instance, the approval of the appointment of governors by the Board each 3 years, instead of annually.

Mr. HOLLISTER. That is rather a major change.

Governor ECCLES. Some may consider it major, but, at least, it is not fundamental. It is extending the period of approval only. When we prepared the legislation we expected, certainly, that modifications would be suggested or made, as is true in all legislation.

Mr. HOLLISTER. Perhaps we might discuss section 201, then, right off. Of course, a Federal Reserve bank is a private bank, which is owned by private capital, the individual banks having the capital stock in that Federal Reserve bank.

Governor ECCLES. It is quite different from the ownership of most private corporations, since the member banks are limited to a 6-percent return on their capital under every circumstance. The board of directors of a Reserve bank must get the approval of the Federal Reserve Board with reference to expenditures and so forth. It is quite different from the average private bank.

Mr. HOLLISTER. It is not exactly the same, of course.

Governor ECCLES. No.

Mr. HOLLISTER. But the fact is that it is the money of private banks which goes to buy the stock of the Federal Reserve banks; and the theory of the Federal Reserve banks was that the private banks, which have the stock, would control the boards.

Governor ECCLES. Of the Federal Reserve Board?

Mr. HOLLISTER. Of the individual banks. Now, you have stated——

Mr. BROWN (interposing). May I interrupt a moment?

Mr. HOLLISTER. Yes.

Mr. BROWN. I have not seen a discussion of it yet, but the law still provides for the issuance of stock to the Government of the United States. I do not think any was ever taken.

Mr. HOLLISTER. But, at the present time, all of the stock is owned by the private banks.

Mr. BROWN. That is the fact, is it not, Dr. Goldenweiser?

Dr. GOLDENWEISER. Mr. Wyatt says there is such a provision. I had forgotten it.

Mr. BROWN. It was in the original Federal Reserve Act.

Governor ECCLES. The purpose of that provision was to enable the Government to provide capital for the Federal Reserve banks if the banks failed to subscribe for sufficient stock; but they did not fail to do so.

Mr. BROWN. It was not put in the alternative, like that, was it?

Governor ECCLES. Yes; I think it was.

Mr. HOLLISTER. It was similar to the method by which the Government had to establish a number of these organizations which are private organizations; to start them by Government backing. It was similar to the home-loan banks, for instance.

You have stated that you did not consider that the change suggested (as to the approval of the Governor) from 1 year to every 3 years, was a major change?

Governor ECCLES. Nothing fundamental. It in no way changes the operation of the system.

Mr. HOLLISTER. It is true, is it not, that the right of the Federal Reserve Board to approve every year the appointment of the chief executive officer—the governor—of the regional banks, makes it possible, of course, for the Federal Reserve Board to insist on someone who is absolutely satisfactory to the Board, and to do it every year.

Governor ECCLES. Well, of course, the right of approval would make it necessary that the Governor be satisfactory to the Federal Reserve Board.

Mr. HOLLISTER. And if that is changed to 3 years, just to that extent the power of the central board over the chief executive of the regional bank is weakened.

Governor ECCLES. It was intended in the original Federal Reserve Act that the chief executives of the regional banks should be the chairmen.

Mr. HOLLISTER. Theoretically, but not as a matter of fact.

Governor ECCLES. Yes; but I think they could possibly be made to be.

Mr. HOLLISTER. Under existing law?

Governor ECCLES. Oh, yes. The law has not been changed in regard to the chairmen at all.

Mr. HOLLISTER. I know that. But I know of no situation, in any corporation, where the board of directors might not designate powers in such a way as to make either the chairman of the board or the president chief executive officer. In some corporations the chairman of the board is the chief executive officer and the president has very little authority, and in some corporations the president is the chief executive officer and the chairman of the board is merely a figurehead.

Governor ECCLES. It depends largely on the strength of the men the respective offices of governor and chairman. The governors have usually exercised more influence than the chairmen. If it was their purpose, the board might make the chairman the chief executive of the bank.

Mr. HOLLISTER. But in the ordinary corporation, if it came to a conflict between two executive officers, the one that would get the power would be the one that the board of directors backed up, would he not?

Governor ECCLES. I suppose he would. That is one of the reasons, if you are going to operate a unified Federal Reserve System; that it is very necessary and desirable that such conflicts should not exist and that there be cooperation throughout the entire system. Otherwise the function of a central bank cannot be successfully carried out.

Mr. HOLLISTER. Well, there is a difference, of course, between cooperation, coordination, and control. What I am trying to get at is whether section 201 does not really take away the control of the regional banks from those who are duly appointed to handle their affairs; that is, their directors, two-thirds of whom are appointed by the banks who own the stock, and actually vest that control in the Federal Reserve Board.

Governor ECCLES. You are not vesting it in the Federal Reserve Board because the Federal Reserve Board would not designate the governor.

Mr. HOLLISTER. They can throw him out at the end of the year if they do not like him. It is rather a strong weapon to hold over his head.

Governor ECCLES. They can only disapprove of the person selected by the board of directors of the bank. The proposal is that the head of the bank be acceptable to the Federal Reserve Board and to the board of directors of the bank, which is certainly necessary if you are going to have coordination. It would not be good organization for a local board to elect or appoint a governor who is also to be a class C director and chairman of the board of directors, under this provision, if that appointee were not acceptable to the Federal Reserve Board.

Mr. HOLLISTER. Is the governor at the present time a class C director?

Governor ECCLES. No; he is not a class C director. He cannot be. Under the present law the Federal Reserve Board appoints all three class C directors and designates one of them as chairman. Under this bill the Board is giving up its power or right to appoint one of the class C directors and to designate a person of its own selection as chairman.

Mr. HOLLISTER. There is no necessity of that if this other suggestion is not effected. There is no particular need of making the governor a class C director.

Governor ECCLES. If he is going to be chairman he would have to be a class C director.

Mr. HOLLISTER. Yes; if he is chairman he would have to be a class C director; but could you not provide for a governor and not change the law with respect to class C director?

Governor ECCLES. The legislation could be left just as it is and you would continue to have a chairman and governor, just as you now have.

Mr. HOLLISTER. You could abolish the chairmanship and still leave the governor, the chief executive officer, appointed by the board of the bank itself.

Governor ECCLES. And have no chairman?

Mr. HOLLISTER. And have no chairman.

Governor ECCLES. The chairman of the board is always a director.

Mr. HOLLISTER. Yes; but the governor could be appointed from one of the class A or class B directors.

Governor ECCLES. That would require that the banks give up their selection of one of the six directors they now select.

Mr. HOLLISTER. I should imagine that in order to keep their control, by having a governor who would not be removable each year, they would be willing to give that up.

Governor ECCLES. I find that the combination of the offices of governor and chairman is universally looked upon as desirable.

Mr. HOLLISTER. And I agree with that. The thing I am doubtful about, very frankly, is the increase in the control of the Federal Reserve Board over the powers of the individual banks.

Governor ECCLES. With this change to a 3-year period, the American Bankers Association is very favorable to this feature. The only opposition comes from one source, and that is New York. Every other place except New York agrees to that change.

Mr. HOLLISTER. The question is whether the independent banks ought not to have the right to name their own chief executive officers without any interference by the Reserve Board.

Governor ECCLES. They cannot do that without at the same time depriving the Federal Reserve Board of the power of appointing or approving of the officers. In that case you might as well do away with the Federal Reserve Board. The Board has no purpose if you are going to make 12 separate banks, to operate as separate banks. Why have a Board if you do that? I do not know what the desire of Congress may be in that regard, but certainly if you want to have 12 independent banks, then there is no reason or no purpose for having a Federal Reserve Board. But if you are going to have a Federal Reserve Board, then it has to be charged with responsibility and it has to be given some authority.

Mr. HOLLISTER. But you have today a Federal Reserve Board that is charged with responsibility, and no one would deny that the Federal Reserve Board today has enormous power, enormous authority, and enormous responsibility; and also that, to all intents and purposes, there are 12 banks which have considerable—not considerable, but some— independence; not as much as they used to have. I am not asking that they have more, but I just dread taking away what that have left.

Governor ECCLES. I do not believe that we are taking it away, because you are giving to them the right to select a chairman and class C director, which they do not now have; and as a consideration for that the Federal Reserve Board would be given the right to approve of the appointment every 3 years. You would have anything but a satisfactory bank situation if the executive head of each of these 12 banks were entirely unsatisfactory to and uncooperative with the Federal Reserve Board.

Mr. HOLLISTER. Well, just to be more specific, at the present time, under the present set-up, what are the unsatisfactory conditions that arise out of the fact that governors of the regional banks are not subject to removal each year or at the end of any specified time by the Federal Reserve Board? I do not mean exactly removal, but they will be in such a position that they may be unapproved at the end of a certain specific time. What are the conditions that arise——

Governor ECCLES (interposing). You mean with the present law?

Mr. HOLLISTER. At the present time in operation.

Governor ECCLES. All the legal relationship of the Board with the bank is through the chairman. The governors, as I stated a while ago, are not directors of the banks. It seems to me that it is a bad organization and that no one would set up a private organization on such a basis.

Mr. HOLLISTER. Well, I understand there are certain mechanics that have to be ironed out, but what I am trying to get at is this: What are the objections under the present operation to having the chief executive officer, who is appointed by the regional bank's board itself——

Governor ECCLES (interposing). The regional banks will appoint their chief executive officers.

Mr. HOLLISTER. Yes; I know. But he can be disapproved at the end of a year. He could be disapproved at the time he is appointed, and if he does not act the way——

Governor ECCLES (interposing). He can be disapproved at the end of 3 years.

Mr. HOLLISTER. That is under the suggested changes?

Governor ECCLES. That is under the suggested changes. He could be disapproved at the end of 3 years, which, I think, is very necessary and desirable in order to avoid friction and to have cooperation and coordination.

Mr. HOLLISTER. Can you point out instances of where governors of the regional banks have conducted themselves in such a way that the Federal Reserve Board has disapproved, and to what extent and what are the nature of such actions? What I would like to get before the committee, if there are such things, is what action these governors take which the Federal Reserve Board feels it should have the right to disapprove. If it is merely a question of making one man both the governor and the technical chairman of the board—that is, of course, easy to settle. What I am trying to get at is, what is the purpose of giving the Federal Reserve Board the right to say to a regional bank, "You cannot appoint the man you want", or, at the end of the year, "You cannot reappoint the man you want"?

Governor ECCLES. Do you not think that there are enough good men so that it is possible to get a man that would be agreeable both to the Federal Reserve Board and to the regional bank board? Do you think it is necessary to have as the head of one of the Reserve banks a man who is unacceptable, because of inefficiency, we may say, or because of incapacity, and yet have him retained because of the personal relationship existing between the managers of these banks, or the governors, and the local boards? There is a sentimental relationship and friendship that is built up due to very close contacts, and a director of a bank, who personally has no stock ownership in a bank, and only goes to a meeting once every week or so, or every month, is not likely to oppose the reappointment of a governor, even though he may feel that he could be improved upon, or that he may not be entirely desirable.

Mr. HOLLISTER. I can answer that very easily by saying that such a man should not be a director.

Governor ECCLES. That is very true. But, after all, the directors are not stockholders. You must realize that.

Mr. HOLLISTER. Would not your objection be met by a suggestion that the governor could be removed for cause, just as you pointed out the other day that the members of the Federal Reserve Board may be removed for cause, or the Governor of the Federal Reserve Board?

Governor ECCLES. I think they already have that power now—to remove for cause.

Mr. HOLLISTER. What did you say?

Governor ECCLES. They already have that power—to remove for cause.

Mr. HOLLISTER. The governor or one of the directors of one of the regional banks?

Governor ECCLES. Yes.

Mr. HOLLISTER. Well, then, there would be no necessity for this. If a man is inefficient or incapable, he can be removed, so that this legislation is not needed for that purpose.

Governor ECCLES. The legislation, I think, is very greatly needed. The matter of inefficiency or inability is a very difficult thing to prove. A man may be filling a position that somebody else could fill more satisfactorily. Questions of ability or efficiency are matters of degree and you would have a very difficult problem if you should attempt to remove a man for cause unless there were some glaring lack of capacity or some personal act that would justify the removal.

Mr. HOLLISTER. Well, it really comes down to this, then: that you believe that, as between the relative efficiency or inefficiency of several men, the power of designating one of such men to conduct that regional bank should be in the Federal Reserve Board rather than in the board of directors, the majority of whom have been elected by those whose money is invested in the stock of the regional bank.

Governor ECCLES. I think that, in the interest of the System, it is very necessary that the Federal Reserve Board have the approval of these governors who are selected by the directors of the Reserve banks; and, as I stated, it would seem to me that there should be a sufficient number of able men to permit appointments that are desirable to both the Federal Reserve Board and the local board. The governors are the liaison officers under this relationship between the 12 Federal Reserve banks and the Federal Reserve Board; and, for this reason, it seems to me, the Federal Reserve Board should have the approval. Any governor who objects and any board that objects to this Board approving would be actuated by the desire to retain office, even though their retention was unsatisfactory and unacceptable to the Federal Reserve Board.

Mr. HOLLISTER. Of course that is a question as to whom the heads of the regional banks should be acceptable. I had understood that the theory of the Federal Reserve organization was that high-class bankers, of independent judgment, should have some say in the conduct of the System. Now it would seem to me to be fairly clear that, if the head of each regional bank must completely follow what the Federal Reserve Board indicates at all times, he ceases to be a banker of independent judgment. Of course, if that is the desire of Congress, that settles it; but that was not the original plan of the Federal Reserve System.

Governor ECCLES. There is no thought or expectation that such a thing will happen. In practice, I am certain that the banks will be run under this bill very largely, so far as everything except monetary policy is concerned, by the local boards of directors and by the governors of the banks. There is nothing in this bill that provides that the Federal Reserve Board shall select or force on a bank a governor who is unacceptable to the board of the bank.

Mr. HOLLISTER. No; they could not force anybody on the bank who was unacceptable to them; but they could keep refusing to appoint people who might be acceptable to the board of the regional bank, indefinitely.

Governor ECCLES. Why should not the governor be acceptable to both boards? If you want good organization, is it not better to have the governor acceptable to both boards?

Mr. HOLLISTER. You have had enough experience to know that if you have a situation of that character, where something must be acceptable to people, absolutely, that they would have the control.

Governor ECCLES. The Farm Credit Adminstration operates in that way, in the question of the appointment of land-bank officers. They are appointed by the local boards, subject to the approval of the Farm Credit Administration, and the banks are owned by the local farm associations, which is private ownership, so that you have an example and it has worked out very well.

Mr. HOLLISTER. Of course their functions are somewhat different from those of the Federal Reserve System.

Governor ECCLES. Yes.

Mr. HOLLISTER. Now, moving to section 203, and raising again this question of independence: In the draft of the bill at the present time the Governor of the Federal Reserve Board cannot be very independent if he can be removed by the President at will. He cannot be particularly independent from the Executive's desire.

Governor ECCLES. You mean in the present legislation?

Mr. HOLLISTER. The proposed legislation.

Governor ECCLES. That is true in the present legislation. There is nothing in the proposed legislation with reference to that.

Mr. HOLLISTER. What is the exact wording of the present legislation with respect to the removal of the governor?

Governor ECCLES. Do you have that, Mr. Wyatt?

Mr. HOLLISTER. What section is that?

Mr. WYATT. Section 10, page 26, of the 1933 edition of the Federal Reserve Act.

Mr. HOLLISTER. Would you read that into the record?

Mr. WYATT (reading:)

> Of the 6 persons thus appointed, 1 shall be designated by the President as Governor and 1 as Vice Governor of the Federal Reserve Board. The Governor of the Federal Reserve Board, subject to its supervision, shall be its active executive officer.

Mr. HOLLISTER. Is that all there is?

Governor ECCLES. Is that all you have on that?

Mr. HOLLISTER. Is there anything in that which permits the President to remove the Governor of the Federal Reserve Board?

Mr. WYATT. It has been interpreted in practice that it does.

Mr. HOLLISTER. I realize that it is so stated, and it has been stated in this room a number of times. It has been stated in the papers, but I have never yet been able to find where the President of the United States has the power to remove the Governor of the Federal Reserve Board.

Mr. SISSON. Is it not true, Mr. Hollister, that these officers are executive or administrative officers, and is it not true that any executive or administrative officer may be removed arbitrarily by the President?

Mr. HOLLISTER. I think it has been settled by the United States Supreme Court.

Governor ECCLES. Yes, sir.

Mr. SISSON. It has been settled, I think.

Mr. HOLLISTER. Let us not get into a discussion of that. I do not want to get into a discussion with any members of the committee, although I think I can point out to Mr. Sisson that he is incorrect in his interpretation of the decision.

Let me ask you a question right in that connection. The Comptroller of the Currency is appointed for how many years?

Governor ECCLES. Five years.

Mr. HOLLISTER. Can the Comptroller of the Currency be removed by the President?

Governor ECCLES. I do not think so. The term of his office is provided under the statute.

Mr. HOLLISTER. Is the term of office of the Governor of the Federal Reserve Board provided by the statute?

Governor ECCLES. Not as Governor. His term as member is provided for.

Mr. HOLLISTER. It is a 12-year term as director?

Governor ECCLES. That is right.

Mr. HOLLISTER. Then he is appointed Governor?

Governor ECCLES. Yes.

Mr. HOLLISTER. So, theoretically, he is Governor up until he is removed?

Governor ECCLES. Up until the time Governor Meyer was appointed the President designated the Governor each year. It had been the custom from the beginning of the Federal Reserve System for the President to designate the Governor from year to year.

Mr. HOLLISTER. And the fact remains that at the present time it is provided that the Governor shall be appointed, and there is no statement as to how he can be removed. It is also true that the change from the existing statute to the proposed statute is that, in the existing statute, there is a provision for the appointment of the Governor, with no provision as to removing him from office; whereas in the proposed statute it is specifically provided that he shall serve solely at the will of the President. That is the case, is it not?

Governor ECCLES. That is correct. It seems to me that it is a matter that should be clarified and that, if it is not the wish of Congress that the Executive shall have the right to appoint a Governor and remove him, the term of office as Governor should be made specific, and the interpretation that has always been placed upon it should be clarified.

Mr. HOLLISTER. I agree with you fully. I am merely trying to bring out by questioning what this bill does. Naturally, the Congress must make the decision as to what they want. I want to make it perfectly clear what the provision of the proposed law will bring about; and it is also true, is it not, that if the changes which you have suggested in your memorandum are not made effective, as I think you have stated earlier in the hearing, it would be possible, always assuming that an Executive desires to do it, for the President to change completely the personnel of the Federal Reserve Board by designating each member of the Board Governor in turn and removing him the next day.

Governor ECCLES. I do not believe that is possible.

Mr. HOLLISTER. I think it is highly improbable, but it is possible.

Governor ECCLES. If a member of the Reserve Board desired to retain his position on the Board, he would refuse to accept the position of Governor, knowing that he would go out the next day or the next week. If, on the other hand, he did not choose to stay on the Board if the President desired to remove him, he very likely would resign without going through the formality of being appointed as Governor.

Mr. HOLLISTER. I think that is highly probable. What I am trying to get at is—I do not like to be influenced into legislation which would make make possible the arising of a dangerous condition, when some irresponsible person might be in the position of Chief Executive, and when such legislation is not necessary. I believe, to that extent, the suggestions for amendment which you have made are excellent.

Governor ECCLES. The possibility of a President resorting to sharp practice of that sort in order to change the Board, of course, did not occur to me, or, I think, anybody else who had anything to do with this legislation. The reason for providing that a Governor's term as a member shall expire when he is no longer designated as Governor was not to give to the President additional power but to make it possible for a Governor who was no longer designated as "Governor" to resume business without waiting for a period of 2 years.

Mr. HOLLISTER. Of course, that could be done by other phraseology.

Governor ECCLES. That is what is proposed. In other words, the same thing has been accomplished, for all practical purposes, by the suggested change; and because of the objection that was raised, that you mention now, the amendment was proposed.

Mr. HOLLISTER. Do you consider it wise that the President should have complete control over the Governor of the Federal Reserve Board?

Governor ECCLES. I think so. It is my feeling that the President should have the right of appointment of the Governor of the Federal Reserve Board. That is true in practically every country in the world.

Mr. HOLLISTER. He should have the right of appointment; but I am talking about the right of removal.

Governor ECCLES. That is right. He should have, it seems to me, the right of appointing the Governor to serve at his pleasure. I think that is in the interest of the Federal Reserve System. I think it is very necessary that there be a very close relationship and liaison between the banking system and the administration in power; and I think that the Governor of the Federal Reserve Board is the channel through which that relationship should develop, in the interest of the banking business.

Mr. HOLLISTER. Can you not conceive of a situation where political exigencies might be in direct conflict with wise banking policy and wise credit policy?

Governor ECCLES. All I can say is that, if you have such exigencies—war is a case in point and depression is a case in point—then I think it would be very unfortunate if the administration was unable to carry out its program. I stated, I think, when I first testified, that the responsibility of any administration in power is largely a social and an economic one. Practically all political questions relate to social and economic problems. An administration cannot be charged, when it comes into power, with dealing with those problems separately, free, apart, and divorced from the money system.

Mr. HOLLISTER. You believe that even though from the point of view of wise banking and a wise handling of the financial business of the country a certain policy would be desirable, that if an administration decided that it should pursue a policy which might be otherwise, it should be in a position to control the banking and credit systems, to force it along with its policy, irrespective of what the best minds of independent banking might think?

Governor ECCLES. Of course, we have an independent banking system, to an extent; and I do not believe that anybody would feel that for the system to be more independent would be in the best interests of the bankers——

Mr. HOLLISTER. I do not want to interrupt you. I believe there is a great deal in what you say. I do not believe we can answer present questions by referring to the improper actions of the past. I am just asking the question of whether or not it is unwise to put the complete control into the hands of the Executive; and I am generalizing entirely, with reference to no particular executive and no particular condition of the country. Before you answer, let me put it a little more specifically. In our democracy, every so often the party in power must appeal to the country, once every 4 years for Presidential elections and once every 2 years for congressional elections. It is a definite time at which such things have to be done, unfortunately. Is it not very unwise to give the power of manipulation to the Executive entirely when it comes to the credit situation and the banking situation? Would it not be probable that the greatest man imaginable, with an election coming on, would try to take advantage of every possible facility to see that that election is assured, and would it not be possible for him to control the banking and credit system of the country for that purpose?

Governor ECCLES. There is nothing in this bill that proposes that.

Mr. HOLLISTER. But it gives the President a much greater control over the credit and banking facilities of the country?

Governor ECCLES. In what way, except as the Federal Reserve Board has increased power?

Mr. HOLLISTER. It gives the Federal Reserve Board increased power.

Governor ECCLES. That is right.

Mr. HOLLISTER. It gives the President greater power over the Board?

Governor ECCLES. No. The President has no different power over the Board.

Mr. HOLLISTER. Well, the President has greater power over the Governor, who is the Chief of the Board.

Governor ECCLES. Not unless you construe the proposal to mean that it gives the President greater power than he now has. Of course, there has never been a legal test as to the power of the President to remove the Governor; but as I say, in practice it has always been accepted as giving him that power.

Mr. HOLLISTER. If it does not give any more power than at present, there is no need of the change.

Governor ECCLES. No; there is no proposal to make the change, except——

Mr. HOLLISTER (interposing). As to the ability of the Governor to go back into business?

Governor ECCLES. That is the sole purpose of it; and there was no purpose or expectation that this was giving to the President additional power.

Mr. HOLLISTER. Then you would be perfectly willing to strike out the provision for removal?

Governor ECCLES. I do not see a particle of objection to it, because, in practice, that is what happens and will happen.

Mr. HOLLISTER. You say you see no objection to striking it out?

Governor ECCLES. The whole purpose of getting that into the legislation was to make it easier to get someone to act as Governor; in other words, to make it easier to get a man to accept.

Mr. GOLDSBOROUGH. May I interrupt? In that connection, Governor Eccles, if there is in fact any legal obstacle to putting into effect the practice that now obtains, you would favor a change in the language which would legalize and carry forward the practice?

Governor ECCLES. Yes; I think it is desirable in the interest of banking and in the public interest that the administration in power designate the governor and that the governor serve during the pleasure of that administration. That has been true in most other countries.

Mr. HOLLISTER. That is not true in England.

Governor ECCLES. England is about the only exception. It is true in practically every other country. It has been recognized, in the establishment of all the central banks, within recent years, that it is very necessary and desirable that the administration in power have that responsibility and that authority.

Mr. HOLLISTER. Now, with respect to those banks, of course, you have one central bank, where the board is privately elected or appointed, and the chief executive, governmentally appointed, who, of course, cannot exceed what the board will let him do. The board itself controls the executive officers, even in the Bank of France—or in most of the great countries, outside of Italy and Russia. In all those cases the board itself, which ultimately controls the chief executive officer, is privately elected or appointed.

Governor ECCLES. There are differences in the various organizations. The Bank of Canada is the most recent; and in Canada the board is really an advisory board and the governor can veto an action of his board. He does not have to follow their recommendations or their authorizations, as I understand it.

Mr. HOLLISTER. In the Canadian bank a board of seven directors is elected from diversified occupations by the shareholders.

Governor ECCLES. That is right.

Mr. HOLLISTER. The Canadian bank has a governor, a deputy governor, and an assistant deputy governor, who have to be appointed for 7 years by the Governor General in council.

Governor ECCLES. The board does not control the governor there to the extent——

Mr. HOLLISTER (interposing). But, after the first term, however, these officials shall be selected by the directors, subject to the approval of the Governor in council.

So that still puts the control of the central bank pretty well in the hands of the private shareholders.

Governor ECCLES. It puts it in the hands of the Governor in Canada, practically. Of course, there is this difference. In every other country except this country, the commercial banks are not the shareholders, but the public are the shareholders.

Mr. HOLLISTER. That is so in England.

Governor ECCLES. It is so in Canada, too. I think it is so in France, and it is so in practically all the countries. I believe this is the only coutnry where the banks control the central banking system through their stock ownership and the majority of the board of directors.

Mr. HOLLISTER. But the public owns the stock in the banks, which, in turn, own the stock in the Federal Reserve banks.

Governor ECCLES. There is a great difference between——

Mr. HOLLISTER (interposing). The governors——

Governor ECCLES (interposing). In fact, in some of the countries the banks are directly prohibited from owning any stock whatever in the central banks, and the bankers are prohibited from being represented on central banks.

Mr. HOLEISTER. Well, of course, under our system, with our regional banks, we have only half of the directors that can be appointed by the member banks.

Governor ECCLES. No. Two-thirds of them are appointed by the member banks.

Mr. HOLLISTER. Yes; but half of these are drawn from industry, and only half may be bankers.

Governor ECCLES. Yes; but they are appointed by the banks. Two-thirds of the board are appointed by the banks, and the stock is owned by the banks.

Mr. HOLLISTER. I want to bring out the change in control this bill will make, so I will take up for a few minutes section 205, which provides for the open-market committee, a committee of five, which is to be appointed and will consist, first, of the Governor of the Federal Reserve Board, who, in turn, serves at the pleasure of the President; next, two members of the Federal Reserve Board; and, next, two governors of the Federal Reserve banks, who, in turn, if the provisions of this bill should become effective, may fail of approval by the Federal Reserve Board at the end of a year, in the event, we will say, that they are unwililng to go along with what the Federal Reserve Board desires. That, of course, places the open-market committee and its operations entirely in the control of the Federal Reserve Board, does it not?

Governor ECCLES. You are discussing the provisions of the bill with reference to the operation of the open-market committee, as provided in the bill.

In my opening statement, if you will recall, I stated that that provision of the legislation was not satisfactory, and that open-market operations should be placed with the same body that had the authority to fix discount rates and reserve requirements; that they were three functions of monetary control that should be together, in the same body, and that I felt that the Federal Reserve Board was the body charged with the public interest; and that it should, therefore, have that power and authority, subject, however, to securing the advice of a committee of 5 governors selected by the 12 banks. I made that suggestion in my opening statement. I suggested that, rather than having an indirect way of putting the Federal Reserve Board in complete control.

Mr. HOLLISTER. Your theory is that it might just as well take the whole thing right over and have no control whatever by the regional banks?

Governor ECCLES. I feel that the authority over open-market policy must be placed in a body that is charged with the responsibility that the present legislation gives to the governors, who are not even directors of the banks, the right to make open-market policies. The Board approves or disapproves of the policy, and then the 12 banks can either participate in the adopted program or they can refuse to do so, so that you have——

Mr. HOLLISTER (interposing). You say all of the 12 banks or each of them?

Governor ECCLES. Each or any.

Mr. HOLLISTER. And any of them might nullify what the others did.

Governor ECCLES. And what this proposed legislation is doing is putting the responsibility and the authority for open-market policy, discount rates, and reserve requirements, which are three instruments of monetary control, in the Federal Reserve Board.

Mr. HOLLISTER. You feel, then, that, notwithstanding how clear it might be, we will say, to practically all the bankers in one particular locality of the country, Dallas, San Francisco, or wherever it might be, they should not participate in the open-market operations. The Federal Reserve Board should have complete power, and no matter how much the bankers might disapprove they should be compelled to take participation?

Governor ECCLES. Absolutely. The question of monetary policy is a national matter, and it cannot be dealt with regionally without having such situations as we have had in the past. I think open-market policy, discount rates, and reserve requirements should be controlled by the Federal Reserve Board, while making it mandatory that the Board advise with the committee of governors before any action is taken with respect to any one of the three instruments of monetary policy that the Board controls.

Mr. HOLLISTER. That, however, is not in the draft as presented.

Governor ECCLES. No. That is the recommended provision.

Mr. HOLLISTER. Just a few questions on the matter of the collateral behind the Federal Reserve notes. In discussing this question on the days you have been before us you have stated that you did not see the collateral added anything to the value of the notes.

Governor ECCLES. That is right.

Mr. HOLLISTER. Do you feel that the gold provision does?

Governor ECCLES. It certainly does not under present circumstances. And under past circumstances, when there was not sufficient gold, or we felt there was not, to back up notes which were secured and issued, the requirement was suspended, as an emergency matter. In other words, when we get into an emergency, these rigid requirements are suspended. So long as everything goes normally and there is no difficulty in carrying out the requirement, they seem to operate all right.

Mr. HOLLISTER. Well, of course, there are those who do not quite agree with the wisdom of suspending such requirements, who do not believe that the emergency justified the suspension. But I am trying to get at your viewpoint. You say that the collateral does not add anything, neither does the gold. Query: Do you go the whole way, that we should remove all provision for some kind of collateral behind Federal Reserve notes?

Governor ECCLES. No. Personally I think it is very desirable to leave the gold-reserve requirement back of the Reserve notes, and also back of the deposits. The law provides that 35 percent of gold should be held back of the deposits.

Mr. HOLLISTER. Gold or lawful money?

Governor ECCLES. Gold or lawful money; and, of course, our lawful money now is——

Mr. HOLLISTER (interposing). Not gold.

Governor ECCLES. Gold certificates and other forms of currency.

The CHAIRMAN. That provision was written into the law when the law was that the legal money was gold?

Governor ECCLES. Yes.

Mr. HOLLISTER. What is the advantage of that gold behind the notes? Is it the limitation on the amount of notes that might be issued?

Governer ECCLES. That is the effect it might have, I suppose.

Mr. HOLLISTER. So that there is some upstairs limit, beyond which you cannot go?

Governor ECCLES. If you have a bank run, and banks closing, just as we did have, and you permit demands in gold again, and you permit the exportation of gold freely, then, through that action you precipitate financial troubles and bring about a suspension of the requirement. Now, if the payment of gold against deposits and the free exportation of gold should be suspended, and serious banking difficulties develop again, we would possibly go off the gold standard, and then these restrictions would be suspended.

Mr. HOLLISTER. Oh, we are off it today, of course, aren't we? But I don't want to get into a long discussion of that. Some people say there is a gold standard, simply because we can ship gold to settle international obligations.

The CHAIRMAN. Nobody can get gold.

Governor ECCLES. We have a price for gold now.

Mr. HOLLISTER. You believe there should be a gold reserve behind the Federal Reserve notes that should be maintained?

Governor ECCLES. I think it is desirable that it should be.

Mr. HOLLISTER. What is the reason for it? Is it to give confidence to the holder of the note that there is something behind it, or what is it?

Governor ECCLES. I think that there is no necessity of making the change. There would be nothing particularly to be gained by it. Without that requirement of holding so much gold back of deposits and back of currency, you would have, I suppose, no restriction of any kind. I think, psychologically, it would have a very bad effect upon the country, and it is unnecessary. It would, of course, leave our money a completely managed currency without any relationship to gold.

Mr. HOLLISTER. In other words, it would shake people's confidence in the pieces of paper that they carried around in their pockets?

Governor ECCLES. I think it would. Whether justifiable or not, that is the effect it would have.

Mr. HOLLISTER. And the shaking of that confidence would immediately be inflation of a kind, would it not?

Governor ECCLES. I doubt that. It has seemed difficult to get inflation.

Mr. HOLLISTER. What I am trying to get at is, if the gold reserve of the Federal Reserve notes were entirely removed, you say it would have a bad psychological effect and it would shake the people's confidence in some way?

Governor ECCLES. Yes.

Mr. HOLLISTER. What would be the result of that, stagnation of business and increasing unemployment?

Governor ECCLES. If you eliminate any gold requirement for Federal Reserve notes and for Federal Reserve deposits, then you would be completely divorced from gold. Your currency would be purely and completely a managed currency, without any regard whatever to a metallic base. It would be a complete divorcement. Now, if it is desirable completely to abandon gold now, to make all the gold we have serve only as a commercial commodity, then, of course, it would be desirable to abandon all Reserve requirements for Federal Reserve notes. Otherwise, it is desirable to keep them, because it is the only recognition we have of the use of gold as a base for money.

Mr. HOLLISTER. You see, what I am trying to get at is the advantage of collateral behind notes.

Governor ECCLES. That is a very different matter, the question of gold and that of collateral.

Mr. HOLLISTER. Both are some assurance of value.

Governor ECCLES. Why not have collateral back of deposits? Gold is held as a reserve against both deposits and notes. Now, other countries have gold requirements back of their notes, but most have no collateral requirements back of them. They have gold requirements back of their deposits, but they do not have collateral requirements——

Mr. HOLLISTER. But we do not have.

Governor ECCLES. Oh, yes.

Mr. HOLLISTER. It does not require gold.

Governor ECCLES. Or lawful money.

Mr. HOLLISTER. Yes.

Governor ECCLES. But, of course, that was based upon the requirement that lawful money was redeemable in gold.

Mr. HOLLISTER. You think that there is an advantage in retaining that?

Governor ECCLES. I think at this time there is, until it is determined what is likely to develop in the future, with reference to the gold standard, and whether other means of stabilizing exchanges can be developed. To divorce completely our money from gold at this time would seem to me to be rather a costly thing for us to do, while we own 40 percent of the world's gold supply.

Mr. HOLLISTER. You feel, as I understand you to say, that there is some advantage in limiting the total amount of Federal Reserve notes that may be issued by the keeping of the gold requirement?

Governor ECCLES. The keeping of the gold requirement does not put a limit, in and of itself, on Federal Reserve notes. As I explained the other day, the notes which the Federal Reserve System issues are the notes which the customers, the depositors, of the commercial banks require to conduct the business of the country. Only when unlimited hoarding is permitted would there be any possibility of the need of suspending specie payments and gold exports.

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The amount of gold, of course, which is held, without regard to the gold held by the Treasury, is considerably more than 100 percent of the amount of notes outstanding. The amount of notes outstanding is as great as we have ever normally used in our business operations.

Mr. HOLLISTER. But the existence of the gold requirement does make a decided limit, beyond which Federal Reserve notes could not be issued?

Governor ECCLES. It is a limit beyond which Federal Reserve notes could not be issued. You would have terrible inflation long before you reached the limit.

Mr. HOLLISTER. Unless further devaluation occurred, in which event you would have still more?

Governor ECCLES. That is right.

Mr. HOLLISTER. Still more gold, against which you could issue more Federal Reserve notes?

Governor ECCLES. Yes.

Mr. HOLLISTER. I would like to ask this question: Is there anything in the existing situation, or what anybody could reasonably predict, that makes this legislation a matter of great present urgency?

Governor ECCLES. I think it is very desirable and necessary that it be passed. I think it is several years late. I think that if legislation of this sort had been passed 4 or 5 or 6 years ago we might have avoided most of the banking difficulties that the country went through.

Mr. HOLLISTER. One of the chief purposes to be accomplished that you see, is the power of checking speculation under the powers granted by this proposed legislation?

Governor ECCLES. Control of speculation is one of the important features. Another is to make a better coordination of the system through the changes in the relationship of the Board to the banks and the governors, combining the governors' positions with those of the chairmen. The eligibility feature is a very necessary and important change in the legislation, in order to make banks feel more free to extend long-term credit.

Mr. HOLLISTER. There are many of the provisions of the Federal Reserve Act, are there not, that ought to be revamped, gone over, and studied pretty thoroughly?

Governor ECCLES. There are quite a number of provisions proposed in title III of the bill.

Mr. HOLLISTER. I realize that.

Governor ECCLES. That go quite a way toward correcting and toward clarifying the existing Federal Reserve legislation. I do not believe that we will ever reach a point in this country where we will have perfection in our banking legislation. We are, of course, in a changing economy and, looking over the past hundred years, we have found that no one has been able to develop a perfect system of money and banking; and I do not believe that this proposed legislation means that we have reached the millenium in banking and in dealing with our banking and money problems.

Mr. HOLLISTER. It comes down to the individuals who are running the thing, finally.

Governor ECCLES. What is that?

Mr. HOLLISTER. I say, it comes down to the individuals who are running the thing, finally.

Governor ECCLES. The individuals who are managing the enterprise are certainly a very important element in any private or public field of activity. The administration can go a long way toward either wrecking or making successful what is done under any legislation.

Mr. HOLLISTER. I asked that because there is a difference in philosophy of government. Some people say there is no need of checks and balances, if you can secure a race of supermen to run things properly. But there is no indication that we are going to have supermen running the banking system any more than in the past, no matter in whose hands it is put.

The CHAIRMAN. You mean there is no such thing as a benevolent despotism?

Mr. HOLLISTER. I think that is very well put. I think that question really answers itself.

With respect to the raising of rediscount rates, the strengthening of reserve requirements, and entering the open market, it has been stated by you and others, with a great deal of justice, that our trouble in the past has been that our so-called "great bankers" have not been equal to the emergency and have not foreseen what was to happen, or, if they did, they did not have the strength to take advantage of the machinery which was available to stop the inflation and boom. Realizing that these men were theoretically the best bankers of their time, are we going to be in any better position by placing the matter entirely in the hands of a Federal Reserve Board, appointed by the Chief Executive? What is there to indicate that the men so appointed, having these supreme powers, would be able to handle them any better than they were handled by the so-called "great bankers" of the past?

Governor ECCLES. There is a great difference between thousands of banks acting independently and a small board charged with the responsibility of monetary control. In the first place, the bankers acting independently have no way of expanding money, and they had no way of stopping the contraction of money, even had they so desired, because they did not have control over the issuance of money, such as is held by the Federal Reserve System. In other words, the independent, private, commercial bank is not a central bank charged with or having central-bank functions, neither has the Federal Reserve Board in the past been charged with the duty of creating business stability. I feel that certainly a board, if given the authority and charged with the responsibility for our monetary policy, is more likely to feel personally that great responsibility and to discharge its obligations and its duty in the public interest than we have had any reason to expect in the past of the banking system, as it has been constituted.

Mr. HOLLISTER. Do you not fear that—and this is a repetition of the question that I asked you a little earlier—that in the event the situation were to create a condition of continued deficits, a time arising when the floating of Government bonds became more and more difficult—would it not be almost impossible for the Federal Reserve Board, constituted as it would be under this bill, to refuse to cooperate with the Treasury in continuing a financial policy which independent bankers might deem was unwise?

Governor ECCLES. I think it would be extremely unfortunate for the bankers if a situation was reached where the Government, having a continuous budgetary deficit, was unable to get the cooperation and support necessary from the Reserve banks and the bankers; for the reason that it would probably mean, under those circumstances, the issuance of currency rather than bonds to pay for the budgetary deficits. It would mean the possibility of the Government taking over the banking system. As I stated the other day, it seems to me that a Congress that can appropriate money to carry out emergency needs, which create deficits, also has the power to create the means of providing that money, in case the existing private system fails to do it. Certainly we would not question that, if we were in war, and the private system failed to meet the demands of Congress in the emergency, the means would be provided otherwise. I think that, in the interest of the banking system, it is important and it is necessary that you have this cooperation in helping to finance the program of the administration in power.

Mr. HOLLISTER. You have just stated that Congress, of course, would have to use its various powers. That is admitted.

Governor ECCLES. Yes.

Mr. HOLLISTER. This bill, however, asks Congress to give to the Federal Reserve Board these powers, which is quite a different proposition; and I ask you whether it is wise to give these powers to a board which undoubtedly would have to be, to a great extent, controlled by the Executive. The question is whether we could afford to give these powers to follow a certain procedure which might be very unwise, from a banking point of view. If Congress were retaining its power, that would be quite a different matter, but it is not.

Governor ECCLES. If I understand your question, it is whether or not I think it is desirable that the Federal Reserve Board, or the Federal Reserve System should be in a position where it could finance a continuing budgetary deficit.

Mr. HOLLISTER. No matter how unwise it might appear.

Governor ECCLES. Yes.

Mr. HOLLISTER. That is, you understand the question?

Governor ECCLES. Yes.

Mr. HOLLISTER. Your answer to that is yes?

Governor ECCLES. Yes.

Mr. HOLLISTER. I meant to follow up the question asked you a little while ago. If the fate of any system depends ultimately upon men, whether or not it was not wiser to include checks and balances?

Has consideration been given to the fact that legislation might be so drafted that, in the event of a rise of a certain percentage in commodity prices or an expansion of deposits over and above commercial loans by certain proportion, or of stock prices, or of capital exports, that then there should be, automatically, rediscount raises, and the reserve requirements strengthened, and open market operations, so that the discretion is not as broad as this bill would give—almost unlimited discretion?

Governor ECCLES. It is not unlimited. The proposal which was made the other day as to what should be the objective confines the responsibilities of the Federal Reserve Board and places upon it a very definite obligation. The proposal was that it should be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability.

Mr. HOLLISTER. Exactly. I understand that. But the very point I am raising is that, because of the frailty of human nature, the Board either would not perform its duty or would not be able to do it, and is it not wiser to put some checks and balances in there? Would the Board be gifted with such insight that they would be able to tell——

Governor ECCLES (interposing). In the past, the Board had neither the authority nor the responsibility. That has been the trouble in the past.

Mr. HOLLISTER. The trouble in the past was not the lack of authority or responsibility. The trouble in the past was that they did not see what was coming. No one has intimated that the failure to check the boom was due to lack of authority or responsibility.

Governor ECCLES. I do not know; but certainly there were a good many people who thought they knew what was coming.

Mr. HOLLISTER. They were voices crying in the wilderness.

Governor ECCLES. However, I personally think it would be a great mistake to put into this bill rigid mandatory requirements that may be impossible of accomplishment; and, even if they are possible, they may not be desirable. Even if the attainment of certain mandatory requirements were desirable at the moment it may be that the conditions and circumstances would be such in a year or in 2 years or 3 years that these automatic controls would not be desirable at all.

Mr. HOLLISTER. I note that there has been stricken out in the proposed act subsection (c), section 12A of the Federal Reserve Act, which provides that:

> The time, character, and volume of all purchases and sales of paper described in section 14 of this act as eligible for open-market operations shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country.

What was the purpose of taking that out?

Governor ECCLES. Because we do not think that should be the objective of monetary policy. The provision that we are proposing to substitute for it, and which I think is much more desirable, as expressing what should be the objective, is the promotion of conditions conducive to business stability and the mitigation of unstabilizing influences in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

Mr. HOLLISTER. That is a pretty big order.

Governor ECCLES. I know. But simply to attempt to provide credit for agriculture, commerce, and industry does not meet the problem at all. Credit is now provided for agriculture, commerce, and industry.

Mr. HOLLISTER. If these powers are granted, if the bill should go through approximately in its present form, what powers of a central bank will the Federal Reserve Board not have, outside of its ownership of gold, or the right to change its value, of course?

Governor ECCLES. It will exercise all the powers of a central bank, so far as monetary policy is concerned, which is very desirable and very necessary.

Mr. HOLLISTER. That is what I am getting at. This bill really makes an entirely Government-controlled central bank.

Governor ECCLES. No; not an entirely Government-controlled central bank. The Federal Reserve System is not a Government-controlled system.

Mr. HOLLISTER. When this bill becomes effective, what powers are there, which the Federal Reserve Board, which is appointed by the President, and the Governor, who is subject to removal by the President—what power hasn't it got?—You say it has the power but is not governmentally controlled?

Governor ECCLES. No; it is not governmentally controlled.

Mr. HOLLISTER. You say it is not governmentally controlled?

Governor ECCLES. The members are appointed for 12 years.

Mr. HOLLISTER. It will be more governmentally controlled than it is at the present time.

Governor ECCLES. The Board will not be more governmentally controlled. The Board will be given more power. What I am contending for is not a governmentally controlled central bank at all. What I am contending for is a central body, charged with responsibility for monetary control, in the public interest. Now, whether it is the Federal Reserve Board or some other board is a thing for Congress to decide. But what I am advocating is that the power and the responsibility for monetary policy be placed in a central body that is charged with the public interest, and if it is felt that the Federal Reserve Board is a political board and will be dominated by political expediency, let us say, rather than public interest, in monetary policy, then, certainly, there should be some changes. But I do not think that the Federal Reserve Board under this legislation should be considered a body that will act in connection with its monetary policies, by reason of political expediency rather than in the public interest.

Mr. HOLLISTER. Is it not true, as a matter of fact, however, that, as a general rule, boards with limited terms, appointed by the Executive, are to a great extent under Executive control, particularly when the chief officer can be removed at will?

Governor ECCLES. I do not think that that is necessarily true. Twelve years is rather a long period for board members. I have suggested, in order to make the board members even more independent, that there be an increase in compensation for future appointive members, and that pensions apply to all members, if they are not reappointed. I think that would give them a degree of independence, under the provision which is suggested or provided for in this legislation.

Mr. HOLLISTER. That is all.

The CHAIRMAN. Well, gentlemen, it is 20 minutes to 1. I suggest that we meet again at 3 o'clock.

Mr. GOLDSBOROUGH. Just one moment. This is not a question of mine, but one of the members called my attention to it. On page 46 of the bill, at the bottom of the page, the second paragraph of section 16, it is said:

> Every Federal Reserve bank shall maintain reserves in lawful money (other than Federal Reserve notes or Federal Reserve bank notes) of not less than 35 percent—

And so forth.

At this time, what is that lawful money—what does it consist of? Do you remember?

Governor ECCLES. There is, first, the national-bank notes, which have just been called; and then there are the greenbacks, $346,000,000; and there are silver certificates. And there is coin, of course, the silver dollar and smaller coins.

Mr. BROWN. Gold certificates could be used also for that purpose.

Mr. GOLDSBOROUGH. Do you remember how much that amounts to—how much that reserve could amount to?

Governor ECCLES. Well, of course, the national-bank notes will soon be out.

Mr. GOLDSBOROUGH. Yes; I know that.

Dr. GOLDENWEISER. I can give you an answer in a few minutes.

Mr. GOLDSBOROUGH. Will you give us that later?

(Recess, 12:45 p. m. to 3 p. m.)

AFTERNOON SESSION

The committee reconvened at 3:15 p. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Tell us about the amount of money in circulation.

Governor ECCLES. According to Doctor Goldenweiser, the amount of lawful money outside of Federal notes was approximately $2,400,000,000.

The CHAIRMAN. This language excludes Federal Reserve notes and Federal Reserve bank notes?

Governor ECCLES. With the retirement of the national-bank notes, which have now been recalled, the amount of lawful money will be reduced to approximately $1,500,000,000.

The CHAIRMAN. Of what would that consist?

Governor ECCLES. Silver certificates——

The CHAIRMAN. How much?

Governor ECCLES. $702,000,000 the first of the year; silver dollars, $32,000,000; subsidiary silver, $309,000,000; and minor coin, $130,000,000; United States notes, $346,000,000. The national-bank notes, on January 1, amounted to $888,000,000, and Federal Reserve notes amounted to $3,520,000,000.

The CHAIRMAN. Federal Reserve notes are excluded?

Governor ECCLES. Yes. After the call of the national-bank notes, there will be $1,500,000,000 lawful money outside of Federal Reserve notes.

Mr. SISSON. I should like to clear up or correct a statement that I made this morning which has reference to an observation of Mr. Hollister. He made the statement, in substance, that it was well settled by the Supreme Court of the United States that the President has the power arbitrarily to remove any administrative or executive officer appointed by him. I want to modify that in this way: It is my understanding that in every instance where the question has been raised as to the power of the President arbitrarily to remove any executive or administrative officer appointed by him, where that question has been decided by the Supreme Court the Court has upheld the power of the President so to do. Mr. Hollister, very likely with some reason, says that is not settled. There is, of course, as we know, a case before the United States Supreme Court involving that question, which case has not been decided. My own opinion is that at any time that question is decided by the United States Supreme Court that power of the President will be upheld. In view, however, of the fact, that it is not entirely conceded, at least it seems to me, as the chairman this morning suggested, that it becomes of some importance to the committee to decide whether the language recommended by Governor Eccles in this bill should be contained in the bill. Therefore, that question does become of some importance here. It appears to me, aside from the reason that the chairman advanced, that it becomes of some importance to have it in the act, so that, in the light of experience, it might obviate a contest in the future. I think that any limitation upon the power of the President in this regard would be unconstitutional—that is, if we attempted to say that he shall not have the power—but for the reason stated by the chairman and also in the interest of clarity, as Governor Eccles has said, and also that it might obviate any question being raised about it in the courts, if we believe that this should be a national body in which there should be some unity of purpose between the administration and the body in control of the monetary policy, it seems to me that at least this committee should decide it while considering the bill. I myself favor the language recommended by Governor Eccles.

I think that is all I have to say.

The CHAIRMAN. Mr. Brown, do you desire to ask questions?

Mr. BROWN. I should like to ask Governor Eccles what the present policy of the Federal Reserve Board is relative to open-market operations.

Governor ECCLES. The open-market committee is composed of the 12 governors. The law recognizes it as their responsibility to intiate a policy and to submit recommendations to the Board for its approval, disapproval, or suggestions; so that the law as now constituted does not require the Federal Reserve Board as such to adopt an open-market policy; except, as I understand it, in giving their approval or disapproval to the policy initiated by the governors' committee, they are required to take into account the credit needs of agriculture, commerce, and industry.

Mr. BROWN. Under the present section B of 12–A you are given practical control of open-market operations, are you not?

Governor ECCLES. In the present law?

Mr. BROWN. Under present law.

Governor ECCLES. Under proposed amendments?

Mr. BROWN. No; under present law. Section B of 12–A provides that—

> No Federal Reserve bank shall engage in open-market operations under section 14 of this Act except in accordance with regulations adopted by the Federal Reserve Board. The Board committee from time to time shall constitute, adopt, and transmit to the committee and to the several Federal Reserve banks regulations relating to the open-market transactions of such banks and the relations of the Federal Reserve System with foreign-controlled or foreign banks.

It seems to me that the power to regulate there is the power to control. I addressed my question having in mind that you are asking us to vest complete authority which will be largely, I think to a greater extent than at present, under the control of the Federal

Reserve Board; and I think it would be interesting to Members of Congress, and particularly to this committee, to know what your policy would be under present conditions. I assume it is the same policy we have at the present time.

Governor ECCLES. I cannot speak for the Federal Reserve Board as to what the policy of the Board would be if this legislation is enacted. That would naturally be a matter that the Board would have to determine.

Mr. BROWN. Do you not think it is fair for us to ask what you would do if given this power under present conditions? It seems to me that we ought to know, that Congress ought to know your attitude as chairman of the Board.

Governor ECCLES. I can speak only for myself with reference to the matter. I cannot speak for other members of the Board, who would be just as independent in exercising their judgment as I would try to be.

Mr. BROWN. When I say "your" I am referring directly to you.

Governor ECCLES. Yes; I understand. Under present circumstances there is very little, if anything, that can be done.

Mr. GOLDSBOROUGH. You mean you cannot push a string.

Governor ECCLES. That is a good way to put it, one cannot push a string. We are in the depths of a depression and, as I have said several times before this committee, beyond creating an easy money situation through reduction of discount rates and through the creation of excess reserves, there is very little, if anything that the reserve organization can do toward bringing about recovery. I believe that in a condition of great business activity that is developing to a point of credit inflation monetary action can very effectvely curb undue expansion.

Mr. BROWN. That is a case of pulling the string.

Governor ECCLES. Yes. Through reduction of discount rates, making cheap money and creating excess reserves, there is also a possibility of stopping deflation, particularly if that power is used combined with this broadening of eligibility requirement.

Mr. BROWN. Does not a Federal Reserve bank have two main functions? Eliminating the temporary loans we provided for last year and other various forms of aid to all banks and industries, are not the main functions of a Federal Reserve bank, first, rediscounting of paper turned in by the member banks?

Governor ECCLES. Eligible paper.

Mr. BROWN. And, secondly, to engage in open market transactions, which, as I understand, relates to the buying of warehouse certificates and other evidences of property back of indebtedness throughout the country as a whole and not confined to the particular Federal Reserve district?

Governor ECCLES. It is largely the purchase of Government bonds.

Mr. BROWN. Do you not engage in the purchase of warehouse certificates?

Governor ECCLES. Bankers' acceptances.

Mr. BROWN. Sometimes you do and sometimes you do not. Is not that a question which the open-market committee decides whether you shall engage or not in that line of work?

Governor ECCLES. The open market committee determines whether or not it shall purchase or sell Government bonds and bankers' acceptances.

Mr. BROWN. Under section D of 12-A of the present law you cannot compel a particular Federal Reserve bank to engage through your open-market committee or Federal Reserve Board in open-market operations, can you?

Governor ECCLES. That is right.

Mr. BROWN. Under the proposed bill is it your idea that such authority will vest in the open-market committee?

Governor ECCLES. That is right.

Mr. BROWN. In other words, you feel that it is proper for the Federal Reserve Board to say to a Federal Reserve bank that it shall engage in the purchase of Government bonds and bankers' acceptances?

Governor ECCLES. That is right. The way it is done is through the system account. The holdings are largely prorated to the banks in relation to their size and their own reserve situations.

Mr. BROWN. Under the second portion of the present bill, section 12-A, it really does not seem to me that it gives you authority to compel banks to engage in open-market operations. I do not find anything in there requiring them to do so. It says that "they shall conform open market operations to the provision hereof." I do not think it provides that they shall engage in open-market operations against the wishes of their own board of directors.

Do I understand that you have proposed an amendment to section 205?

Governor ECCLES. Do you mean additional amendments to the bill that was introduced?

Mr. BROWN. Yes.

Governor ECCLES. Yes.

Mr. BROWN. Is there any language in your amendments that makes it obligatory upon the Federal Reserve banks to engage in open-market operations if they do not want to do so.

Governor ECCLES. It was expected in the original legislation that, where there was a committee of five proposed, the governor and two other members of the board, and two governors of reserve banks, the reserve banks would be required to participate in the purchase of securities or bills as determined by the open-market committee.

Mr. BROWN. Does your general counsel think that the language of the act as you propose is sufficiently broad to enable the Board to so command the Federal Reserve banks? It does not seem so to me. If it is desirable that such an authority should be effected, I think the language of the bill should be broader.

Governor ECCLES. It was intended to be; whether it is or not I do not know.

Mr. WYATT. The bill as introduced contains this language, on page 45, lines 3 to 9: "The committee from time to time shall consider, adopt, and transmit to the Federal Reserve banks resolutions setting forth policies which, in the judgment of the committee, should be followed with respect to open-market operations of the Federal Reserve banks, and the Federal Reserve banks shall conform their open-market operations to the provisions thereof." That means that the

Federal Reserve banks must conform their open-market operations to the provisions of the resolutions adopted by the committee.

Mr. BROWN. Suppose the bank says, "We have only sufficient funds, in our judgment, to take care of the necessary rediscounting of our own member banks and we do not desire to engage in open-market operations." Is there anything in that law to compel them to so engage in open market operations?

Mr. WYATT. Suppose that the committee adopts a resolution directing that the banks shall purchase a billion dollars worth of Government bonds and that each bank shall buy its pro rata share of such bonds. How can they conform to the provisions of that resolution without each bank buying its pro rata share?

Mr. BROWN. By simply refusing to engage in open-market operations and confining their business to rediscounting with its own member banks. That is a logical conclusion, I believe.

Mr. WYATT. I think the point you raise is a good one and that the bill should be clarified so as to eliminate any doubt on the point.

Governor ECCLES. The intention is to make it mandatory, otherwise it would be impossible effectively to carry out any monetary policy.

Mr. BROWN. I do not mean to say that I approve the policy, because I am inclined to agree with some things Mr. Hollister indicated this morning, among them being that such control of Federal banks and district banks is more than we ought to give. I want to point out that it did not seem to me that your statement at the beginning of these hearings said it was desirable.

Governor ECCLES. It seems to me that when we speak of centralizing control outside of the banks we fail to recognize the peculiar structure of our Federal Reserve banking system as contrasted with central banks elsewhere in the world. If we had here, which may have been the more desirable arrangement, one bank with 12 branches, or as many branches as may be necessary to serve the country, then the board of directors would be charged with the responsibility of the monetary policy as well as the responsibility of providing credit to business, agriculture, and industry.

Mr. BROWN. Instead of that kind of system we have 12 separate, distinct banks.

Governor ECCLES. Yes.

Mr. BROWN. With 12 different capital set-ups varying in amounts of surplus.

Governor ECCLES. Capital and surplus do not determine the ability to lend or to participate.

Mr. BROWN. It determines the amount of money they have available.

Governor ECCLES. No; they create money.

Mr. BROWN. Only based upon the assets?

Governor ECCLES. Only based upon the gold limits.

Mr. BROWN. So that you are attempting here to give such control to the Federal Reserve Board similar in authority to that of a board of directors over one bank with 12 branches?

Governor ECCLES. But, actually, so far as open-market policy is concerned, if we recognize the need of a monetary policy, it must be carried out in the public interest. It cannot be left to the 12 banks, acting independently.

Mr. BROWN. I grant that. But I do not agree with you that your control relates only to open-market operations. You are establishing under this law, or, at least, you are given the right to establish, general rules for the eligibility of paper for discount.

Governor ECCLES. That is correct; but that does not mean that the Federal Reserve Board has anything to do with the passing upon the loans which are made. The Board has only the responsibility of making rules and regulations with reference to the conditions under which Federal Reserve banks can rediscount for or lend to member banks; and its power is strictly limited, according to the present statutes, to permit loans only upon certain specific types of paper, of which there is very little in existence.

If the Board were given more discretion, the system would become more flexible. The proposed amendment in no way gives the Board power to compel the Reserve banks to make the loans. It is expected that the Reserve banks will be just as independent as they have been with reference to their autonomy in matters of regional interest.

Mr. BROWN. Principally rediscounting?

Governor ECCLES. Not only in rediscounting, but also in all relations with member banks. The examinations are all conducted through the Reserve banks. The Federal Reserve Board depends upon the Reserve banks to carry on all of the relationships with the member banks and with the communities. We are only providing here for the placing of responsibility in a comparatively small body that can be charged with the public interest, to deal with monetary policy. That seems to me to be absolutely essential, if we expect to avoid in this country the dangers inherent in a purely banker control over the creation and the extinguishing of credit. We have had experience with that, and we know that it does not work very satisfactorily. Whether it will work any differently under the proposed arrangement, time alone will determine. But it does seem to me that to deal with the monetary needs of a Nation on other than a national basis and with any other purpose than that of serving the public interest is to invite disaster.

Mr. BROWN. In that connection, I note that by section 208 of the pending bill, you repeal the provisions of the banking law, I think, of 1933, by which we authorized the issuance of Federal Reserve notes based upon the eligible paper that had been turned over to the Federal Reserve banks by the member banks. And it was under the authority of that section that the President recently extended the right so to do from March 3, 1935, on for 2 years. That was done 2 or 3 weeks ago, was it not?

Governor ECCLES. That is right.

Mr. BROWN. Now you are repealing that provision of the law?

Governor ECCLES. That is right.

Mr. BROWN. And you propose to substitute section 16 of the law, I presume, where the Federal Reserve Board have practically complete control of that matter of the issuance of new money. Is that right?

Governor ECCLES. As I understand what you mean, the Emergency Banking Act referred to permitted the Federal Reserve banks to secure Federal Reserve notes with Government bonds, in addition to commercial paper. The period of time during which that could be done was extended, very recently, for a period of 2 years.

Mr. BROWN. That is right. Governor Eccles, not only Government bonds, but notes, bills of exchange, and acceptances were eligible as collateral for the issue of Federal Reserve notes, were they not?

Governor ECCLES. Yes; that is right.

Mr. BROWN. Now we are repealing that section of the law.

Governor ECCLES. Because we are making it unnecessary to put up any collateral with the Federal Reserve agent for the purpose of securing Federal Reserve notes. It adds nothing whatever to the value of the notes, as I have explained here on several occasions; and it is an unnecessary requirement. No central bank requires it except that it is still adhered to in the Bank of England; but no other bank in the world requires it, and the amount of Federal Reserve notes that are used has no relationship whatever to the collateral requirement. Federal Reserve notes may be required in great amount when there are practically no discounts. The amount of the rediscounts by member banks with the Reserve banks has no direct relationship to the amount of Federal Reserve notes required. Only the people of the country can determine the amount of currency is required by the drawing of currency instead of checks.

Mr. BROWN. It seems to me that there is a considerable disagreement upon that matter of policy. We specified in the Banking Act of 1933 certain types of commercial paper that were eligible as collateral for the issue of Federal Reserve notes, the issue of new money. Now, you repealed that, and, under section 16, you cover it all by one sentence: "Federal Reserve notes shall be issued and retired under such rules and regulations as the Federal Reserve Board may prescribe and shall be legal tender for all purposes." Now, is it not a fact that when people borrow money from banks it shows that they are engaging in business, that they need credit? Their notes are turned over to the Federal Reserve banks and money issued.

Governor ECCLES. No.

Mr. BROWN. It was under the Banking Act of 1933.

Governor ECCLES. No currency is issued as a result of that transaction at all.

Mr. BROWN. I am glad to hear that, because we have heard a great deal over in the House about money being issued. You say there is none issued?

Governor ECCLES. No. The borrowing by a member bank from the Federal Reserve bank does not determine the amount of currency that the member bank or the banks as a whole or the public as a whole may require or use.

Mr. BROWN. Well, was not that law passed for the purpose of supplying the need of banks for currency to pay their depositors when they demand it?

Governor ECCLES. No; 40 percent of the amount of notes outstanding must be secured by gold certificates and 60 percent was required to be secured by commercial paper. As a matter of fact, there was so little commercial paper that it was impossible to provide the 60 percent; and therefore at one time there was over a billion dollars of gold, in addition to the 40 percent gold reserve, that had to be used as a substitute for the lacking commercial paper. In other words, it was used to help make up the 60 percent; because there was not sufficient commercial paper available. There is not the quantity of commercial paper in the country upon which to——

Mr. BROWN (interposing). How about the individual banks? Let us take a bank with a capital of a million dollars and a deposit liability of 10 million dollars, and it has commercial paper that would be eligible under this section of the Banking Act of 1933. I think this committee supposed that if that bank wanted to convert that commercial paper into cash it would be able to do so.

Governor ECCLES. It still can do it under this. There is no change in the law proposed that prevents that. That bank can still go to the Reserve bank and can take that commercial paper and can get credit in its reserve account with the Reserve bank and can draw down currency to the extent that it needs——

Mr. BROWN. That is, by rediscounting its notes?

Governor ECCLES. Or, as we are proposing here, if it has not the eligible paper and it has other sound assets.

Mr. BROWN. I may be dense on this, but it seems to me that you are throwing out the basis for the issue of currency by issuing currency upon the resolution of the Federal Reserve Board instead of basing the issue upon the assets that are in the vaults of the member banks of the country and the demand for money on the part of the depositing public.

Governor ECCLES. Let me explain that again.

The Federal Reserve banks have two kinds of liabilities—three with their capital and surplus: Deposit liability, note liability, and the capital and surplus liability. Loans and discounts and investments, lawful money, and gold certificates are the assets of the Reserve banks.

The member banks which carry their reserves with the Reserve banks ask the Reserve banks for currency only to the extent that they have deposits with the Reserve banks. They must maintain a minimum reserve balance with the Federal Reserve banks, and when they want currency they must acquire additional balances to which they can charge the currency withdrawn. In order to get that, they may send paper to be discounted with the Reserve banks.

The member banks supply currency to their customers, to their depositors, when the depositors want to draw out their deposits, or a portion of them, in currency; and if a bank reaches a position where the customers have called upon the bank for currency and it is unable to meet that call, that bank closes. Many of the banks in this country were unable to meet that call, not because they were not sound but because they did not have the eligible paper with which to go to the Reserve bank and get credit; and therefore, because of the fact that the banks were unable to do that, those banks were compelled to close.

As the number of banks closing increased, the demand for currency increased, not because of the activity of business but because of hoarding; and the very fact that the banks were unable to go to the Reserve banks with sound assets to meet the demands of these depositors meant finally a banking collapse. Had the banks been able to pay their depositors in currency, the depositors would not have wanted the currency, as was demonstrated after the bank holiday.

Mr. BROWN. Does it not come down then to this question, or to this situation: That the reason for the collapse of the banks that were actually solvent, but that had so-called "frozen assets" or "frozen loans"——

Governor ECCLES (interposing). Deflation created a frozen condition.

Mr. BROWN. But it was a lack of liberality in regard to the eligibility of paper for rediscounting that caused a good deal of the distress.

And, by your next section, 206, you seek to liberalize those rediscounting rules?

Governor ECCLES. That is right.

Mr. BROWN. Now, that brings me to the meat of my discourse, What are those rules going to be? That is the same question I asked you regarding the open market operations. I think this committee and this Congress ought to know what your own idea, Governor Eccles, is and what those rules of eligibility are going to be. I recognize that the law sets a standard as to real-estate loans.

Before you make your answer let me get one of my favorite objections to Government practice in the past with regard to those notes stated on the record. I am thinking of a small national bank in the country. Now, the Comptroller's office has a rule by which certain collateral listed on the New York Stock Exchange, or other large exchange, is recognized as collateral and the paper which that collateral secures is eligible for loans. We have tens of thousands of small manufacturing concerns, whose securities are good, but which are not listed upon the New York Stock Exchange or the Detroit Stock Exchange or the Chicago Stock Exchange, or any other large exchange. Their statements show them to have plenty of cash assets back of those securities. But, because of the rules of the Comptroller's Office—and I am not very familiar with the examination made by the Federal Reserve banks, but I presume they are the same—the collateral of those small concerns does not stand nearly as well for loans as does the stock of large concerns. Now, it seems to me that that condition is unfortunate for the small banks and the small businesses; and I am wondering, with respect to that situation, whether or not there is going to be any liberalization regarding the eligibility of that type of paper as collateral for loans rediscounted with the Federal Reserve banks.

Governor ECCLES. The matter that you refer to has reference to the treatment of certain types of loans in banks by the Comptroller's office.

Mr. BROWN. Well, and by the Federal Reserve Board's examiners.

Governor ECCLES. The Federal Reserve Board's examiners accept the Comptroller's examinations for all national banks. They make no independent examinations. That would be only a duplication. The Comptroller's examinations are accepted by the Federal Reserve banks.

Mr. BROWN. That would apply to thousands of member State banks.

Governor ECCLES. There are only 900 State banks, and these are examined by the Reserve banks. But there is no prohibition either under the law or in the regulations, to my knowledge, against banks making loans secured by other than listed collateral, either stocks or bonds.

Mr. BROWN. You say there is none?

Governor ECCLES. There is no prohibition either in the regulations or in the law against them.

Mr. BROWN. There is in the practice.

Governor ECCLES. No; not in practice.

Mr. BROWN. I disagree with you.

Governor ECCLES. There is none in practice. The question is, of course, to establish values back of loans which are secured by unlisted collateral. Now, if collateral is listed it becomes much easier to establish whether or not that particular loan is adequately secured than is the case where the loan is secured by some local security that it is very closely held and has no market ability. It becomes difficult for an examiner to determine whether or not a loan is adequately and safely secured for that reason, but——

Mr. BROWN (interposing). Governor Eccles, don't you know it to be a fact that, with regard to the bonds of concerns throughout the country, the Comptroller's office has refused to approve bonds that are not listed on the New York Exchange or some other large exchange so as to be readily marketable?

Governor ECCLES. Refused to accept them for what?

Mr. BROWN. As loans.

Governor ECCLES. To secure loans?

Mr. BROWN. Yes.

Governor ECCLES. There is no prohibition in the law.

Mr. BROWN. There is no prohibition in the law, but the practice is to decline to approve such loans.

Governor ECCLES. There is no such requirement.

Mr. BROWN. What I am wondering is if you are going to be a little more liberal on this?

Governor ECCLES. I know that there are literally thousands of bond issues, municipal issues, all kinds of issues, which are held by banks; and, so long as those bonds are not in default, and their payments are being met——

Mr. BROWN (interposing). I will except municipal bonds.

Governor ECCLES. There is no restriction or prohibition against the holding of those bonds. It is true that the examiners make an effort to establish the value back of them, in the absence of a quoted market, which is very desirable and necessary, in order to determine whether or not the loan which the bonds or stocks secure, or the bonds which are held directly, are worth what they purport to be worth.

Now, in the case of a local stock issue or local bond issue, there is, naturally, the problem of attempting to determine the value of that security.

I know, in my own banking experience, over a period of 20 years, that we have had no trouble with the Comptroller's office with reference to matters of that sort; and many loans have been made on local securities, and various bond issues have been purchased that were not listed. The main thing is to have available and be able to give to the examiner information with reference to the local company whose stock is put up as collateral or whose bonds are put up as collateral. Such information is necessary to establish the value of the collateral which secures the note in question.

I find that most of the trouble is that in accepting local securities, stocks or bonds, banks fail to provide sufficient information to enable the examiners to substantiate the value of the securities which they have taken. It is lack of information.

Mr. BROWN. I want to say to you that it is my judgment, then, that the attitude of the Comptroller's office has been very much more severe in the Chicago district than it has been in the San Francisco district or the Salt Lake City district, because that rule was enforced when the banks were reorganizing in Michigan and Ohio in 1933 and 1934; and they did insist that those bonds be listed bonds.

I am glad that you have stated in the record what I think is a more liberal policy regarding local stocks as collateral, as well as local bonds.

I have two or three other questions, but I would like a little further answer to my question as to what other classes of paper, in your judgment, the Federal Reserve Board should determine to be eligible paper, for rediscount in the Federal Reserve banks.

Governor ECCLES. It would be my personal opinion—I cannot speak for the Board—that very broad rules and regulations should be made with reference to this subject and that a broad discretion should be left to the Federal Reserve banks. I think that, in matters of local credit concerning each Federal Reserve district, if they are given discretionary power, the Federal Reserve banks can be relied upon to make only sound loans; and I do not think, as a practical matter, that there should be a lot of limitations and restrictions with reference to what may be considered sound paper.

Mr. BROWN. Well, for instance, as I understand it, 3-months' paper has been rediscounted, one renewal allowed, and after that it was taken out of the class of commercial paper that was eligible for discount. That was a general rule in the Minneapolis and Chicago districts and always enforced. Now, that was a general rule, whereas there are a great many businesses that take a year for a turnover; and they were limited there to 6 months' credit. Now, would your own personal disposition be to so liberalize the rule, if what I say is true of that, so that paper for 9 months or 12 months could be taken?

Governor ECCLES. I would not like to say, under normal conditions, that paper should be taken on a bills-payable basis, for longer than a 6-months' period, because it is always an easy matter to renew the paper.

Mr. BROWN. Well, what would you say?

Governor ECCLES. That would be up to the Reserve banks, the question of renewal would be up to them. Certainly it would be bad for the banking system as a whole to permit continuous borrowing from the Reserve banks by the member banks. Continuous borrowing from the Reserve banks by the member banks could only mean that the member banks were lending money and rediscounting or borrowing because of the difference in the rate that they paid the Reserve banks and the rate at which they were able to loan. However, I can well imagine a situation where you would have a crop failure, drought conditions, catastrophes, and so forth, where it would be very necessary for the Reserve banks in those areas not to expect liquidation in that particular area; and it would be desirable to carry the loans over for an additional time. Past experience and the attitude of member banks toward borrowing indicate that we can be assured that member banks are not going to borrow from the Reserve banks except for short, seasonal periods of time, unless an emergency develops, which may require that they borrow for longer periods of time; and that is the purpose of this legislation.

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Mr. BROWN. But I am talking about the small business man now. It happens that in my district, in one of the large resorts of Michigan, the practice in the merchandising business there is for a merchant to buy his goods in December. If he can pay for them then he gets a substantial discount. He will not get his return on the bulk of those goods until the following August. Now, it seems to me that it is just as legitimate for that purpose to get a 9 months' loan, in that type of business, as it is in certain other types of business, where the turnover is made in 3 months, as it is in the grocery business; and that he should be accommodated for the 9 months' period. Now, do you have in contemplation, when you lay down these rules and regulations for eligibility, such a situation, and that the normal course of a business of that character should be accommodated?

Governor ECCLES. There is nothing to prevent the individual banks from making loans of that sort today.

Mr. BROWN. I am talking about rediscounts.

Governor ECCLES. Of course, there is not any rediscounting today. There are excess reserves of tremendous amounts.

Mr. BROWN. There is, of course, in some banks.

Governor ECCLES. That is true of the country as a whole. There is practically no borrowing from the Reserve banks, and most banks have excess reserves. In addition to that, if they had to borrow, they would borrow on their Government bonds; because they would be the easiest assets upon which to borrow.

Mr. BROWN. Well, I take it that, on all these questions, you are very much adverse to stating what, in your judgment, the policy of the Federal Reserve Board will be in regard to the rediscounting of paper.

Governor ECCLES. I think——

Mr. BROWN (interposing). But, with the utmost good humor, I do not think you have told me yet of any particular liberalization that you propose to make in the rediscounting rules.

Governor ECCLES. Rediscounting rules today are not made by the Board.

Mr. BROWN. But they will be under this bill, if it becomes a law.

Governor ECCLES. Yes; but the law today states that only certain specific types of paper, which are known now as eligible, short-term, self-liquidating paper, are eligible. Now, this proposed legislation broadens the power to a point where the Reserve Board is able to make rules and regulations which will permit Reserve banks to make advances against any sound assets.

Mr. BROWN. What I am trying to find out is, what is your idea as to what they should do?

Governor ECCLES. I would leave that up to the Reserve banks. I would favor broad enough rules to leave discretion to the Reserve banks in passing upon credit. You might put a limitation of 6 months advances on a bills-payable basis. To make rules and regulations in Washington as to what would be adequate security for advances to member banks would be rather a complicated procedure and would certainly be inadvisable and unnecessary.

Mr. BROWN. But the banks are given the authority, under the law, to make those rules and regulations.

Governor ECCLES. Which banks?

Mr. BROWN. The Federal Reserve banks and the Federal Reserve Board are given that authority.

Governor ECCLES. That is right.

Mr. BROWN. To determine the maturities and other matters.

Governor ECCLES. That is right.

Mr. BROWN. Now, what I am trying to find out is what your present attitude is toward the eligibility of the various classes of paper.

Governor ECCLES. I am just saying that I would permit the Reserve banks to loan on any and all assets, real-estate mortgages, collateral loans, bonds, or other assets, which they considered sound, on such a basis as they considered sound.

Mr. BROWN. And with what maturities?

Governor ECCLES. My personal opinion, without giving any thought or study particularly to the problem, would be that 6 months advances on a bills-payable basis should be adequate. That does not necessarily mean that a bank, at the end of 6 months, could not renew for another 3 months or 6 months. But I do not believe that, on a bills-payable basis, for advances, that 6 months would be working any hardship upon the banks.

But in case of a rediscount, you would have maturity based upon what would be considered the period of natural liquidation. For instance, agricultural and livestock loans are 9 months, as it is considered that the underlying transactions take that length of time. Those are rediscountable now. Collateral loans, loans which are not considered rediscountable and are not self-liquidating, through the completion of business transactions, such as loans against mortgages or loans against bonds, would likely only be made in cases of emergency, in cases of deflationary situations, and they would not be made in the natural course of business except to a very limited extent. Certainly, the Reserve bank should be given the power to enable a bank that has an unusual shrinkage of its deposits, and yet has sound assets, to get credit on them until it can carry out a normal process of liquidation, without closing and without bringing about an undue deflation. That is the purpose of this legislation.

The CHAIRMAN. And you mean sound assets made within the limitation of the law establishing the rules under which those loans should be made?

Governor ECCLES. Yes.

The CHAIRMAN. In other words, if the borrowing bank had made those loans within the law?

Governor ECCLES. That is right.

Mr. BROWN. Now, getting back to commercial paper—expressed in my poor way—should not the rule be that the discount should be permitted for such length of time as would cover the normal period from production to sale of the goods?

Governor ECCLES. I think that is what is contemplated under the law now.

Mr. BROWN. Personally, I would like to have you say that you feel that way about it yourself. In other words, that you feel that that is the kind of rediscounting that you, as a member of the Board, would favor.

Governor ECCLES. You mean in case the Board is making rules with reference to rediscounting?

Mr. BROWN. Yes.

Governor ECCLES. What do you have in mind, what particular item?

Mr. BROWN. Let us take something that you and I know something about. Suppose we did not have the system of handling sugar by warehouse receipt. It takes from September, generally, to August, in Michigan, to bring about the cycle from payment to the farmer for the production of sugar beets, to the final payment for the sugar and collection. Now, it seems to me that the period of discounts should be that length of time and that notes for that period should be eligible for rediscount.

Governor ECCLES. Do you mean on a straight bills-payable basis?

Mr. BROWN. Straight bills-payable basis; yes.

Governor ECCLES. As a general rule, manufacturing companies, such as sugar companies and other companies, borrowing from the banks, seldom want to borrow for a period longer than 6 months, or, maybe, even 90 days, because they are constantly reducing the outstanding loans.

Mr. BROWN. That is right.

Governor ECCLES. And they do not know exactly by what amount they are going to be able to reduce it; and, hence, they do not want to rediscount up to the maximum amount of the financial requirements for a period of 9 months, because it may be that they can pay a substantial amount in 3 months and renew the balance. I believe that, even if a 9-month rediscount were permitted in that type of transaction, there would be very few that would use it.

Mr. BROWN. But you might find one fellow that would want to do it.

Governor ECCLES. I see no objection to that, if the condition of the company is such that an open line of credit is desirable, and they were willing to borrow for 9 months, and the bank should take 9 months' paper. There would be no reason for the Reserve bank not taking such paper as quickly as they would take livestock paper.

Mr. BROWN. In other words, you feel that no such rule should be established by the Federal Reserve Board as would prevent the taking of paper having such maturity or length of time as would cover the normal period from production to final consumption, sale, and collection.

Governor ECCLES. It would seem to me that that should be permitted. If a borrower wanted to borrow for that length of time and the credit was good credit, and the member bank was willing to accept that type of credit as being self-liquidating commercial credit, there should be no objection and the Reserve bank should be permitted to take that type of loan from the member bank.

Mr. FORD. Governor Eccles, you used the phrase there "good credit." Now, is not the Federal Reserve bank in a district, when a member bank comes to the Reserve bank with its assets, going to be reasonably certain that the assets offered are sound?

Governor ECCLES. I think there is no question about it.

Mr. FORD. Then, I think that the question that Mr. Brown brings up is largely a matter of local prestige, based on the actual knowledge of the member bank that makes the original loan, of the soundness of the person who makes the loan, and it can back him up if it has to go to the Federal Reserve bank.

Mr. BROWN. Up to the present time they have held them down to the 3-months' period, which I think is too short.

Governor ECCLES. I think that is largely due to the member banks, rather than to the Reserve banks. The member banks prefer 90-day paper, because they have seen in the past the very wide fluctuation in the value of commodities against which they loan. In loaning for a period of 9 months on any commodity, there is room for very wide fluctuations in prices; and it is my belief that the member bank passing on the credit, for its own protection, will adhere to 90-day paper, and renew; because, after all, even if it borrows from the Reserve bank, it is responsible for the obligation, and the Reserve bank is not making the loan directly to the original borrower.

Mr. FORD. Would there be anything wrong with this type, or would there likely be a refusal to discount this type of paper: A man borrows $20,000 for 90 days; at the end of 90 days he pays $8,000 back; there is still $12,000 left. An emergency arises, where the local bank has to go to the Federal Reserve bank to rediscount; would there be anything against that remaining $12,000, if it were sound, if it is part of the renewal note?

Governor ECCLES. Not the fact that it is a renewal note.

Mr. FORD. Does it not give it the status of the original?

Governor ECCLES. Yes. In fact, that is what is usually done with commercial paper. It is paid off by renewals.

Mr. BROWN. The rule has been in the Minneapolis district, at least, that they would allow one renewal, and at the end of 6 months you would have to pay back.

Governor ECCLES. The member banks did that.

Mr. BROWN. The member banks would.

I want to discuss with you just a moment a subject that I took up with Mr. Crowley, Chairman of the Federal Deposit Insurance Corporation, this matter of bank examinations. It seems to me that we have too many governmental authorities examining banks. We have 3 at the present time, and 4 if we include the Reconstruction Finance Corporation, which, I grant, is a temporary organization. We have the Federal Reserve banks, the Comptroller's Office; the Federal Deposit Insurance Corporation has now asked for authority, in the present bill, to examine national and member State banks.

I want to ask first if the Federal Reserve Board has followed the policy of appointing only such examiners as are designated by the Comptroller of the Currency? Now, I will explain that. Under the first section of the law on bank examinations, it appears to have been the policy of the act to require that Federal Reserve bank examiners should be designated by the Comptroller of the Currency. Then, under a section or so later, it is provided that the Federal Reserve authorities themselves may designate examiners.

Now, what I am wondering is whether the general practice has been to get examiners designated by the Comptroller of the Currency or to use the authority conferred in the second portion of the law, which is section 483 of the United States Code, annotated. The first section I referred to is section 481.

Governor ECCLES. I cannot speak as to what the Reserve Board may have done in the past. I am not familiar with it. But it is my understanding that the Federal Reserve Board chooses its own examiners entirely. The Examining Division of the Federal Reserve Board deals, of course, with the member State banks. The Comptroller's examinations are accepted for national banks.

Mr. BROWN (interposing). For the national banks?

Governor ECCLES. There is no point, of course, to duplications of examinations.

Mr. BROWN. Well, am I right in assuming, then, that the Comptroller is not examining member banks of the Federal Reserve System who are not national banks?

Governor ECCLES. That is correct. They are not examining them, and the Federal Reserve Board is not examining the national banks.

Mr. BROWN. No.

Governor ECCLES. The examination reports are available and are given to the Federal Reserve banks, so that they can get any and all information that they desire from the Comptroller's office, with reference to national banks, which, of course, are members.

Mr. BROWN. The statute says that the Comptroller of the Currency shall appoint examiners who shall examine every member bank. Evidently the law is not being followed in that respect. I do not have any objection to it.

Governor ECCLES. Do you know whether that question has ever come up, Walter?

Mr. WYATT. The original Federal Reserve Act required the Comptroller to examine all members banks; but section 9 was amended by the act of June 21, 1917, so as to say that State member banks shall not be subject to examination by the Comptroller of the Currency but shall be subject to examination by examiners selected or approved by the Federal Reserve Board.

Mr. BROWN. You will find, two sections later, that special examinations are provided for by the Federal Reserve Board, but I do not believe that the first section was ever repealed. But that is an academic question; I am not particularly interested in that. But I believe that the examinations should be conducted by 1 bureau of the Government and not by 3.

Governor ECCLES. So do I.

Mr. BROWN. And I think it is a good time to change the law in that respect. The expense of the Government examination of the bank is borne by the bank?

Governor ECCLES. It is.

Mr. BROWN. Not only the examination by the Federal Reserve Board but the examination by the Comptroller's office?

Governor ECCLES. That is right

Mr. BROWN. Take a community having 3 banks, 1 a national bank and 2 member State banks, and you have a great deal heavier expense upon that bank by reason of a trip by the national bank examiner and then a subsequent trip for the examination of the other 2 banks by the Federal Reserve bank examiner; and it seems to me that it is an unjust and unnecessary expense upon the banks.

Now, the Federal Deposit Insurance Corporation is the only all-inclusive bureau with respect to the examination of banks in the Government, is it not?

Governor ECCLES. I do not understand that the Federal Deposit Insurance Corporation was given the power to examine national banks.

Mr. BROWN. Yes; it is under this bill. They may, with the consent of the Comptroller of the Currency and with the consent of the Federal Reserve Board, examine any bank.

Governor ECCLES. Yes.

Mr. BROWN. National banks or member State banks.

Governor ECCLES. Yes.

Mr. BROWN. I say "an all-inclusive bureau", with respect to the examination of banks, because of the fact that they, of course, include all national banks, all member banks in the Federal Reserve System, and a great many nonmember banks; in fact, all nonmember banks which are in the Federal Deposit Insurance Corporation. That is a fact, is it not—that they cover them all?

Governor ECCLES. They cover them all.

Mr. BROWN. And the only banks in the country that they do not cover are the uninsured banks, which are very few in number?

Governor ECCLES. That is correct.

Mr. BROWN. I think I will close that part of the discussion by this: I understand that you, yourself, feel that it would be best if we could have one examining authority to examine all the banks of the country.

Governor ECCLES. Let me first state that the existing duplication is not as serious as it appears on the face of things. The Reconstruction Finance Corporation make no examinations, as a regular thing. The examinations they made were in connection with subscriptions to preferred stocks and debentures; and those examinations were made only once, at the time they were determining their investment in the capital stock of the particular bank.

Mr. BROWN. And, to be perfectly fair, I understand now that they are not making even that examination. They are accepting the other examinations.

Governor ECCLES. That is right; and they have always accepted the other examinations, except in very important instances, where a great deal of money was involved and there was a good deal of question about the bank.

The Federal Reserve Board only examines the member State banks. Their examinations are usually made along with the State banking examinations, so as to avoid duplication. The Comptroller's office examines all national banks. No other agency examines national banks. The Federal Deposit Insurance Corporation makes no examination of national banks and makes no examination of State member banks but examines the nonmember State banks, along with the State banking departments, so as to avoid duplication there, so that there is really not the duplication in actual examinations that would appear on the face of things.

However, there is, of course, a division of the examining authority between the 48 State banking departments, with reference to State banks, and the Comptroller's office with reference to the national banks, and the Federal Reserve with reference to the State member banks, and the Federal Deposit Insurance Corporation with reference to all banks. There is not any question that you would get a much more general unification of the policy in making examinations if the examining were all done under the direction of one organization.

Mr. BROWN. You certainly would eliminate the duplication of organizations.

Governor ECCLES. That is right. You would eliminate the duplication of organizations, more than duplication of examinations.

Mr. BROWN. Or, we might say, triplication of organizations.

Governor ECCLES. Yes, sir; you would do that; and you would make, probably, for a greater unity of examination policy, which has been very sadly lacking. However, there has been a great amount of work done in the past 6 months with reference to improving the matter of unifying the policy as to examinations. The Comptroller's Office, the Federal Deposit Insurance Corporation, and the Federal Reserve have had a great many meetings, and much progress has been made toward the development of unification of examinations.

The CHAIRMAN. Let me ask you a question. What is the purpose of the examinations?

Governor ECCLES. To determine the condition of the banks.

The CHAIRMAN. What I want to develop in asking you the question is this: Is not one of the purposes of the examination of the banks to develop and disclose bad practice and any fraud that is being perpetrated by those in charge?

Governor ECCLES. It is to see that the bank is carrying out the provisions of the law.

The CHAIRMAN. One purpose of conducting the examination is to make sure there is no criminal violation or mispropriation of funds?

Governor ECCLES. That is one reason.

The CHAIRMAN. Do you think that one system of examination, under one standard, is more likely to uncover or disclose fraud in the conduct of a bank than two examinations?

Governor ECCLES. As a matter of fact, there is only one system in effect now. As I explained, the Federal Reserve accepts the Comptroller's examinations of national banks. If the banks were required to pay the examination expense of all these independent agencies, they could be constantly harassed and bothered with two examinations a year from each one of them; and I cannot see how they could endure it. As it is today, the banks are pretty well harassed with examinations and with the various reports that they are required to make to the various agencies, which is a great expense to them.

The CHAIRMAN. Are not the reports worse than the examinations?

Governor ECCLES. They are both bad enough, but necessary.

The CHAIRMAN. From what I have heard, it would appear that the reports are worse than the examinations.

Governor ECCLES. In most countries they have no examinations. In Canada there are no bank examinations whatever; and there never have been any bank examinations whatever. They have never had them.

The CHAIRMAN. Of course, they enforce criminal law in Canada, you know.

Governor ECCLES. They have reports. As I understand it, in Canada they have complete monthly reports. That is correct, is it not?

Dr. CURRIE. Yes, sir; but they also have examinations now.

Governor ECCLES. No; not examiners going out into the banks. What they do is this, they get the monthly reports into the head office; and there are two examiners that go over those reports in the head office. What I meant was that there are no examiners who go out into the banks and carry out the examinations.

Mr. FORD. Unless they find something wrong with the report?

Governor ECCLES. They make an inquiry. But, you see, those banks have numerous branches, and the banks themselves have their own examiners. That is the way the British banks operate, in the same manner; they have their own examiners.

It is not expected that this proposed legislation will create a perfect banking system by any manner of means. We will still have plenty to consider, looking into the future.

The CHAIRMAN. Mr. Brown, have you finished?

Mr. BROWN. There is nothing in there to abolish the human equation.

Mr. CROSS. I was wondering how to abolish these glass eyes.

The CHAIRMAN. Well, gentlemen, we will ask Governor Eccles to come back in the morning, at 10:30.

(Thereupon the committee adjourned until tomorrow, Tuesday, Mar. 19, 1935, at 10:30 a. m.)

# BANKING ACT OF 1935

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TUESDAY, MARCH 19, 1935

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Hon. Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Governor Eccles, Mr. Goldsborough desires to ask you some questions.

## STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Resumed

Mr. GOLDSBOROUGH. Governor, you have been here for some time now and have been exceedingly patient, and I will not take very long, I am sure.

During the discussion of this bill, and, practically every bill the committee considers, the question of inflation is raised. I do not want to get outside of the issue, and I do not think I am. I have made, so far as I am able, a very careful study of so-called "inflation." I understand it means an increase in the volume of money to the point where its value is either worthless or partially worthless. I am unable to find in history any single instance where, under a stable government there has ever been that sort of inflation, and I am wondering if you are able to cite a case where there has been any inflation under a stable government.

Governor ECCLES. I am not much of an authority on the subject of what has happened throughout the history of the world with reference to the matter of inflation. What study I have given to it applies more to recent developments, particularly since the war.

The conditions in this country at the present time are in no way, to my mind, parallel with the conditions in those countries that have had more or less inflation.

Mr. GOLDSBOROUGH. Generally, the cases that are cited by those who are sometimes called reactionaries—and I do not want to be offensive, but that is the best I can do—the cases cited by them are the continental money, the French assignats and the German money after the war. Of course, the Continental money was issued at a time when nobody knew in this country whether we were going to be under a king or under a president, or what the government was going to be. Conditions were almost absolutely chaotic.

The same thing existed when the assignats were issued in France, and insofar as Germany was concerned, that inflation was deliberately created for the purpose of destroying the internal debts.

I remember not very long ago, Mr. Bernard Baruch had an article on inflation in the Saturday Evening Post—you may have seen it—which was propagandized by pictures, some 3 or 4 pictures or cuts were in the article depicting the printing presses in Germany during the immediate post-war period, which seemed to me to be so utterly unfair and inappropriate as to make the article absolutely valueless.

In this bill which we are considering, the banking system is allowed to remain in exactly the same position that it has been for a great many years. We have in all the banks, State and national, capital, surplus, and undivided profits of less than $7,000,000,000. The deposits of those banks have been as high, I think, as $57,000,000,000 during 1929.

Governor ECCLES. Including time deposits.

Mr. GOLDSBOROUGH. Including time deposits. Do you care to express your opinion as to that sort of a system, or do you think that is outside the inquiry?

Governor ECCLES. What was the question?

Mr. GOLDSBOROUGH. I am asking you if you care to express your opinion about a monetary system which is not the creation of society, but is the creation of a private institution, and which is based on debt.

As I said before, that may be, in your opinion, so far afield that you do not care to discuss it.

Governor ECCLES. I do not believe that it is practical at this time to abandon the present system of creating money by bank credit.

Mr. GOLDSBOROUGH. By bank debt.

Governor ECCLES. Bank credit means a debt of somebody.

Mr. GOLDSBOROUGH. It is better to use the word debt, because that is what you are speaking about.

Governor ECCLES. I do not know that we have any alternative. It is my view that we should attempt through this legislation to make the existing system of banking more responsive to the needs of the country than it has been, and also to exercise a greater degree of conscious control over the creation and the extinguishing of money, and thereby attempt to create a greater degree of business stability than we have had in the past.

Mr. GOLDSBOROUGH. You agree with me, do you not, that permanent prosperity cannot be based on debt? You cannot have debt, which is increasing all the time, and have any sort of permanent prosperity, can you?

Governor ECCLES. I do not agree that it is not possible to have permanent prosperity with the existing banking system, if, in connection with its operation, a taxing system is recognized as an adjunct in helping to bring about a more equitable distribution of income during periods of prosperity.

Mr. GOLDSBOROUGH. We never have had any such tax system, have we?

Governor ECCLES. No; we never have, and we have never had very much control over the banking system.

Mr. GOLDSBOROUGH. Do you or not agree with me that under the present set-up, insofar as banking is concerned and currency is concerned and taxation is concerned, we can only have pseudo prosperity which will collapse from time to time—do you think that is true?

Governor ECCLES. In our past history we have had periods of prosperity by the process of building up debt and then periods of depression by the process of bankruptcy and the extinguishing of debt. That has been true of all capitalistic countries.

Mr. GOLDSBOROUGH. That has not been the condition in France, has it, where the banks only have about a 50-percent reserve? France has never had these recurring periods of collapse.

Governor ECCLES. It is more or less true of every country, I think. Possibly it may be less true in France than it has been here, and I think it is possibly less true in Britain than it has been here because in recent years they have exercised, I think, a better control over their money system than we have.

The volume of money in Great Britain during the period of our depression did not decline. It remained very stable.

The wiping out of a third of our deposit money by bank liquidation of debt, and by bank closings, accentuated the depression.

Mr. GOLDSBOROUGH. Now I am old enough to remember that part of the deflation period from 1886 to 1896, and I, of course, remember the much better economic condition existing between 1898 and 1914.

I think it is thoroughly understood and agreed by everybody that it was the want of money which caused the depression in 1879 and 1896, which culminated in the Bryan free-silver campaign. After that time gold was discovered in South Africa, in the Klondike, and in Australia—we were on the gold standard, with a continually increasing supply of money—so that from about 1898 to the opening of the World War this country had what can be termed, at least relatively speaking, "considerable prosperity."

It was not the banking system, or fractional reserve system, that gave us that prosperity. It was the fact that we were able to put into the market a continuously greater supply of money. I do not believe anybody disputes that. Let us see what happened to our debt structure during this period about which I have just spoken, from 1896 to 1914, and up until 1920.

After 1920 our supply of gold was of such a character that we could not put it in the market as fast as our production wanted to increase, so our production did not increase, but our debt increased and our speculation increased.

Take, for instance, the period from 1913 to 1921. Our real estate, Government, State, and local debts increased from $38,000,000,000 to $75,000,000,000, and $15,000,000,000 of that was the war debt.

So that, as a matter of fact, our debt increased, outside of the war debt, 60 percent, and our income increased 83 percent. Our national wealth increased 67 percent.

In the period from 1922 to 1929 which is spoken of as a period of prosperity—and I never could see any prosperity during that period and I have never been able to see any since; it was a period of speculation—during that period our debt, that is, our real-estate debt, our Government debt, and our State and local debts increased from $75,000,000,000 to $126,000,000,000. The increase was 68 percent.

Our wealth only increased 20 percent; that is, from 321 billions to 385 billions. Our income only increased 29 percent, from 66 billions to 85 billions. We liquidated during that period $4,000,000,000 of long-term debts, and we took on $55,000,000,000 of other debts.

That was a period in which our present monetary system, as handled by bankers, was in full sway, but a period in which our money supply, based on the gold standard, was not increasing. It ended up in collapse.

I have never seen anybody who could, but if you can, I wish you would give us your view as to how, loaded up with all this debt, we are going to get out of this depression under the present system, with what amounts on the average, to a 10-percent bank reserve. How can it possibly be done, unless we have complete deflation and wipe out the debts by bankruptcy.

Governor ECCLES. There are two ways of doing it. One is the way you have just stated, that is, continuing a process of deflation and wiping out a large part of existing debts through the process of bankruptcy, because the national income at the present time is not sufficient to support the existing debt structure.

And that is one reason we are possibly not getting recovery today, because liquidation and the pressure of debt is very, very great, and it acts as a millstone around the neck of the economic system.

The other way to get recovery, the only other way I can think of, is by a process of reflation.

Mr. GOLDSBOROUGH. Under our present system we cannot have any reflation without an accumulation of more debts, you know.

Governor ECCLES. I believe it has been very genereally recognized, certainly since March 1933, when the banking structure collapsed and closed, that it was not practical or possible, without involving very great political and social upheavals, to continue the process of deflation. The situation had reached the limit of human endurance, beyond what the people were willing to stand by way of deflation, which creates unemployment and all of the other attendant ills, and reflation was desired and was expected.

The only way that that can be brought about is by increasing the means of payment, either currency or bank deposits, in the hands of those who will spend faster than production increases.

Mr. GOLDSBOROUGH. Can you spend faster than you accumulate debt, under our present system? That is the difficulty, the debt is always ahead of the spending.

Governor ECCLES. Interest is a very important element in connection with the creation of money by debt. Very low interest, it seems to me, creates a far less dangerous situation than debt created on a basis of very high interest.

Mr. GOLDSBOROUGH. That is true, but of course the banks ordinarily now charge the same interest as they always have been charging.

Governor ECCLES. Not generally. Most of the debt today is at a much lower rate than it was. I would say the average interest income of the banks today is 40 percent less than it was in 1928 and 1929.

Mr. GOLDSBOROUGH. That is because they have accumulated long-term Government obligations.

Governor ECCLES. And other Government obligations.

Mr. GOLDSBOROUGH. When they loan to their customers they do charge a large rate. In our State it is 6 percent. They have not reduced it, certainly within the range of my observation.

Governor ECCLES. I think that is true more in the country banks than in the city banks, where they are largely influenced and affected by the money market. And the rate of lending goes up and down in pretty close relationship with the general supply of money, and you get an excess of money as you have now, when the rates are at a ridiculously low figure for certain short-term eligible paper.

Now, to get back to the question of creating prosperity out of debt. It is true that the bulk of the means of payment under the present system is created by an expansion of bank credit.

Mr. GOLDSBOROUGH. In other words, you create more debt to pay the present debt.

Governor ECCLES. A part of the debt of the country is not bank debt. The debt that the banks create in creating money is, in fact, only a small part of the total debt.

Mr. GOLDSBOROUGH. That is true.

Governor ECCLES. And it is not by any means the burdensome part of the total debt.

Money is created in our present system by banks loaning to corporations, to individuals, and to the Government. During the past 2 years there has been no increase in the supply of money as the result of the banks lending to individuals or to corporations. As a matter of fact, the money supply would have been actually diminished since 1933 had it not been for the Government not only making up the deficiency, but greatly exceeding it by its borrowing and spending. Had it not been for the Government's budgetary deficit, I do not believe the deflationary processes would have stopped.

The credits which the banks have extended to others than the Government are less now by several hundred millions than they were right after the bank holiday.

The Government has been forced to supply the money deficiency by reason of the other creditors being either unable or unwilling to supply it. I believe I made a statement yesterday in connection with the Government supplying money by borrowing from the banks that might have been misunderstood. I am sure it was misunderstood by many of the press comments that were made. That is, the question of the Government paying the banks a subsidy.

Mr. GOLDSBOROUGH. I probably made the mistake of accentuating that too much myself. I am at fault probably more than anybody else.

Governor ECCLES. I would like, for the purpose of the record, to make an explanation of my understanding of the question of the Government interest paid to the banks.

In purchasing offerings of Government bonds, the banking system as a whole creates new money, or bank deposits. When the banks buy a billion dollars of Government bonds as they are offered—and you have to consider the banking system as a whole, as a unit—the banks credit the deposit account of the Treasury, with a billion dollars. They debit their Government bond account a billion dollars, or they actually create, by a bookkeeping entry, a billion dollars.

Mr. GOLDSBOROUGH. By a sort of magic or necromancy.

Governor ECCLES. The Government in turn draws out those deposits and disburses them in the payment of all of its obligations and various appropriations.

Mr. GOLDSBOROUGH. These payments, of course, go in the banks.

Governor ECCLES. Yes; these payments of the Government, of course, immediately go right back into the banks, and therefore the total deposits of the banks are not changed; but the ownership of the deposits is transferred from the Government to individuals and corporations, who can spend it or use it to reduce their debts to banks.

Mr. Goldsborough brought out the point that the Government, because of its sovereign power, is able, if Congress so wills, to finance its operations by payment of currency for its obligations, and that it could go so far as to take up its bonds by paying out currency. The result of that operation, insofar as the bonds were purchased from others than banks, would be that bank deposits would increase.

Mr. GOLDSBOROUGH. Bank reserves, not deposits.

Governor ECCLES. Deposits. If the Government paid its bills in currency, that currency would be disbursed, the money would come into the banks to the credit of individuals and corporations, and thus the deposits would be increased in exactly the same way.

Mr. GOLDSBOROUGH. I wish you would speak about that for a while. The deposit would not increase, but the reserves would increase.

Governor ECCLES. Both would increase, both the reserves and the deposits would increase. To the extent that the bonds were purchased from banks, reserves would increase and deposits would not. To the extent that bonds were purchased from others both deposits and reserves would increase.

The proposal was that, when you substituted currency for bonds, the reserves would be greatly in excess of what they now are; because the banks would not have the deposits invested in Government bonds, but would be carrying those deposits as excess reserves, and to the extent that present holdings of governments by the banks were taken up by currency, the reserves of the banks would increase by about 11 or 12 billions of dollars. Thus, you would have excess reserves of, say, 13 or 14 billions including the more than 2 billions now held by simply taking up the existing holdings of Government bonds.

That, of course, would be a means of potential inflation of a tremendous amount.

Mr. CROSS. Could you not raise the reserves of the banks so as to check that?

Governor ECCLES. I was just going to say, it was suggested that the reserves of the banks would be increased by the amount of the Government bonds that were taken up, as the result of the issuance of currency in payment for them, and the currency would come right back into the banks as a deposit.

The point I raised was that the banks would under no circumstance be willing to handle the deposits which would be created without getting a return, without being able to invest them at interest. But, if reserve requirements were increased by the amount of the increase in reserves, the banks would be unable to perform the services which they do perform in the handling of the business of the community, of their customers, of the clearing of financial transactions and the keeping of the individual and corporation accounts without making service charges that would compensate them for their loss of income or interest, as a result of depriving them of interest on the Government obligations.

Mr. Goldsborough stated the other day that that charge could be socialized and I stated that the best way to socialize it was to do as is being done now, by permitting them to get interest on Government bonds.

Instead of the interest on Government bonds being a subsidy to the banks, it seems to me it is a payment for services which they are rendering in handling the deposit accounts which are created as a result of the Government deficit.

Mr. GOLDSBOROUGH. Now, Governor, it seems to me, now, and has always seemed to me that the real way to do a thing is to do it directly, instead of going through the pretense of issuing bonds to the banks that have not anything to loan, except what their bookkeepers can put on their books.

The banks have nothing except their capital and surplus, which amounts to less than 7 billion dollars, and they have used that up long ago in loaning to individuals.

Governor ECCLES. Except their time-deposit funds.

Mr. GOLDSBOROUGH. Except their time-deposit funds.

Governor ECCLES. That represents half of the deposits of the banking system.

Mr. GOLDSBOROUGH. But long before that they come to the Government for help. They have used up all they have.

We go through the racket—and that is all I am able to see that it is—of issuing to the banks, sending to the banks bonds, and they put a money credit on their bank books in favor of the United States Government. The United States Government by depositing that money as it does, when it gets the money credit, lends the money back to the banks and proceeds to pay them interest on it. That is a racket.

If we owe the banks for that service they render, and we do, there is no doubt about that, they render service outside of their lending service and they should be compensated for that; they will have to be compensated for that to live.

But there is created in the public mind the idea, and it is done deliberately by the class which controls the money of the country—there is created in the public mind the idea that there is some economic impropriety in the Government furnishing its own medium of exchange, that it has to do it through borrowing money from the banks that the banks do not have.

Society has everything; the banks have nothing, and yet we go through this farce of borrowing money from the bank and creating the impression that it is inflationary for society itself to issue the necessary medium of exchange with which to conduct the country's business.

What I am getting to is this. I am not suggesting any immediate revolution. But we could pay these bonds as they are callable; we could pay these bonds when they come due with money issued on the credit of the Government of the United States. And if the public knew that would be done it would have two effects, first it would reconcile them to this debt, which is having a terribly depressing effect on their minds and on their psychology. It would do that.

And the second thing it would do would be to have them understand, to make them understand, that society is not dependent upon a banking system for its currency. Our currency system in this country was not the creation of society; it was the creation of the banks.

Last year about this time a subcommittee of this committee considered what was called a monetary authority bill. The goal of that proposed legislation—whether it could be reached or not—the goal of the proposed legislation was to separate the profession of banking from the issuing of the money of society. It placed the issuing and the control of the money which society uses in the hands of an independent authority, which would have no selfish interest in making the medium of exchange as scarce as possible and as high as possible.

I am wondering if something of that same idea is not involved in this present bill, which undertakes to take from the Federal Reserve banks and place in the hands of the Federal Reserve Board the control of the open-market operations of the Federal Reserve System.

Governor ECCLES. Discount rates and reserve requirements.

Mr. GOLDSBOROUGH. Discount rates and reserve requirements. Is that so?

Governor ECCLES. It is contemplated to centralize the responsibility and the authority for control over the volume of money.

As I have stated upon several occasions, so long as most of our money supply is created by the willingness of private citizens and corporations to borrow from banks, the control of deflation is much more difficult than that of inflation. If there is too much borrowing from banks and, as a result of that operation, the creation of inflation, when the means of payment is increasing faster than the raising of discount rates and the selling of securities in the market would discourage further expansion of private borrowing from the banks and would act as a means of retarding the inflationary process.

On the down side, the reverse action, the reduction of rates and the creation of excess reserves, would tend to slow up liquidation and would tend to encourage the use of credit.

In our present money system I know of no other means within the banking system itself of influencing or effecting a control over the supply of money.

I have stated that we should seek to use these controls which I have just mentioned to combat deflation, which means unemployment, and unemployment means reduction in national income, in wealth production, and wealth consumption.

That is where the problem must be met, and it must be met, it seems to me, by society as a whole, through government.

The tax system—our income-tax system—must be worked in and timed with the money system. When private credit is expanding and there is a budgetary surplus, the Government debt should be reduced. The reduction of the Government at a time when there is a rapid expansion of private debt tends to offset the inflationary effect of the expansion of private debt. That is where the contraction comes, as result of the banks reducing their holdings of Government bonds.

It is very important that the problem of income taxation and the operation of a central banking monetary policy should be coordinated and properly timed. A substantial increase in taxes at the present time, if they would pull into the Treasury money which would otherwise be spent and thus reduce private spending, would be of no particular help in our economic as a whole. The time to increase income taxes, of course, is when incomes are such that income taxes would produce substantial revenue; in other words, in the upswing.

I believe that there is only one way by which we will get out of the depression, and that is through the process of budgetary deficits until such time as private credit and private spending expands. The expansion of private credit depends upon the will and ability of private interests to borrow and spend. Until private borrowing and spending expands, and puts people to work, the Government must do the borrowing and spending.

Mr. GOLDSBOROUGH. Governor, going back to the subject of inflation, it seems to me that the fear of so-called "inflation" is the thing which makes it increasingly difficult to improve our monetary system.

I have been following this whole matter through for a great many years, and I remember very distinctly that back in 1931—I do not want to go too far back—but I remember that in 1931 we were told that if we adopted the policy of buying Government bonds that would cause violent inflation. That was when the original so-called "Goldsborough bill" was passed through the House.

During that period, and before that period, if anybody had suggested that it was possible for the Government to raise any money except by borrowing it from the banks, he was immediately cast into outer darkness; he was not even thought fit to sit in the room with intelligent people. That was the exact condition.

We went off the gold standard and nothing happened. We passed the so-called "inflationary bill" in 1933 and nothing happened.

And it is the feeling, I am sure, of a great many Members of Congress—it is certainly my own feeling—that one of the things we need in this country is more real money and less false money in circulation.

If, as a matter of fact, we could get to the point where the money we use was real money and could not be contracted by the payment of debt, then you could not have any violent deflation; we could not have any violent inflation; you could not have either one.

Governor ECCLES. It depends upon the distribution of that money and the willingness of people to put it in circulation.

Mr. GOLDSBOROUGH. I know that it would be very much more difficult than it is now to have deflation, or inflation, either.

Governor ECCLES. I agree with you that all of this inflation talk we have heard for 3 years has been largely imaginary.

It is true that, based upon existing excess reserves of the banks, there is a possible means of creating a tremendous credit inflation. That, of course, does not necessarily mean that you are going to get that inflation.

In the first place, in order to get it, we have to get people willing to use the bank credit. It cannot be gotten in any other way.

Then it also would be necessary that there be no control exercised after private credit began to expand to a point where prices were going up rapidly and production had reached a peak.

I do not believe that it is going to be so easy to get inflation. Certainly efforts have been made now for several years to get it; but from all indications, we are as far from it now as we were 2 or 3 years ago. There is not the slightest indication of inflation.

Unless the people in this country have money and jobs or are put in possession of money through jobs or without jobs, so that the means of payments increases, and unless those people and corporations with money will spend the money that they have, we cannot get inflation.

It cannot be obtained merely by changing the gold content, or by silver legislation, unless the result of such changes will actually put money in the hands of people to spend, and unless it induces the holders of existing money to spend. Otherwise you do not increase the volume of money and you do not increase the velocity of money, both of which are necessary in order to get inflation.

Mr. KOPPLEMANN. Mr. Eccles, with reference to section 210, page 49, in regard to making loans on mortgages, you know about that?

Governor ECCLES. Yes.

Mr. KOPPLEMANN. As I understand it, it authorizes commercial banks to make loans on real estate for a period of 3 years, and repayment is to be made in full at one time or up to 20 years to be amortized. It puts commercial banks and investment banks in the building and loan business.

Governor ECCLES. They are already in.

Mr. KOPPLEMANN. But this bill is intended to put them into it further than ever.

Governor ECCLES. No. The bill is not for the purpose of putting them into any particular business that they are not already in. They are in the investment business and in the mortgage business and have been to a very large extent for a great many years. They are in the investment business in that there is no limitation as to the amount of long-term bonds of all kinds that they are permitted to buy. There is a limitation with respect to making first real-estate mortgages on improved properties. That limitation is 50 percent of the time deposits and up to 50 percent of the appraised value of the property, and up to a period of 5 years; and the banking system today holds over $2,000000,000 of those mortgages. Therefore, they are not being put into any business that they are not already in. What we are attempting to do in this case is to permit them in the making of real-estate loans to make loans on an amortized basis over the life of the loans or over a period of time which would give to the borrowers some assurance of being able to pay. The straight 5-year mortgage has proven to be a very bad form of instrument, both for the banks and for the borrowers, and also for the building and loan companies engaged in making mortgage loans and a few insurance companies and mutual savings institutions engaged in that type of mortgage lending.

I have said, and I repeat, that either the banks in this country will have to give up their time deposits or they will have to be permitted to invest or loan those deposits in the same field where the mutual savings banks, the insurance companies, and the savings and loan institutions, loan their deposits; because the time deposits of the banking system are of the same type and represent the same type of money as the funds which the mutual savings banks and the building and loan companies loan and invest.

Mr. KOPPLEMANN. It was the bad practice of the banks which caused the debacle.

Governor ECCLES. I do not agree with that.

Mr. KOPPLEMANN. Did not the banks themselves claim that it was their long-time loans which were the chief cause of their difficulty?

Governor ECCLES. I do not think so.

Mr. KOPPLEMANN. Is it not commonly so stated?

Governor ECCLES. It is commonly stated; but it is not the fact.

Mr. KOPPLEMANN. I might digress for a moment and ask you if you can in a single statement, without taking too much time of this committee, let me have what is your opinion of the cause of the difficulty of the banks?

Governor ECCLES. I think the record of my answers to the questions that have been asked quite a number of times shows it; but I can state it very very briefly. One of the principal troubles or difficulties that brought about the depression was not the shortage in the supply of money altogether, but it was due in part to the inequitable distribution of income which contributed to a speculative situation in the security markets and to an expansion of productive capacity out of relationship to the ability of the people of the country to consume under the existing distribution of income. That condition was not created by the banking system. Long-term credits were not responsible for the depression; they only became unsound when the national income shrank. A perfectly good credit over a short term or a long term may become a very bad credit if business conditions change. Short-term credit is not necessarily a sounder loan than long-term credit. Most of the short-term bonds which were held by the banks that became due during the depression could not be paid but had to be refunded.

Mr. KOPPLEMANN. Supposing that I ask you this further question.

Governor ECCLES. In order to obviate that situation of forced deflation, this bill proposes that Reserve banks be legally permitted to make advances to member banks against sound assets. The only place where liquidity can be created is through the Reserve System and that would permit the Reserve System to stop forced credit deflation and bank failures so long as banks had assets upon which they could secure credit.

Mr. KOPPLEMANN. In part you anticipated the question I was about to put to you, which is: Are loans made on real estate expected to be rediscounted by the Federal Reserve?

Governor ECCLES. They are expected to be available as security for advances to be made by the Reserve banks. The credit departments of the Reserve banks will pass upon credit extended to member banks in the future as they have always done in the past, except that in the past they have been limited by statute to a certain type of what is known as eligible paper which today is small in volume.

Mr. KOPPLEMANN. Where in this bill does it provide that such discounting, or in effect rediscounting, can be done?

Governor ECCLES. It provides in section 206 that section 13 of the Reserve Act is to be amended so as to authorize the Federal Reserve banks, subject to the regulations of the Federal Reserve Board, to discount for member banks any commercial, agricultural, or industrial paper and to make advances to member banks on their promissory notes secured by any sound assets.

Let me say this in connection with extending credit against mortgages. That does not mean that Reserve banks will discount a 20-year mortgage for 20 years. It means that the Reserve banks can make advances to the member banks for such periods as reasonable banking practice permits, which would be 90 days or possibly 6 months, secured by mortgages, collateral loans, or bonds with such margin as the credit divisions of the Reserve banks may deem necessary to protect the Reserve banks.

Mr. KOPPLEMANN. Then it does not compel the Federal Reserve to rediscount these loans?

Governor ECCLES. No.

Mr. KOPPLEMANN. Now, supposing I go to you as a banker and ask for a loan upon my property in the form of a mortgage and the banker knows that he cannot rediscount, what will be the effect upon your mind if I ask for a loan of you as a banker?

Governor ECCLES. The banks today will not make such loans. In the first place, they cannot make real-estate loans for more than 5 years. That precludes people from borrowing. Nobody today that can secure a long-term, amortized loan will go to a bank and borrow on a straight loan for a period of 5 years. They want longer-term credit on mortgage loans.

Mr. KOPPLEMANN. I am trying vary hard not to take any more of your time than possible. Now, if section 210 should succeed in encouraging banks to make long-time loans, they cannot be rediscounted?

Governor ECCLES. But they can be borrowed against.

Mr. KOPPLEMANN. Yes. What becomes the bank's liquidity which, after all, as you and I know, is the foundation of the safety of a commercial banking system?

Governor ECCLES. The liquidity of the banking system depends upon the Reserve System as I have indicated.

Mr. KOPPLEMANN. What I am trying to bring out is this. I am not opposing the bill nor do I want to appear unduly critical. What I am trying to bring out is that the effect of section 210 is more apparent than real. It seems to me that it contains language rather than a real and effective method of giving property owners a chance to obtain mortgage loans.

Governor ECCLES. That will depend entirely upon the willingness of the banks themselves to extend mortgage credit. In the absence of any field for investment of the excess funds of the banks, it seems to me that there will be a willingness, not only a willingness but a desire, of bankers to invest those funds where a substantial portion of the deposit money is represented by time money upon which they are paying 2 to 2½ percent.

Mr. KOPPLEMANN. Right there may I ask you this question? You talk about time loans. Are not time deposits in reality nothing more than demand deposits?

Governor ECCLES. Only in case of bank runs. The time deposits in a bank remain stable unless banks are permitted to fail.

Mr. KOPPLEMANN. That answers my question. Only in time of bank runs.

Governor ECCLES. That is right. At other times time deposits fluctuate very little and, as a matter of fact, usually, or at least during the past, they have shown a gradual increase over a long period of years.

Mr. KOPPLEMANN. What effect will such loans have upon building and loan associations and do you interpret that commercial banks are to compete with them?

Governor ECCLES. I think there is a field for both. It seems to me that we might ask what effect will it have upon insurance companies and mutual savings banks.

Mr. KOPPLEMANN. That is right.

Governor ECCLES. The more agencies we have for extending credit the more likely the borrower is to get favorable terms for his credit; and I think that, in the interest of recovery, long-term low rates are necessary.

Mr. KOPPLEMANN. Yet under section 210 all of this is quite improbable of happening insofar as banks making loans due to the fact that they cannot rediscount excepting on short time, as you say, 90 days, perhaps 6 months.

Governor ECCLES. That is very true; but that will not deter the banks from making long-time loans. The banks today can only borrow on Government bonds on a 15-day basis but they can renew. Banks are certainly not expected to make real-estate loans and sell them to the Federal Reserve banks and then take the funds and make additional loans, because that would create credit inflation. Banks should not loan beyond the amount of their available funds and the rediscounting facilities of the Reserve banks are for the purpose of enabling the bank system to meet temporary fluctuations in their deposits and to meet withdrawals due to unusual conditions that may develop.

Mr. KOPPLEMANN. I agree with you that commercial banks should do a safe and sound business, and that under section 210 of this bill, it would be bad business to make these mortgage loans. That is all. Thank you.

The CHAIRMAN. Would you like to come back this afternoon or tomorrow morning?

Governor ECCLES. I would appreciate it if I could come back in the morning.

The CHAIRMAN. We will ask you to come back tomorrow morning at 10:30. Mr. Goldsborough and Mr. Cross and Mr. Williams would like to ask you some questions and with that we hope to conclude.

(Thereupon, at 12:05 p. m., the committee adjourned to meet again at 10:30 a. m., Wednesday, Mar. 20, 1935.)

# BANKING ACT OF 1935

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**WEDNESDAY, MARCH 20, 1935**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON BANKING AND CURRENCY,
*Washington, D. C.*

The committee met at 10:30 a. m., Honorable Henry B. Steagall (chairman) presiding.

The CHAIRMAN. Mr. Cross, do you desire to interrogate Mr. Eccles at this time?

## STATEMENT OF MARRINER S. ECCLES, GOVERNOR FEDERAL RESERVE BOARD—Resumed

Mr. CROSS. Governor Eccles, you know, I am very much disturbed about your testimony as it has been given. You have testified that with the levers you have in this bill you feel that you could control inflation, but that the question of deflation was another story. In other words, you have a string with which to pull down inflation, but you have no string with which to pull up deflation.

And you also testified as to the depression, as I recall your testimony, that deflation meant depression, and as long as you have deflation you will have depression.

What is troubling me is how to get some means by which we can lift deflation.

Also, in your testimony you stated that you thought the income-tax question would have to be worked into the monetary system somehow.

I introduced a bill—I do not suppose you ever heard of it, or have ever read it—in an attempt to control the whole commodity price level through the system of the income tax. That bill provided that when the wholesale commodity price level was below the purchasing power of a dollar; say that the purchasing power was up to twice what it was in 1926 and 1927, for the sake of argument, that the Government, or some agency of the Congress be permitted to lower the income tax, to pay the running expenses of the Government, the salaries of the civil-service employees, and the Army and the Navy, and other governmental expenses, and pay off the bonds and other obligations as they fall due by simple currency, having it printed, until the prices of things rise, or the purchasing power of the dollar fell, whatever it was, taking it in the year that you are taking as a standard.

Now, if the prices rise more than 2 percent, as was provided in the bill, above where they were in the year taken as a standard, you are going to be laying on income taxes and taking currency out of circulation; in other words, performing the same function as the open-market transactions, and you would take currency out of circulation the same as you would if you were to sell bonds and take it out, or you put currency in circulation by paying the expenses off, doing it in one or the other way.

Do you not think that by means of the currency you could get a string to lift up your depression?

Governor ECCLES. I do not know that I can add anything to what I have already said on that subject.

Mr. CROSS. It is very patent that we cannot get out of this depression, depending upon credit, as long as the conditions remain as they are. You can reduce the rediscount rate to nothing, and you can put the reserves of the banks down to nil, but as long as conditions are such that a man cannot produce his goods and sell them for what they cost him, as long as there is no purchasing power among the people he cannot get a price that will enable him to pay the expenses of operating his factory or his farm, or whatever he is operating, because the banks could not loan him anything. If I was a banker, or if you were a banker, you could not afford to loan him any money; he could not borrow that money to produce the goods and pay the money back because he has to have buyers, and that means purchasing power, and upon that depends credit.

I do not see any way in the world to bring the country out of this depression unless we get it out by deflation.

It is not a question of the income tax taking money out of circulation; it will have the same effect as if you sold bonds and took them out of circulation. It is the same thing, is it not?

Governor ECCLES. I do not see what you mean. You say it is not the income tax.

Mr. GOLDSBOROUGH. Mr. Chairman and Mr. Cross, I was examining the witness yesterday when I yielded to Mr. Kopplemann, and now I have yielded to Mr. Cross. I had under discussion with Governor Eccles yesterday the discussion of a major subject.

Mr. CROSS. You go ahead; I thought you were through.

Mr. GOLDSBOROUGH. You have started on a major operation.

Mr. CROSS. You go ahead.

Mr. GOLDSBOROUGH. Governor Eccles, at a meeting of economists the other day, and also on the floor of the House, I made the statement that, under our present banking system, if every man in the United States had the financial genius of the senior Morgan and the inventive genius of an Edison or a Ford, and the energy of a North German farmer, we could not have any permanent prosperity in the United States because of the fact that just as soon as they began to show their ability and pay off this load of debt it would immediately cause another deflation, and prosperity would therefore defeat itself.

What is your criticism of that statement?

Governor ECCLES. That goes into the whole subject of the way money is created and extinguished.

Mr. GOLDSBOROUGH. I mean under our system.

Governor ECCLES. I feel that it is possible to have prosperity under our system, if we have the intelligence to manage our banking and our money systems, and our tax system in conjunction there-with, and our public spending, so as to insure employment; that you can have prosperity under the system whereby money is created through bank credit, and is extinguished by the paying off of the bank credit. Whether there are other ways of getting it or not, I do not know that I am prepared to say. It is difficult to make changes; we found that out.

People are prone to change their habits, their customs, and their belief very, very slowly; and changes largely come about as the result of social and economic pressure.

Mr. GOLDSBOROUGH. I will put it in another way.

Summer before last, at the Century of Progress Fair, a very noted statistician made a speech in which he said that the country owed in debts about $200,000,000,000, but that if we all got good and were thrifty, and saved our money and kept out of saloons, and things of that kind, we could pay off $25,000,000,000 of the debt a year, and in 8 years we would not owe any money at all.

I knew him very well, and I wrote him a letter and asked him what, under our system, we would use for money, when that happy condition arose. He wrote back and said he had not thought of that. When the debts were all paid off we would not have any money with which to do business.

Governor ECCLES. When the community begins to pay its debt to the banks, it extinguishes money, deposits currency, and if that process of deflation gets under way it is more or less self-generating and it is very difficult to stop it.

You can reduce rates through the operations of the Federal Reserve System; you can create excess reserves; you can broaden the eligibility requirements so as to make it unnecessary for banks to bring pressure to collect debt.

When the community's volume of money is rapidly contracting, it means that unemployment is developing; and the compensating factor is the budgetary deficit, which keeps up the volume of money, and those funds are used to give employment when unemployment develops.

That is what I meant when I said that the money system and the tax system, Government borrowing and paying must be worked in with our banking system as the compensatory agency. Otherwise, it seems to me what you say is likely to be what will happen. It is what has happened in the past, to a very large extent.

Mr. GOLDSBOROUGH. Of course, what I have in mind—and I do not know that you should be questioned particularly about it, in view of the fact that it does not bear directly on any item in the bill—but what I have in mind is that society should begin to bear in mind the fact that our present banking system is an artificial one, built up by the bankers themselves for the purpose of controlling money. That society should begin immediately to endeavor to take that control out of the hands of any one class and place it back where it belongs, in society itself, and that one way to begin that is to inject money into business. As an example, by reduction of Government debt, paying off Government debt with currency.

Governor ECCLES. I think that this discussion came up the other day, and I stated my objection to paying off the Government bonds in currency, which would result in the creation of very large excess reserves by the banking system, unless the reserve requirements were increased accordingly.

Mr. GOLDSBOROUGH. Of course, that could be done by legislation, and that very thing is contemplated by the bill we are now discussing.

I have never had in mind, and I have never introduced in Congress any bill which would require the national debt to be paid immediately. There is only about 5 billion dollars of bonds which are callable now. It seems to me that to start a system of teaching society that banking is one thing, and the issuance of currency an entirely different thing, would not only relieve society of a tremendous burden of interest, but would be a great educator, because in my opinion we are never going to do anything by creating more debt except to create a pseudo prosperity which will carry us along a few years longer and then, as by building up capital goods and selling on the installment plan with the use of more credit, have a greater collapse than we have now.

Governor ECCLES. I do not think the change in the system that you propose would put money into the hands of people that do not have it.

Mr. GOLDSBOROUGH. When you reduce taxes you declare a national discount, do you not? You are speaking of income taxes, but that would apply to any kind of taxes, any sort of taxes?

Governor ECCLES. Yes; when you reduce taxes that is true.

Mr. GOLDSBOROUGH. It is fair to suppose, is it not, that society would get the benefit of that discount?

Governor ECCLES. If you reduce income taxes it should be kept in mind that they are paid by a very small percentage of the total population—it would mean that the funds saved by the class that received the benefit of the reduction——

Mr. GOLDSBOROUGH. You do not think the ultimate consumer would get any benefit at all?

Governor ECCLES. They would possibly get some benefit; but it would tend to go into the capital field, and get productive facilities out of relationship to consumer buying power.

I do not like the idea, personally, of paying off the Government debt through currency; because it seems to me that it gives to a great many people the idea of expecting benefits that they will not get.

The paying off of the debt by currency would simply increase the bank reserves by the amount of Government bonds that they hold. When the reserves are increased by that amount, you have created a very difficult problem, unless you increase the reserves by the amount of the Government bonds that have been retired. Otherwise you have huge excess reserves.

If you retire the Government bonds with currency, that currency is the property of the banks and they will immediately send it into the Reserve banks; so it would not go into circulation at all. It would simply become a credit to the member bank on the Reserve bank's books; and, as I said, would make for an increase in the excess reserves by the amount of the bonds retired with currency.

Let us see what problems that creates. In the first place, you would have to increase the reserve requirements then by the amount of bonds which you retired, which would be today about 40 percent of the banks' loans and discounts. Government bonds are about 40 percent of the total loans and discounts.

Mr. GOLDSBOROUGH. If you retired them all at once.

Governor ECCLES. Of course; or you would increase it as you retired them.

You have a short-term financing of about 13 billion dollars, so that there are more short-term maturities than the total holdings of the banks. So in the course of a year or two the whole amount could be retired, because of the very large amount of short-term financing.

Let us assume, then, that you increase the banks' reserves by the amount of the bonds which you retire, or, we will say, 40 percent. Some banks only hold 10 percent of their resources in Government bonds, and if a 40-percent increase in reserves were imposed upon them they would have to reduce the credit they are now carrying by 30 percent in order to meet the reserve.

Mr. GOLDSBOROUGH. Could not that be controlled by a system of rediscounts between the banks?

Governor ECCLES. Reserves would have to be uniform among the banks; you could not have every one of the banks with a different reserve requirement. If you made a uniform reserve requirement in the banking system, with a bank holding 10 percent in bonds, when the reserve requirement is 40 percent, it would either have to go into the Federal Reserve System and borrow 30 percent, which was the deficiency, or it would have to collect loans and discounts to the extent of the 30 percent, in order to build up its reserves. Most of the banks in small communities hold Government bonds in the small amounts, and the deflation would come in those areas.

In the reserve cities the percentage of bonds held by banks, I think, is in excess of 40 percent, on the average. That is one problem it creates.

Another thing is that the State nonmember banks, which would not be influenced by the increase in the reserve requirements made by the Reserve System——

Mr. GOLDSBOROUGH. Yes; they would be.

Governor ECCLES. They are not members of the Reserve System.

Mr. GOLDSBOROUGH. That does not make any difference, you can put a check tax on them which will make them amenable.

Governor ECCLES. And force them into the Reserve System?

Mr. GOLDSBOROUGH. No; but force them to abide by the Reserve Board's dictum in the matter of raising and lowering reserves, under penalty of having their checks taxed.

Governor ECCLES. Then we get back to this problem. The retirement of these bonds through currency, or through giving the banks credit on the reserve bank books, would not, of course, in any way reduce the total deposits of the banks. It is 12 or 13 billions of the Government bonds issued.

Mr. GOLDSBOROUGH. You said yesterday it would increase the deposits. I agree it would not decrease them.

Governor ECCLES. It would increase deposits if the Government's expenses and its future deficits were paid with currency. That would increase the deposits by the amount of the deficit. But if you simply retire the bonds now held by the banks, it would in no way change their deposits.

Mr. GOLDSBOROUGH. That was our discussion yesterday, in reference to the retiring of bonds.

Governor ECCLES. That in no way would change the deposits.

Mr. GOLDSBOROUGH. In other words, we agree on that.

Governor ECCLES. The deposits would just remain the same.

Mr. GOLDSBOROUGH. Correct.

Governor ECCLES. But those deposits are not the deposits of the Government now. Twelve or thirteen billions of Government bonds held by the banking system represent money which the Government has spent. It has gone into circulation, and it has become the property of the individuals and corporations, and the banks have the responsibility of managing it and serving those customers in the handling of their business, in their deposit accounts. Unless they can invest those deposits which the Government has created as the result of its borrowings, at an interest return, they would have no object at all in handling the deposits. If they had to carry reserves equal to the amount of the deposits which are created, there would be no interest in the banks handling the accounts. Therefore, I think, as you stated the other day, the cost of handling that business should be socialized, and I stated that it was being socialized through the interest which was being paid on the bonds which the banks hold.

Mr. GOLDSBOROUGH. You think that is the proper way to socialize it?

Governor ECCLES. I think it is, and I do not think it is an unjust way to socialize it for the reason that the banking system as a whole has never been more remunerative than the average business, and there is no indication at the present time that it is particularly attractive. Bank stocks have possibly suffered as much or more than any other kind of an investment security, and based on my own experience in the banking business as well as in various other lines of business, I would say that from an investment standpoint the banking business is the least attractive.

Mr. GOLDSBOROUGH. My dear sir, before the war the banks were extremely prosperous, and there were practically no bonds out at that time.

Governor ECCLES. Before the war we were in a rapidly growing, new country; we were a debtor nation.

Mr. GOLDSBOROUGH. Being a debtor nation does not create prosperity.

Governor ECCLES. Being a debtor nation creates a degree of prosperity for the banks; I mean, in part, because of the shortage of capital, and the high interest rates that were generally being paid.

The banks, like every other business, have had periods of prosperity and profits, and then they have had reverses. But outside of the banks in the large centers, the average banks throughout the country have certainly not been overpaid for the services which they render, and if any revolutionary change is made in the method of creating money, and if we should take all the Government bonds up from the banks, as you propose, by currency and other methods, how would they be compensated for the very necessary and the very valuable and the very useful services which they render the community in the clearing and handling of the transactions which they are required to handle?

Mr. GOLDSBOROUGH. But now an artificial institution, our present banking system, creates the necessity of rediscounts, intermediate credit banks, and the army of bank examiners, and divides the country into simply a creditor and a debtor class.

It is this artificial system that has created all this trouble, and you cannot cure that by making additional paper or additional collateral eligible for rediscount; you are simply prolonging the final debacle.

You have to get some real money into circulation in this country, in my opinion.

Governor ECCLES. I do not know how, under capitalism, you are going to avoid the debtor and creditor relationship. Communism or socialism, of course, would not——

Mr. GOLDSBOROUGH. I did not even suggest communism or socialism. I did not intimate any such thing as that.

What I am suggesting is that in a country as rich as this is we ought to be stockholders and not bondholders, and we ought to get rid of the enormous creditor element and creditor complex and manipulation which is going on in this country.

That is what I am talking about, and in my judgment, unless it is done, we are ultimately destroyed; the debtor is a slave to the creditor, and the tremendous banking forces of this country absolutely run the country. Either that class has got to take its normal position in society, or else it is going to swallow us all up, and for this reason:

In this machine age where, as a matter of fact, labor is constantly being released from industry, you have got to get some system whereby you can declare a national dividend, either by a direct dividend or by a discount system. It cannot be done in any other way, in my opinion.

I am not suggesting for one minute that we shall revolutionize the banking system in one stroke, but it does seem to me that we are not helping matters any to be saying, "It is not time now; let us wait until next week, or next month, or next year." We have been saying that for 200 years.

Governor ECCLES. I think this bill is taking a very great step forward, and I believe that it is as far as we should go at this time with reference to the matter of control of our system of money.

Mr. GOLDSBOROUGH. Just along that line—and I only have one or two more suggestions I want to throw out—let me say this: During all of the ages the battle of the people has been for a government of laws and not of men; and all of my investigations during a period of 35 years have taught me the truth of a saying of one of the Rothschilds, "If you give me control of the credit and money of a country, I will control everything in it."

So, it seems to me that a legislative direction ought to be directly injected into the monetary system, and that too much discretion, except insofar as the mechanics and the technical phases of the law are concerned should not be left to the administrator. It seems to me it is the duty of Congress to lay down the policy on behalf of the people, that policy to be carried out by technical experts.

Under this bill, members of the Federal Reserve Board—that is, under the bill as amended—who are not necessarily benevolent despots, and who are certainly not immortal, have almost the economic destiny of the American people under their control, without control. Do you think that is a good thing?

Governor ECCLES. I am proposing it. The Board is in session all of the time; Congress is in session part of the time. There is nothing to prevent Congress at any time it is in session giving such instructions by congressional action as it chooses to give to the Reserve Board, which is appointed by the President, and is required to operate in accordance with the Federal Reserve legislation passed, and amended from time to time, by Congress.

I cannot see how it is possible for Congress to operate a money system except through a body such as the Federal Reserve Board, or some other board that they may create for the purposes of carrying out the wishes of Congress, as provided in legislation which Congress passed.

I do not think the proposed legislation in any way takes away from Congress the sovereign power which they have and should have and should retain. It is simply delegating to a body which should represent the Nation and the interests of the Nation, the carrying out of the mandates of Congress.

Mr. GOLDSBOROUGH. Of course, if we are going to assume that Congress has no wisdom in this country, I agree with you.

Governor ECCLES. I am not assuming that.

Mr. GOLDSBOROUGH. But if you are going to assume that Congress has the wisdom it is supposed to have, then it certainly is fair to say that Congress should give legislative direction to those who are to carry out the law.

Governor ECCLES. I think that is being done here.

Mr. GOLDSBOROUGH. It is a declaration of policy.

Governor ECCLES. Yes.

Mr. GOLDSBOROUGH. Which, in the case of a cynical board, would simply amount to a stump speech.

Governor ECCLES. The question of how to make rigid requirements that will better represent the best interests of the people is a question I do not know how to answer, and I doubt if anybody else does.

Mr. GOLDSBOROUGH. I am going to conclude by saying this, that in my judgment what you have proposed is infinitely better than anything we have ever had before.

Governor ECCLES. I thank you.

Mr. CROSS. Governor Eccles, what disturbs me is that it seems that this system upon which you rest, judged by your statement, is that debt is a good thing, and the more debts the better off we are. I cannot figure that out.

You say you think the Budget ought not to be balanced and we should keep going in debt.

Governor ECCLES. No; I did not say that.

Mr. CROSS. In substance.

Governor ECCLES. The Budget must be balanced over a period of time; but I think we should not look at the question of Budget balancing purely on the basis of a year.

Mr. CROSS. No; the more debt you have the more money you create; that is, the more money the banks can create.

As you said a while ago, the banks are prosperous when there are a lot of debts, with high rates of interest. But does that make people prosperous?

Governor ECCLES. The intimation is that all debts are created and carried by banks, and that if we in some way can create money without bank credit we have prevented people from getting in debt.

As a matter of fact, the money which we create as the result of bank debt is not very much more than 10 percent of the debts of the country.

Then, what about the insurance companies of this country? One class of people save and pay into an insurance company, and another class make it possible for the savings to return something to their posterity, because somebody goes in debt.

The whole system of capitalism is built up on a basis of debtor and creditor relationship, and the debt that the banks create, or the money they create, is a very small part of the debt. You have not taken the people out of the bondage of debt that you refer to by simply changing the banking system and finding some other method of creating money.

Mr. FORD. If it were possible to create money by a Government just making the money, and if it should just go on paying its bills and making money, would it be necessary for the Government ever to go in debt, on the theory that it can just print the money and hand it out?

Governor ECCLES. The Government is a sovereign power, and it has the power to create such money as the Congress appropriates. There is no question about that. It does not have to depend upon the banking system, as I have stated upon several occasions, to provide credit for it. But it is my feeling that that is the most desirable way.

Mr. FORD. If the Government could make all the money it needed, it would not have to go into debt, would it?

Governor ECCLES. You mean if it could collect in taxes what was spent?

Mr. FORD. No; I am talking about this idea of running printing presses. If the Government could print all the money it needed, it never would need to go in debt, would it?

Governor ECCLES. It could do that, but if it did it to a sufficient extent it would certainly make an inflationary condition which would destroy the value of all money.

Mr. FORD. It would break it down some.

Governor ECCLES. Of course.

Mr. CROSS. You have to have controlled currency, if you are not going to stick to a metallic base.

Governor ECCLES. You have to have a managed currency, and I believe that the present system, through the banking system, with the public interest represented through the Federal Reserve Board, is as desirable a way of controlling the value of money as has been devised in capitalistic economies.

Mr. CROSS. The proposition is to devise something more than has been devised, if possible, because under the very system we are talking about you may create debt and prices may rise and you create more debt, and it is inevitable that the crash will come directly, and we go right back into the condition in which we find ourselves now.

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Suppose we have a severe crisis, and people commit suicide, or go into bankruptcy, and then finally come out again. Then the same cycle starts over, and you keep going and coming back.

It seems to me we ought to have, if possible, more of what might be called backbone money, or development money or credit-creating money. If we can, we ought to get something that is more substantial than currency, or money that will fade out over night, pocketbook money.

It seems to me our trouble is that when prices begin to fall, this credit money, or check-book money, all vanishes and leaves us helpless, and ruins us.

Governor ECCLES. It would be very fine if we could find some method of avoiding these cyclical changes and always have complete and full employment and business stability. But I do not know of any rule whereby we can accomplish that. We can make that an objective.

Mr. CROSS. You will agree with me on this, will you not? Suppose there was no money; as long as crops were good and people raised plenty, it would be a golden era, would it not?

And if you had currency that would reflect the real exchange values of those things which society needs; if you could get a currency that would reflect the real values of those things in response to the law of supply and demand, we still ought to be in the heyday of prosperity, ought we not?

Governor ECCLES. It depends on whether or not the currency is distributed so that people could spend. If you still had inequitable distribution to the point where a great majority of the people had no money to spend, it would not make any difference whether you used a currency system or some other system. The buying power has to be in the hands of people, no matter what kind of money system you use.

Mr. CROSS. When you trap a lot of people into debt and distress them and they want to eat something, then what would be the result?

Governor ECCLES. But the banking system, as I have indicated, is not responsible for trapping the people into debt. This system of Government loaning agencies, the Howe Owners' Loan Corporation, the Farm Credit Administration, and the Reconstruction Finance Corporation, are three of the greatest credit-extending agencies or creators of debt that we have in the Nation today.

Mr. CROSS. Really, it is just postponing the day of execution, is it not, to shift that from private concerns to the Government? If the Government insists on foreclosing later on it is just postponing the day of execution, is it not?

Governor ECCLES. There is not any question about it; but a debt can be supported when the national income is sufficient to support it. The trouble was that our national income went down in a hurry, and it was going in that direction through the process of bankruptcy and foreclosure. But debt was adjusting itself through that process so that it could be supported by the national income.

Mr. CROSS. What I am trying to get at is this, if it can be done, to evolve a system that is not fatalistic. I believe that if we continue in this helpless condition, in substance, it will get in time where it means the end of capitalism.

Mr. FORD. Governor Eccles, is not the plan you have in mind of creating debt on the part of the Government for the purpose of priming the pump, and when the pump catches and the fluid begins to flow, then let the Government, through its taxing power, wipe out that deficit, and therefore have self-liquidating recovery. Is that not what you want to do?

Governor ECCLES. When you correct the causes for the deficit and the deficit disappears, with an increase in employment and an increase in the national income, the Government's revenues would increase and you would no longer have a deficit.

As private-bank credit expands, and the velocity of existing funds held by corporations and people in banks increases, you would likely have a condition of pretty full employment. At that time income taxes should be increased and not decreased, and Government obligations should be reduced as the community's obligations are increasing. Thus you would be creating a compensatory condition in the money system which would help to iron out the difficulties, if it is done with proper timing. If it is done in that way it would help to iron out the tremendous cyclical depressions which create booms and collapses, which create huge armies of unemployed and the terrible loss of national income.

Mr. FORD. We have that condition now, and we are trying to prime the pump, and by priming the pump create increased business and increased national income, and when the income increases, then the plan, in substance, is self-liquidating, is it not?

Governor ECCLES. Yes.

Mr. WILLIAMS. Governor, I do not know that I have anything additional to ask you about, but there is a feeling among some people, as has already been indicated here, that we should substitute currency for Government bonds, retiring them as they become due, not only what the banks hold, but the entire amount that the Government has outstanding. What would be the result of that?

Governor ECCLES. In the case of the bonds that the banks have, it would increase their reserves by that amount.

Mr. WILLIAMS. What percentage of the bonds outstanding do the banks own?

Governor ECCLES. Oh, I think, of the total outstanding it is somewhere around 44 to 45 percent.

Mr. WILLIAMS. Almost half. What would happen to the rest of them, to the other 55 percent?

Governor ECCLES. Insurance companies are very large holders of those bonds, and the savings banks are very large holders, and the trusts of various kinds, hospitals, educational institutions, and charitable organizations of various kinds, as well as private or individual trust estates——

Mr. WILLIAMS. Would not that release their holdings in bonds and give them currency that might be invested in other securities?

Governor ECCLES. Where other securities are available for such investment. If they were available the excess reserves of the member banks would go into those securities; but what that would create would be an inflation of the security markets, because the volume of money available in relation to the volume of investment securities would cause the bidding up of the stocks and other securities.

Mr. WILLIAMS. Then finally the currency would all come into the banks?

Governor ECCLES. Yes; it would go into the banks immediately.

Mr. WILLIAMS. And in the case of these other institutions that have no use for it for investment purposes, what would they do with it?

Governor ECCLES. They, of course, would deposit the currency in the banks, which would increase the banks' deposits by the amount of the 55 percent of the Government bonds they hold.

As to the bonds held by the banks, it would increase their excess reserves by the amount of Government bonds they held but would not change their deposits.

Mr. WILLIAMS. It would possibly result in the entire amount of Government bonds going into currency being deposited in the banks, increasing their reserves?

Governor ECCLES. That is exactly what it would do.

Mr. WILLIAMS. That would create either one of two conditions. It would present a situation of unlimited inflation, unless——

Governor ECCLES. Unless the reserve requirements were raised by that amount.

Mr. WILLIAMS. It would raise the reserve by that amount, but you would not necessarily have to raise it to the full amount, would you?

Governor ECCLES. You have already over 2 billion excess reserves. You have enough excess reserves now to give you a large inflation; and, if you did not raise reserve requirements by the full amount, you would have additional excess reserves over the 2 billion now held.

Mr. WILLIAMS. Would the fact that the reserves were increased, we will say, to 5 billion, tend to create an inflationary condition? Would that help to make money more easy and induce people or institutions to borrow?

Governor ECCLES. I doubt that it would have any such effect. The rates now on bankers' acceptances and commercial paper, and short-term, high-grade bonds, and Government bonds are almost at the vanishing point, lower than at any time, I suppose, in the history of the country.

But I do not believe that increased reserves, beyond the present excess, would induce any more borrowing or any more lending.

If we begin to get recovery and private credit begins to expand, and the banks increase their investments in securities, and the funds go into the capital markets for building new capital facilities, by the time the banking system had used up their present excess reserves of 2 billion dollars, you would have a volume of money far in excess of anything that the banking system has ever had, and with that volume, with the income velocity that we had in 1927, 1928, and 1929, it seems to me you could have a great inflation, without using any of the increase in the reserves. I mean without using any of the increase in the reserves which would be brought about by retiring Governments through issuing currency.

Mr. WILLIAMS. In other words, the credit expansion potentialities, at least, are as great as you think they ought to be now?

Governor ECCLES. Yes; they are sufficiently great right now, I think, and it would be necessary to carry out open-market operations, or to raise the reserve requirements, before the present excess requirements were entirely used up.

Mr. WILLIAMS. I would like now to get down to section 202 of this bill, with reference to the admission of nonmember banks into the Federal Reserve System, about which you talked a great deal.

In the first place, the bill itself as proposed here provides that the Federal Reserve Board may waive the capital requirements for admission, with the understanding that within the time specified by them the bank admitted into the System makes up those requirements.

Governor ECCLES. That is right.

Mr. WILLIAMS. That is the provision of the bill.

Governor ECCLES. That is right.

Mr. WILLIAMS. As I understand it, the amendment offered by you—I did not understand that you presented any definite language.

Governor ECCLES. We have definite language. I did not submit it here, but I submitted this statement before the committee, and I will read it, if you desire.

Mr. WILLIAMS. I did not understand that you submitted definite language.

Governor ECCLES. Not here, but we are prepared to submit to the committee suggested language, if they desire us to do so.

Mr. WILLIAMS. That is exactly what I wanted to ask you about. I understood your general statement to be that they may waive this requirement and other requirements.

Governor ECCLES. This is what that meant. This provision with reference to the admission of insured nonmember banks is very short. It provides—

> On the admission of insured nonmember banks, the Board shall have authority to waive not only capital requirements, but all other requirements for admission, and the Board shall be permitted to admit existing banks to membership permanently with capital below that required for the organization of national banks in the same places, provided that their capital is adequate, or is built up within a reasonable time to be adequate, in relation to liabilities to depositors and other creditors.

Your question was in relation to capital and all other requirements for admission.

Mr. WILLIAMS. What is meant by the waiving of all other requirements?

Governor ECCLES. I have in mind one particular situation. Quite a number of banks that closed during the bank holiday and wanted to reopen found it necessary to get waivers of a certain percentage of their deposits from their depositors. In getting those waivers the banks issued to the depositors certificates of claims for the amounts of the deposits which they waived, which were, of course, secondary to the deposits of the reopened banks, but senior to the stockholders' interest in the banks.

It has been construed by the counsel of the Federal Reserve Board that, under our present Federal Reserve Act, that claim of the depositors is a liability of the bank, and therefore that they cannot figure they have any sound capital so long as those claims exist, whereas those claims are secondary to the depositors' rights.

For all practical purposes, the depositors are as fully protected under that arrangement as they would be if the claim did not exist, and they are given that protection. That is the only case I have in mind at the moment; there may be others.

But we felt that we wanted the language of the bill broad enough to give the Reserve Board the power to get nonmember banks into the system; whereas if conditions were imposed that they could not meet, it would be undesirable, and that was not what the reserve organization felt should be done.

Mr. WILLIAMS. Is it your thought that these capital requirements should be waived permanently, or that they should be required to make them up after they get in?

Governor ECCLES. No, sir; it is our thought that they should be waived permanently, if the capital and surplus which they have is adequate in relation to the bank's liabilities.

Mr. WILLIAMS. And you would consider them solvent?

Governor ECCLES. Yes. For instance, a bank with $40,000 of capital and surplus combined and with a deposit liability of $250,000 has adequate protection for its deposit liability. That is as much protection, on the average, as the deposits have throughout the banking system, as a whole.

Mr. WILLIAMS. The thing that has disturbed me, and has disturbed me very much, is what we are going to do with the 8,500 nonmember banks.

Governor ECCLES. Seven thousand.

Mr. WILLIAMS. That is, the banks which during all these years have not seen fit to come into the Federal Reserve System, and now compelling them to come in if they are going to enjoy any of the benefits of the Insurance Corporation.

Governor ECCLES. Of course, that is not a provision of this legislation.

Mr. WILLIAMS. I understand that, but we are legislating on that subject.

Governor ECCLES. We are simply making it possible to liberalize the Federal Reserve requirements so that the legislation requiring their membership which was passed last year can be complied with without hardship to the nonmember banks.

Mr. WILLIAMS. You understand how it was passed?

Governor ECCLES. It was passed and is in the law; and of course I, personally, am very much in favor of it. I feel that this whole banking policy cannot be successfully carried out so long as you have a substantial part of your banking system not under the Federal Reserve System. The control over your reserves and the control over your money is reduced just to the extent that a substantial part of your banking system is entirely out of the Reserve System.

And, since the nonmember State banks came to the Federal Government in an emergency, the same as the banks under the direction of the Reserve System and/or the Comptroller of the Currency, and requested the benefits of the Reserve System and the Reserve System was rquired to lend to the nonmember State banks at the time of the bank holiday, I believe that in the interest of the nonmember State banks the legislation passed last year, with the amendment proposed, is very necessary and a very constructive thing to require.

I have met with a lot of nonmember State bankers, and I know that they feel that it is against their best interests to be members of the Federal Reserve System. That may have been true in the past, to the extent that they could carry their reserve balances in the city banks and get 2 percent interest, I think, or 1½ percent interest.

Today they get no interest whatever on their reserves in the city banks, and they would be just as well off to have those balances in the Reserve banks now as to carry them in the city banks, whereas that was not true until the time of the Banking Act of 1933.

Another advantage in becoming a member of the Federal Reserve System, that will exist if this legislation passes and that did not formerly exist, is that by the broadening of the eligibility features, it will give them a protection that they did not have before.

The CHAIRMAN. May I interrupt you right there? That means, of course, with the inducements that are offered to the nonmember banks to join the Federal Reserve System. There is not a nonmember bank in the United States that will object to entering into the Federal Reserve System that tends to induce them to come in. Some of them do not want to be forced in, and I do not think you have given all the reasons for it yet.

For instance, one is in connection with the matter of their right to charge for service rendered.

Governor ECCLES. Exchange.

The CHAIRMAN. Which, in the case of a small community bank with a small capital, goes a long way toward meeting their overhead.

And there is another reason. Nonmember banks come in contact with member banks, or the officials of nonmember banks come in contact with the officials of member banks, and they get from those contacts, in addition to what they gather otherwise, impressions as to the desirability of membership in the Federal Reserve System, and there has been unfortunately an accumulation of complaints on the part of national banks that were automatically taken into the Federal Reserve System.

This question here, if I may say so, comes back to this proposition. It seems to me it must be considered separate and apart from the fundamental thought that enters into the policy that should be finally deermined as to the unification of the entire banking system; that is, our efforts to deal with the emergency that confronts us.

If we attempt to set up requirements of nonmember banks which they cannot meet—if such a provision is put into effect—they can have the benefit of deposit insurance; and I think it is generally conceded that would result in disaster, as a general rule, to small nonmember banks.

Governor ECCLES. It would be suicide for the Reserve Board to set up requirements that the small nonmember State banks could not meet, and thus force them out of the deposit insurance and force them to close. There would be nothing constructive accomplished by any such action as that.

The CHAIRMAN. I here and now register my complete acquittal of you as to any fear of that kind. But we cannot have you in control always. I wish you would live a hundred years, but you cannot.

Governor ECCLES. I do not wish that.

The CHAIRMAN. We do not know who will be Governor of the Federal Reserve Board 5 years from now.

Governor ECCLES. Or next month.

The CHAIRMAN. Or possibly next month.

What happened when we were faced with the complete collapse, or at least the complete closing—I guess it is fair to call it a collapse—of the entire banking system of the Nation in 1933? The bankers were desirous then of having Congress meet, and for once they were willing to meet with Congressmen and confer, and we did confer. We passed the Emergency Banking Act. You know how it was written, I assume.

Governor ECCLES. I read Huey Long's speech after he had voted for it.

The CHAIRMAN. Huey Long was not the only one who felt that way. The entire administration thought that way, and what happened was this—and that is what I was about to call attention to—that the controlling voice in framing that legislation did not come from nonmember State banks in the United States; and the result was that when member banks found they could not get currency enough to pay their depositors and keep their doors open, they arranged for currency to be printed on their assets and supplied to them.

Governor ECCLES. Clearing-house certificates.

The CHAIRMAN. Under the Emergency Banking Act of 1933, as originally passed, we provided for the issuance of Federal Reserve bank notes to member banks, but nonmember banks were not permitted to have that privilege under that act.

Under that legislation, a town of 10,000 or 20,000 population might have two banks, half of the business activity and life of the community being centered in one bank on one corner and the other half in the other bank.

With this situation affecting the Nation under that bill we provided relief for half of that community and its interest and its deposits in the member banks of the Federal Reserve System. And we said to the member bank, "Here is the way you may print money or get currency to take care of your deposits"; and we said to the people of the community interested in nonmember banks, "You take care of yourselves." Of course, that was finally corrected, but it took a struggle to do it.

They have that recollection before them; and there are a lot of just such experiences, not just exactly like that but experiences of that kind that influenced the nonmember bankers; and if we attempt to set up arbitrary standards to force them into the Federal Reserve System, I am not sure that we will not get into difficulties.

Governor ECCLES. If we had a unified banking system at the time you refer to, the question as to whether or not a bank could get the benefits of advances from the Federal Reserve bank and receiving therefor Federal Reserve bank notes would not have come up.

The question came up, because here was a system set up for member banks, and all banks had been invited to join the Reserve System from its very beginning. An emergency developed after a period of 20 years, and those banks that had not taken advantage of the opportunity to join wanted in the emergency, the benefits of a system of which they were not members.

I recognize that it was in the public interest to do just what was done.

The CHAIRMAN. What was finally done, but not what was done so long as we were moving under the counsel of one class of bankers.

Governor ECCLES. But I do think that the possibility of the recurrence of such a condition should be prevented by getting a unification of the banking system. I believe you will never have in this country a banking system that can withstand the pressure of periods of financial distress, and we will never have a sound, dependable banking system until we get a unified banking system. And neither do I think it will be possible to exercise through monetary policy the same control over the money system when a substantial number of banks which create money just the same as the member banks are subject in no way to the regulation or control of the authority that is responsible for monetary action.

I have been in the banking business for a period since 1913, a period of 22 years, up until the time I came over here a little more than a year ago.

My first banking connection was with about a million-dollar bank which joined the Federal Reserve System shortly after the Federal Reserve System was organized. It is a State bank. From that period a banking organization of over $55,000,000 was built up, operating over 25 banks, national and State, member and nonmember.

I found, as the result of experience, that it is in the interest of a bank to be a member of the Federal Reserve System, whether it be a small country bank or a substantial sized city bank; and I am stating here my honest conviction of what, as a result of experience and as a result of study for a period of years, I feel is in the public interest and in the bankers' interest.

And I believe that the great majority of the nonmember State banks, if they understood this problem, could be induced, in their own interest, to become members. I have found in talking, as I have upon many occasions, to nonmember State bankers, that invariably they can be sold upon the idea, and the difficulty today with very many of them is a lack of understanding and lack of information with reference to the problem.

The CHAIRMAN. I think one reason why they have not wanted to come in was because they did understand. When a bank becomes a member of the Federal Reserve System its other connections are practically terminated.

Governor ECCLES. You mean its other banking connections.

The CHAIRMAN. Yes; its other banking connections. So far as obtaining relief in an hour of need is concerned, those connections are terminated, and any small bank, a member of the Federal Reserve System, would be dependent upon its Federal Reserve bank for relief in the hour of difficulty, as a general proposition. I think that is undeniably true.

Governor ECCLES. Not altogether, because every bank carries usually an account or two with a city correspondent.

The CHAIRMAN. Sometimes they do, but they do not always do that.

I can point you to instances in my own district where a bank in a town of not over 20,000 population was allowed to close. I know the history of it.

I know that there were criticisms and faults to be found with the management, and its papers were not all desirable. But the bank came very near liquidating 100 percent to its depositors during this depression. The Federal Reserve turned them down and abandoned them.

That very institution, if it had not been a member of the Federal Reserve System, and had kept up the other connections that would have existed, in all human probability would have been able somewhere to have secured relief to tide them over their difficulties.

Of course, that is one instance that happened many times.

I want to say in that connection that I think the story would have been different if we had then the experience we have gathered since that time and had had the legislation now proposed and had it administered with some degree of common sense.

Governor ECCLES. I think that there was a lack of power for the Federal Reserve banks to extend the relief that they should have been able to extend; there is not any question about that.

The CHAIRMAN. In connection with what I said, I want to add this, that I have not the slightest doubt that this legislation, if it is administered as I think it will be, and I believe it will be in the light of our experience, with a more liberalized view of the situation to be reflected in the administration of the Federal Reserve System, will induce many State nonmember banks to join the Federal Reserve System voluntarily.

Governor ECCLES. There is not any question that the Reserve banks were extremely rigid in their credit extension, in their interpretation of eligible paper. As the depression proceeded and as deflation continued, the attitude and the action of the Reserve banks, based upon my experience, and I know upon the experience of thousands of other bankers, was to the effect that the Reserve banks became more rather than less restrictive.

I think the experience of the past has been a very salutary one, and I agree with Mr. Steagall that, if this legislation is passed and is administered with understanding and in the spirit that has motivated the legislation, a repetition of the banking catastrophes that we have had in the past would be impossible.

Mr. CAVICCHIA. The other day, Governor, I asked you if this bill aimed at a centralized banking system, or whether it was merely regulatory.

I notice this morning you used the word "unification." As I understand it, this bill aims at unifying the National and State banking systems under the Federal Reserve System; am I correct?

Governor ECCLES. No; this bill does not deal with that problem at all. That matter was covered by the legislation which was passed in 1933.

Mr. CAVICCHIA. In what sense did you use the word unification?

Governor ECCLES. I was simply stating that I thought a unification of the banking system was necessary, and according to the legislation that Congress passed in 1933 unification will be brought about by 1937, when the nonmember State banks will be required to become members of the Federal Reserve System in order to get deposit insurance.

Mr. CAVICCHIA. And your program is to unify the banking systems?

Governor ECCLES. No; that is the program which was passed, and which I am favorable to.

Mr. CAVICCHIA. The aim of the legislation we passed and that which we are now considering it to unify the banking systems, whether it be National or State?

Governor ECCLES. That is correct.

The CHAIRMAN. You mean this legislation was not designed to accomplish that purpose, but its purpose was of another nature, and you merely accepted the existing law with reference to unification.

Mr. CAVICCHIA. You still have the two systems.

Governor ECCLES. This legislation only facilitates the carrying out of the legislation which has been passed, without imposing unnecessary hardships on the nonmember State banks.

The CHAIRMAN. You might state your views to be that a proper interpretation and understanding of the proposed legislation is that it really liberalizes the requirements heretofore imposed in the act of 1933.

Governor ECCLES. Yes.

Mr. WILLIAMS. I want to ask whether or not you think that State legislation authorizing the creation of State banks ought to be entirely abolished, making it one system, sure enough.

Governor ECCLES. It is my personal belief that that may be desirable, but it is impracticable at the present time.

In practically every other country in the world they have one banking system; and, as the result of that, they have, I believe, avoided many of the banking troubles which we have had. But we are young, and I do not believe that we can make changes in our methods and habits too rapidly. We cannot go faster than the people of the country are willing to have us go.

Mr. WILLIAMS. It seems to me we are inevitably going to that, and I have the view in reference to the general philosophy of the legislation that we are certainly going in that direction.

If it is desirable, as you think—and I am not controverting that here—to have the entire system under a central control, so far as the monetary policy is concerned——

Governor ECCLES. That is what this would do, without eliminating the State banking departments.

Mr. WILLIAMS. Undoubtedly; but it brings them into the picture, subject to that policy.

Governor ECCLES. Not so far as the examination of banks is concerned, and not so far as the chartering of banks is concerned; but it does unify the System by placing State banks under the influence of monetary policy of changes in Reserve requirements and changes in discount rates.

Mr. WILLIAMS. If we are going to bring them into one system, I can see no reason at all for the further existence of State banks. I cannot see the necessity of having a separate examination of them.

Governor ECCLES. There is not any question but what there are many improvements that can be made in the banking system that the proposed legislation has not provided for. But I believe that banking legislation must be evolutionary and not revolutionary. We cannot expect in one session of Congress to get all the banking legislation we want, when we take into account the size of the country and the habits of the country, the adverse and diverse opinions. Therefore, what has been proposed here, it seems to me, is about as far as we could expect to go at this time with reference to banking legislation, and the question of other problems of banking legislation which have been discussed from time to time, such as the matter of unification, the examining problem which you raised, Mr. Williams, and the question of branch banking has come up a good many times here and it has come up in many State legislatures. All of those problems are problems which will come up from time to time for consideration. There is not any question about that.

Mr. CLARK. The Federal Reserve System as it has existed and has been administered, as Mr. Steagall pointed out, has not been sold for some reason or other to thousands of banks throughout the country that did not want to join, whether they understood the facts or not.

In title II of this proposed legislation, if it is passed, I think, personally, you have an article that will sell the System, if properly administered.

But why do you think it is necessary to use the F. D. I. C. as a club to force the sale of an article that ought to sell on its own merits?

Governor ECCLES. I think that membership in the F. D. I. C. should be confined in the future to member banks. In 1933 it was found that the Federal Reserve System was the only agency that could provide liquidity to the banking system and thus enable the banks of the country both member and nonmember banks, to reopen and to make available the depositors' money. This had to be done at that time by the Federal Government, even though it had nothing whatever to do with the chertering or the supervision of nonmember banks. The Government had the responsibility through the Reserve System of giving them the benefits and the protection of that system in the same manner in which it was accorded to member banks.

Now, I do believe that, in the public interest, after a reasonable time—and 1937 is a reasonable time—and after providing a liberalization of the requirements of membership, any bank which is being insured by the Federal Deposit Insurance Corporation should be required to become a member of the Federal Reserve System for better protection to the Federal Deposit Insurance Corporation. Although it is a bank mutual insurance plan, at the same time the moral obligation of the Federal Government is there; because the public looks to the United States Government to make that insurance company solvent if the banks cannot or do not.

Mr. CLARK. You think, that the insurance features of the F. D. I. C. are so closely involved with the entire banking system that it is good practice in this instance, whereas ordinarily it would not be, to use one agency as a club to force membership into another agency; that they are so interrelated and tied up that it is a fair thing to do.

Governor ECCLES. I agree with you. I do not like the use of a club at all in dealing with human problems. The F. D. I. C. and the Federal Reserve System are so closely interwoven that it is necessary in the public interest to require membership of insured banks; but I do not like to look upon the use of the F. D. I. C. as a club.

Mr. CLARK. That has been suggested several times while we were discussing title I, and that is why I used the term. I merely wanted to get your statement in the record because numerous State banks have written members of the committee raising that very question, stating, in effect, that they were being clubbed by a desirable institution into joining the System, which, as presently constituted, they do not like.

That is one reason why I wanted to get your views in the record so that we might have the entire picture.

Mr. HOLLISTER. With respect to section 210, which pertains to the lending power of national banks, are you going to mention that?

Governor ECCLES. That is just what I was going to refer to.

Mr. HOLLISTER. I was just going to bring that out.

Governor ECCLES. I wanted to put in the record a suggestion with reference to section 210, which is the provision dealing with real-estate loans, a section that has possibly been misunderstood as much or more than any other section, and a section which has been discussed here, possibly, as much as any other section.

I recommended before this committee that, instead of providing in the bill a specific maximum amount based on appraisal that could be loaned, a specific maximum period, and a maximum amount of time funds, that there should be more flexibility, and that the Reserve Board should be required to make rules and regulations governing the making of real-estate loans by member banks.

There are many reasons for that which I do not think it is necessary to review here. It has been suggested that it would be desirable, and that the proposal would be far more acceptable to the bankers in general, if there were a limitation of 60 percent instead of the 75-percent limitation placed in the legislation; that is, to permit the Board to make rules and regulations with reference to real-estate loans, with the limitation that no loan made after the passage of this legislation or after the promulgation of the Board's rules and regulations could exceed 60 percent of the appraised value of the property.

I see no objection to that. I do not believe the banks would loan more than 60 percent on the appraised value in any case.

My purpose in suggesting the 75 percent was not with the expectation that the banks in the future would loan 75 percent of the appraised value of the property; but it would enable them to carry the more than 2 billion of real-estate loans which they have, which, due to depreciation values, are in excess or 50 percent in many cases, possibly as high as 65, 70, or 75 percent in some cases. It would permit them to carry the loans they have and extend them over a long period with an amortized basis of payment, rather than to bring pressure on the borrowers because the examiners bring pressure upon the banks, to reduce these loans to the 50-percent limit, which would force the borrowers on to the Government, through the Home Owners' Loan and the Farm Credit Administration.

I would like to see the banks able to carry the real-estate loans they have, even though they are in excess of 50, or 60, or 70 percent, and to refund those loans.

But I think a 60-percent limitation is desirable in the case of making new loans in the future. I have no objection to it, and would like to recommend that, in connection with giving the Federal Reserve Board the authority to make rules and regulations, such a limitation be put upon that authority.

The CHAIRMAN. We have concluded with Governor Eccles, and I want to thank you, in behalf of the committee for your faithfulness in attending these hearings, and for the very able presentation you have made of this legislation. All of the committee, I am sure, cannot agree with everything you have said, but we agree with you.

Governor ECCLES. I appreciate your courtesy and the patience which the members of the committee have accorded me.

*Statement on National income, money, and income velocity, submitted by Gov. M. S. Eccles*

| | National income, Copeland [1] (billions) | National income, Department of Commerce (billions) | Money [2] (billions) | Income velocity based on Copeland (I+III) (times per year) | Income velocity based on Department of Commerce (II+III) (times per year) | Percentage change in income, Copeland | Percentage change in income, Department of Commerce | Percentage change in money | Percentage change in income velocity, Copeland | Percentage change in income velocity, Department of Commerce |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
| 1921 | 56.8 | | 21.7 | 2.62 | | | | | | |
| 1922 | 60.3 | | 21.6 | 2.81 | | +6.2 | | −1.2 | +7.3 | |
| 1923 | 68.9 | | 22.6 | 3.04 | | +14.3 | | +5.5 | +8.2 | |
| 1924 | 70.2 | | 23.1 | 3.04 | | +1.9 | | +1.8 | | |
| 1925 | 74.5 | | 24.6 | 3.03 | | +6.1 | | +6.7 | −0.3 | |
| 1926 | 78.8 | | 25.3 | 3.11 | | +5.8 | | +2.9 | +2.6 | |
| 1927 | 80.9 | | 26.0 | 3.11 | | +2.7 | | +2.8 | | |
| 1928 | 83.3 | | 26.4 | 3.16 | | +3.0 | | +1.3 | +1.6 | |
| 1929 | 87.0 | 82.3 | 26.4 | 3.29 | 3.12 | +4.4 | | +0.1 | +4.1 | |
| 1930 | | 75.8 | 25.4 | | 2.98 | | −7.9 | −3.8 | | −4.5 |
| 1931 | | 63.3 | 23.8 | | 2.66 | | −16.5 | −6.3 | | −10.7 |
| 1932 | | 49.7 | 20.5 | | 2.42 | | −21.5 | −13.9 | | −9.0 |
| 1933 | | 46.8 | 19.9 | | 2.35 | | −5.8 | −2.9 | | −2.9 |
| 1929–33 | | | | | | | −43.1 | −24.6 | | −24.7 |

[1] Less imputed nonmonetary incomes.
[2] Deposits subject to check plus cash outside banks as of June 30.

MODIFICATION IN THE BANKING BILL OF 1935 PROPOSED BY GOVERNOR ECCLES IN HIS TESTIMONY BEFORE THE HOUSE BANKING AND CURRENCY COMMITTEE

1. SEC. 201. The governors and chairmen and vice governors of the Federal Reserve banks shall be approved by the Federal Reserve Board every three years rather than annually, so that their terms as governors would coincide with their terms as class C directors.

2. SEC. 202. On the admission of insured nonmember banks, the Board shall have authority to waive not only capital requirements, but all other requirements for admission, and that the Board be permitted to admit existing banks to membership permanently without requiring an increase in capital, provided their capital is adequate in relation to their liabilities.

3. SEC. 203. The pension provision shall be modified so that any member of the Board, regardless of age, who has served as long as five years, whose term expires and who is not reappointed, shall be entitled to a pension on the same basis as though he were retired at seventy. That is, he is to receive a pension of $1,000 for each year of service up to twelve.

SEC. 205. Authority over open-market operations shall be vested in the Federal Reserve Board, but that there be created a committee of five governors of Federal Reserve banks, selected by the twelve governors of the Federal Reserve banks, and the Board shall be required to consult this committee before adopting an open-market policy, a change in discount rates, or a change in member-bank reserve requirements.

5. SEC. 209. The Board shall not have the power to change reserve requirements by Federal Reserve districts, but only by classes of cities. For this purpose banks shall be classified into two groups: one comprising member banks in central reserve and reserve cities, and the other all other member banks. Changes in reserve requirements, therefore, would have to be either for the country as a whole or for the financial centers, or for the country districts.

6. SEC. 210. The conditions on which real-estate loans may be granted by member banks shall be left to the discretion of the Federal Reserve Board to be determined by regulation. No real-estate loan hereafter made shall exceed 60 percentum of the appraised value of the property; but this shall not prevent the renewal or extension of loans heretofore made.

7. It shall be the duty of the Federal Reserve Board to exercise such powers as it possesses to promote conditions making for business stability and to mitigate by its influence unstabilizing fluctuations in the general level of production, trade, prices, and employment, so far as may be possible within the scope of monetary action.

(Thereupon, the committee took a recess until 3 p. m., this day.)

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