HOW DID MAJOR CHANGES IN FEDERAL RESERVE AUTHORITY, POWERS, AND DUTIES GET INTO THE LAW?

In the following pages there are discussed the major changes made in the statutory authority, powers, and duties of the Federal Reserve System which have come about since the enactment of the Federal Reserve Act in 1913. This discussion is intended to include only those changes which are regarded as having significance directly or indirectly in the field of credit and does not cover matters of minor importance. The topics are treated according to subject matter rather than according to statutory enactments; in other words, where one topic is the subject of several different amendments to the law, it is discussed as a unit with consideration of the changes brought about by each amendment.

In each case, the date of the statutory change with the citation is given; and the reasons for the amendment and other background material are set forth either through quotations from Congressional Committee Reports, from debates in Congress, or from testimony before Congressional Committees.

For convenient reference, a table of contents is set forth on the following page.

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M.A.

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RESERVE REQUIREMENTS OF MEMBER BANKS

In the original Federal Reserve Act, member banks were required to maintain reserves equal to specified flat percentages of their time and demand deposits, although part of their reserves could be carried as vault cash. By the Act of June 21, 1917 (40 Stat. 232), permission for the use of vault cash was eliminated and the required statutory percentages were fixed at 3 per cent of time deposits for all member banks, and 13 per cent of demand deposits for banks in central reserve cities, 10 per cent of demand deposits for banks in reserve cities, and 7 per cent of demand deposits for banks located elsewhere.

No authority was given the Board to change reserve requirements of member banks until 1933, although the Board had recommended such authority in its Annual Report for 1916 (pages 28,140). Also by the Act of September 26, 1918 (40 Stat. 967), the Board was authorized by Congress to permit individual member banks in outlying districts of central reserve and reserve cities to carry reduced reserves in certain circumstances.

During the debates on the Agricultural Adjustment Act of 1933, (48 Stat. 31) after the bill had passed the House and while it was under consideration in the Senate, Senator Thomas of Oklahoma, on April 20, 1933, introduced an amendment to the bill - the so-called "Thomas Amendment" - which, among other things, provided authority for the Federal Reserve Board to change reserve requirements of member banks. As approved by the President on May 12, 1933 (48 Stat. 54), the Thomas Amendment added a new paragraph to section 19 of the Federal Reserve Act reading as follows:

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"Notwithstanding the foregoing provisions of this section, the Federal Reserve Board, upon the affirmative vote of not less than five of its members and with the approval of the President, may declare that an emergency exists by reason of credit expansion, and may by regulation during such emergency increase or decrease from time to time, in its discretion, the reserve balances required to be maintained against either demand or time deposits."

By the Banking Act of 1935 (49 Stat. 706), this paragraph of section 19 was amended to eliminate the necessity for the existence of an emergency and for the approval of the President, and to provide that the affirmative vote of only 4, instead of 5, members of the Board should be necessary in the case of any change in reserve requirements. It was also provided that the Board could not reduce reserve requirements below the statutory percentages prescribed by the law or increase them beyond twice the amount of those percentages. As thus amended, the paragraph was changed to read as follows:

"Notwithstanding the other provisions of this section, the Board of Governors of the Federal Reserve System, upon the affirmative vote of not less than four of its members, in order to prevent injurious credit expansion or contraction, may by regulation change the requirements as to reserves to be maintained against demand or time deposits or both by member banks in reserve or central reserve cities or by member banks not in reserve or central reserve cities or by all member banks; but the amount of the reserves required to be maintained by any such member bank as a result of any such change shall not be less than the amount of the reserves required by law to be maintained by such bank on the date of enactment of the Banking Act of 1935 nor more than twice such amount."

Explaining the purposes of this amendment, the report of the House Banking and Currency Committee stated:

"Section 209 amends section 19 of the Federal Reserve Act, as amended by the Thomas amendment, so as to permit the Federal Reserve Board, without the necessity of approval of the President and without declaring the existence of an emergency, to decrease the reserve requirements in order to prevent injurious credit contraction as well as to increase the reserve requirements in order to prevent injurious credit expansion. Changes might be made applicable to demand or time deposits or both and might be made different in two different classes of cities: (1) Reserve

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and central reserve cities and (2) nonreserve cities.

"This proposal represents a clarification and modification of a power which the Board now possesses under the Thomas amendment. The present law provides that the Board, in order to change reserve requirements, must obtain authority from the President. It does not seem desirable to require Presidential approval for action which should be within the competence of the Federal Reserve Board.

"It is essential to give the Board more authority in controlling credit conditions in view of the possibility of dangerous credit expansion on the basis of existing member bank reserves, and also in order to give the Board another instrument for easing credit conditions if at some time in the future that policy should become in the public interest.

"Changes in reserve requirements are similar in their effects to open-market operations, although they differ from those operations in the fact that they directly and immediately affect a wider group of banks. It is probable that ordinarily these powers would not be used; but, in view of the very large volume of available excess reserves and the possibility of credit expansion on these reserves, it is important to clarify the Federal Reserve Board's power to arrest inflation." (House Report 742, 74th Cong., page 13.)

The report of the Senate Committee on Banking and Currency contained the following:

"Section 209 of the bill as it passed the House authorized the Federal Reserve Board, in order to prevent injurious credit expansion or contraction, to change by regulation the requirements as to reserves to be maintained against demand or time deposits or both by member banks in reserve and central reserve cities or by member banks not in reserve or central reserve cities or by all member banks. This provision has been modified by section 206 of the bill as reported by the committee so as to provide that the power to change the requirements as to reserves be conditioned upon an affirmative vote of not less than five members of the Board of Governors of the Federal Reserve System, and a limitation has been added that the amount of the statutory reserves required to be maintained under existing law may not be decreased, nor increased to more than twice such amount." (Senate Report 1007, 74th. Cong., page 13.)

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The following statements were made in the House during the debates:

Mr. Hollister:

"Section 209 gives the Federal Reserve Board the power to change the reserve requirements in various classes of cities. * * * *

"At the present time these requirements may be changed by a vote of five members of the Federal Reserve Board, who must declare an emergency and must get the approval of the President, thus making it not a particularly easy thing to do quickly." (79 Congressional Record, Part 6, page 6732, May 1, 1935.)

Mr. Russell:

"The object of the title is to give certain controls over the instrumentalities of credit, to prevent injurious expansion and contraction of the country's credit so that it may be available at all times to the people of this Nation. * * * Furthermore, everyone is agreed that the only way we can exercise this function of preventing injurious expansion and contraction of credit is by centralizing control over certain instrumentalities. The bill accomplishes just that:" (79 Congressional Record, Part 6 page 6929, May 3, 1935.)

In the Senate debates Senator Glass made the following statement as to the changes made by the Senate Committee:

"I have not referred to the reserve requirements of the bill as it came over from the House, but the committee wisely, I think, and as the committee unanimously thought, insists upon the retention of a statutory reserve, or a reserve defined and enacted into law by the Congress itself and not left to the doubtful or ignorant judgment or whim of any bureau here in Washington. Under the proposition as originally presented, the central board here could destroy any business or ruin any section of this country from Maine to California, or from the Great Lakes to Texas.

"The Board was given complete control of the reserves of member banks. It could determine whether the textile business was overproduced, whether the steel or the coal business was overproduced, whether the wheat crop or flour mill products were overproduced, and if, in its view, there was overproduction, the Board could so fix the reserves of the member banks as to deny credit to such industries. No such stupendous authority was ever granted to any central board in any civilized country on earth.

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"The pending bill provides that the existing reserves of 7 percent, 10 percent, and 13 percent may not be reduced -- * * * -- and that they may not be increased beyond a certain percentage. We declined to leave to the discretion of a board here in Washington or anywhere else the determination of a matter of this sort." (79 Congressional Record, Part 11, page 11827, July 25, 1935.)

The provisions of section 19 authorizing the Board to change reserve requirements of member banks were further amended by the Act of July 7, 1942 (56 Stat. 648), in order to make possible more flexibility in the fixing of reserve requirements as between central reserve cities and reserve cities. In explanation of this change, the report of the Senate Banking and Currency Committee stated:

"Section 2 of the bill amends section 19 of the Federal Reserve Act so as to authorize the Board of Governors of the Federal Reserve System to change the Reserve requirements of member banks in central Reserve cities, within the limits of the present law, without necessarily making a change in the Reserve requirements of member banks in Reserve cities. Under the present law the Board of Governors of the Federal Reserve System, in order to prevent injurious credit expansion or contraction, may change the requirements as to the maintenance of reserves by banks located in Reserve and central Reserve cities or by member banks located elsewhere, but it may not change the Reserve requirements of member banks in central Reserve cities without at the same time changing those of member banks in Reserve cities. In order to provide the necessary flexibility with respect to Reserve requirements, especially in connection with heavy withdrawals of deposits from banks throughout the country in order to meet Federal tax liabilities and to prevent a depressing effect upon the Government security market as a result of such withdrawals, it is felt that the Board of Governors should be empowered to change the Reserve requirements of member banks in central Reserve cities without, at the same time, changing the Reserve requirements of other member banks." (Senate Report 1523, page 1, 77th Congress.)

As thus amended in 1942, the sixth paragraph of section 19 has not since been changed and now reads as follows:

"Notwithstanding the other provisions of this section, the Board of Governors of the Federal Reserve System, upon the affirmative vote of not less than four of its members, in order to prevent injurious credit expansion or contraction,

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may by regulation change the requirements as to reserves to be maintained against demand or time deposits or both (1) by member banks in central reserve cities or (2) by member banks in reserve cities or (3) by member banks not in reserve or central reserve cities or (4) by all member banks; but the amount of the reserves required to be maintained by any such member bank as a result of any such change shall not be less than the amount of the reserves required by law to be maintained by such bank on the date of enactment of the Banking Act of 1935 nor more than twice such amount." (12 U.S. Code, Sec. 462b)

In 1948, by a Joint Resolution approved August 16, 1948 (62 Stat. 1291), the Board was given temporary authority to increase reserve requirements of member banks, within certain limitations, above the maximum percentages authorized by the sixth paragraph of section 19 of the Federal Reserve Act. This Joint Resolution added to section 19 the following new paragraph:

"Notwithstanding any other provision of law, the Board of Governors of the Federal Reserve System, in order to prevent injurious credit expansion, may by regulation change the requirements as to reserves to be maintained pursuant to this section against demand or time deposits or both (1) by member banks in central reserve cities, or (2) by member banks in reserve cities, or (3) by member banks not in reserve or central reserve cities, or (4) by all member banks; but no such change shall have the effect of requiring any such member bank to maintain a reserve balance against its time deposits in an amount equal to more than 7-1/2 per centum thereof, or a reserve balance against its demand deposits in an amount equal to more than 30 per centum thereof if such bank is in a central reserve city, 24 per centum thereof if in a reserve city, or 18 per centum thereof if not in a reserve or central reserve city. No change in reserve requirements made under authority of this paragraph shall continue in effect after June 30, 1949."

In connection with this Resolution, the report of the House Banking and Currency Committee contained the following statement:

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"Existing law provides for statutory maximum reserve requirements for member banks of the Federal Reserve System, against the net demand deposits in the following amounts: For central Reserve city banks, 26 percent; for Reserve city banks, 20 percent; and for country banks, 14 percent. The maximum reserve applicable against time deposits of all member banks is 6 percent. While reserve requirements of country banks and Reserve city banks have been at the legal maximum since November 1, 1941, the reserve requirement of central Reserve city banks (New York and Chicago) remained at only 20 percent from October 3, 1942, through February 26, 1948. Effective February 27, 1948, the reserve requirement of the central Reserve city banks was increased to 22 percent and on June 11, 1948, it was further increased to 24 percent where it presently stands. Required reserves of the central Reserve city banks therefore still remain 2 percent below the present statutory maximum. Reserve requirements of all member banks against time deposits have been at the legal maximum 6 percent since November 1, 1941.

"The administration proposal would authorize increases up to 10 percentage points in the reserves of all member banks maintained against net demand deposits and an increase of up to 4 percentage points in the reserve against time deposits of all member banks. This is the first time that this committee has been presented with a formal proposal either from the administration or from the Federal Reserve to give consideration to any increase in these primary reserve requirements. None of the administration witnesses appearing before the committee would state how much, if any, increase would be made in reserve requirements if this most substantial increase in reserve requirement authority was granted. The power would be so broad that if abused, it might well cause a serious upset in the banking structure of the country resulting from a possible widespread calling of commercial loans and heavy liquidation of Government securities. The committee was reluctant to give any such broad grant of authority when no indication could be given of its possible use and particularly in view of the fact that the Federal Reserve even today has not made full use of the statutory reserve requirements applicable to the banks in the two most important banking centers of the country, namely, New York and Chicago.

"For the past 12 years the greatest single change in reserve requirements made by the Federal Reserve at any one time has been 3-1/4 percentage points in the case of reserves against net demand deposits and 1 percentage point in reserves against net time deposits. The committee believed that it was appropriate to limit this increase in reserve requirement authority, which under the provisions of the bill continues only until March 31, 1949, to an amount in keeping with past actual performance

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of the Federal Reserve Board. Accordingly, authority is granted for an increase up to a maximum of 3 percent in reserves required against net demand deposits and an increase of 1 percent in reserves required against time deposits of member banks of the System." (House Report 2455, 80th Cong., August 4, 1948, pp. 8, 9)

The temporary authority to increase reserve requirements provided by this amendment expired on June 30, 1949. Consequently, since that date the Board's authority to change reserve requirements has been limited to the authority contained in the sixth paragraph of section 19 under which the Board may increase percentages of required reserves up to twice the specified percentages fixed by the statute.

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OPEN MARKET OPERATIONS OF FEDERAL RESERVE BANKS

One of the most important of the credit control functions of the Federal Reserve System is its power to conduct purchases and sales of securities, particularly Government securities, on the open market and thus increase or decrease the volume of credit outstanding. The Federal Reserve Banks organized a voluntary open market committee in 1923 for the purpose of controlling Federal Reserve purchases and sales in the open market. Shortly thereafter it was voluntarily agreed that the committee should not engage in open market operations except with the approval of the Federal Reserve Board.

The existence of this Open Market Committee was first recognized by Congress in the Banking Act of 1933 (48 Stat. 181) which created a "Federal Open Market Committee" consisting of one representative of each Federal Reserve Bank. By the Banking Act of 1935 (49 Stat. 705) the Committee was reconstituted so as to consist of seven members of the Board and five representatives elected by the Federal Reserve Banks and all open market operations of the Federal Reserve Banks were subjected to the direction of the Committee. The legislative history of this matter is described below.

On January 21, 1932, Senator Glass introduced S. 3215 containing a section providing for the statutory creation of an Open Market Committee, and on March 17 and April 18, 1932 he introduced bills superseding S. 3215. With reference to the bill introduced on April 18, 1932 (S. 4412), the Senate Banking and Currency Committee made the following statement in its report:

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

"To reform these conditions the committee recommends.

* * * * * * *

"(d) Better definition of powers with respect to speculative transactions, particularly as to authority over open market dealings, by establishing a so-called 'open market committee' with designated authority." (Senate Report 584, 72d Cong.)

This legislation, however, was not enacted in 1932 and Senator Glass reintroduced the bill in the next Congress. This bill became the Banking Act of 1933 which was approved June 16, 1933. Among other things, it amended the Federal Reserve Act by inserting a new section 12A (U. S. Code, Title 12, sec. 263) reading as follows:

"Sec. 12A. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'committee'), which shall consist of as many members as there are Federal reserve districts. Each Federal reserve bank by its board of directors shall annually select one member of said committee. The meetings of said committee shall be held at Washington, District of Columbia, at least four times each year, upon the call of the governor of the Federal Reserve Board or at the request of any three members of the committee, and, in the discretion of the Board, may be attended by the members of the Board.

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"(b) 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 shall consider, 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 central or other foreign banks.

"(c) 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.

"(d) If any Federal reserve bank shall decide not to participate in open-market operations recommended and approved as provided in paragraph (b) hereof, it shall file with the chairman of the committee within thirty days a notice of its decision, and transmit a copy thereof to the Federal Reserve Board."

In both the Senate and House Committee Reports on the bill which became the Banking Act of 1933 the following statement appears:

"Section 8.--Adds a new section 12A to the Federal Reserve Act providing for the creation of a Federal Open Market Committee of 12 members to supervise the open market operations of the Federal Reserve Banks and the relations of the Federal Reserve System with foreign banks, in accordance with regulations adopted by the Federal Reserve Board. This in effect legalizes and gives official recognition to the present open market committee." (Senate Report 77 and House Report 150, 73d Cong.)

By the Banking Act of 1935, as indicated above, the Federal Open Market Committee was reconstituted and all open market operations of the Federal Reserve Banks made subject to the direction and regulation of the Committee. However, the manner in which the Committee should be constituted was one of the most controversial points in the 1935 Act. The bill as first passed by the House on May 9, 1935

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provided for an Open Market Advisory Committee consisting of 5 representatives of the Federal Reserve Banks and the following views were expressed by the House Banking and Currency Committee:

"Majority Views

"Section 205 of the bill amends section 12A of the Federal Reserve Act so as to provide for an Open Market Advisory Committee consisting of 5 representatives of the Federal Reserve banks elected annually by the governors of the 12 Federal Reserve banks. It will be the duty of the committee to consult and advise with, and make recommendations to, the Federal Reserve Board from time to time with regard to the open-market policy of the Federal Reserve System and to aid in the execution of open-market policies. The Federal Reserve Board will be required to consult the committee before making any changes in the open-market policy, discount rates of Federal Reserve banks, or in the reserves required of member banks. After consulting with and considering the recommendations of the committee, however, the Federal Reserve Board will be empowered to prescribe the open-market policy of the Federal Reserve System, and this policy will be binding on all Federal Reserve banks.

"Having enlarged the duties of the Federal Reserve Board with regard to the economic objectives of monetary action and credit administration, it is essential that the Board be given the same definite responsibility and final authority with respect to the open-market policies of the Federal Reserve System as it already possesses with respect to the discount rates of the Federal Reserve banks and the reserves required of member banks.

"Under the present law, open-market policies are formulated by the Federal Open Market Committee, which consists of the governors of the 12 Federal Reserve banks. The recommendations of the committee are subject to the approval of the Federal Reserve Board, and the boards of directors of each Federal Reserve bank retain the authority to refuse participation in the policy adopted. We have, therefore, an arrangement by which there is a policy-making body of 12, which has power to formulate policies, but not to put them into effect. We have the Federal Reserve Board, consisting of 8 members, who have the authority to approve or disapprove of the recommendations of the committee; and we have 108 directors of the Reserve banks, who have the final determination as to whether the policy is to be carried out or not. It would be difficult to conceive of an arrangement better calculated than this for diffusing responsibility and creating an elaborate system of obstructions.

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"The amendment will cure this situation by placing responsibility for national monetary and credit policies squarely upon the Federal Reserve Board. It will eliminate conflicts of jurisdiction and policy because the final decision as to all matters affecting national policies would be vested in the Federal Reserve Board. The participation of Federal Reserve bank governors in the deliberations leading to the adoption of open-market policies will be preserved. Open-market operations may be initiated either by the committee of the governors or by the Board, but the ultimate responsibility for making a final decision and the power for adopting and carrying out national policies will be concentrated in a national body, as they properly should be in the public interest.

"The Federal Reserve Board is appointed by the President and confirmed by the Senate. It has a national viewpoint and has long been accustomed to considering matters as they affect the country as a whole, without regard to the special interests of any particular group or locality. It was created for the purpose of supervising and coordinating the activities of the 12 Federal Reserve banks 'in order that they may pursue a banking policy which shall be uniform and harmonious for the country as a whole' (report of the Banking and Currency Committee of the House of Representatives on the original Federal Reserve Act, Rept. No. 69, 63d Cong., 1st sess., p. 16). It is for this reason that the original Federal Reserve Act gave the Federal Reserve Board final authority over discount rates. Since open-market operations have in more recent years come to be recognized as a much greater factor in credit policy than discount rates, it is entirely consistent with the philosophy of the original Federal Reserve Act to vest in the Federal Reserve Board final authority with respect to the open-market policies of the Federal Reserve System.

"Minority Views

"At the present time open-market operations, that is, the buying and selling of Government obligations by the Federal Reserve banks, are recommended by a committee of governors of the Reserve banks, but no such bank may be compelled to take part in these operations if it prefers not to do so. Under this bill the Federal Reserve Board becomes the open-market committee and its decision as to buying and selling of Government bonds is mandatory on all the Federal Reserve banks.

"Open-market operations are always conducted for all the banks by the New York Federal Reserve Bank, for New York is the money and bond market of the country. If this new provision

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becomes law, it means that the resources of the Federal Reserve banks from the 12 districts may be drained to New York for the purpose of acquiring bonds, no matter how unwise it might appear to bankers generally. Thus the board of directors of a particular Federal Reserve bank might consider that it was already overloaded with Government bonds, and yet be forced to buy more.

* * * * * * *

"One of the things most dreaded today by thinking people is the possibility of the weakening, or perhaps collapse of Government credit because of continued deficits. Government financing should be on the same basis as a private financing; that is, a free and open market where the savings of the people are voluntarily used in the purchase of Government obligations. Whenever the Government is in a position to compel the use of the savings of the people to acquire such obligations, such financing becomes a forced loan and is one of the most vicious inroads on liberty. Weakening of the market for Government obligations is a danger signal in the spending program of any government, and this bill would make it easy to ignore such a danger signal. What most people do not realize is that whenever banks may be forced to acquire Government bonds against their will, or at rates which they would not recognize if the transaction were voluntary, as far as the actual credit of the Government is concerned, deficits might just as well be financed by fiat money." (House Report 742, 74th Cong.)

The Senate Banking and Currency Committee revised the proposed amendment to section 12A of the Federal Reserve Act, and in its report the Committee commented as follows regarding this section:

"Section 205 of the bill as it passed the House provided for an Open Market Advisory Committee, consisting of five representatives of the Federal Reserve banks, to take the place of the Federal Open Market Committee provided for in existing law. The Advisory Committee was authorized to consult and advise with and make recommendations to the Federal Reserve Board. It had no vote in determining open-market policies, but the Board was required to consult the Committee before making any changes on its own initiative in open-market policies, in rates of interest and discount to be charged by Federal Reserve banks, or in the reserve balances required to be maintained by member banks. In lieu of this provision, the committee in section 204 of the

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reported bill amends existing law so as to provide for a Federal Open Market Committee, consisting of the members of the Board of Governors of the Federal Reserve System, and five representatives of the Federal Reserve banks to be selected annually. Four of such representatives are to be elected by the boards of directors of the Federal Reserve banks by regions, that is to say, 1 to represent the Boston, New York, and Philadelphia banks, 1 to represent the Cleveland, Chicago, and St. Louis banks, 1 to represent the Richmond, Atlanta, and Dallas banks, and 1 to represent the Minneapolis, Kansas City, and San Francisco banks. The fifth representative, who is to be chosen from the country at large, is to be elected annually by the presidents of the 12 Federal Reserve banks. An alternate to serve in the absence of each such representative is to be elected annually in the same manner.

"It is provided that no Federal Reserve bank shall engage or decline to engage in open-market operations under section 14 of the Federal Reserve Act, except in accordance with regulations adopted by the Committee. The provision of existing law which allowed a Federal Reserve bank to decline to participate in open-market operations recommended and approved by the Committee, upon filing a notice of its decision within 30 days, is eliminated. The provision of existing law is retained which states that the time, character, and volume of all purchases and sales of paper described in section 14 of the Federal Reserve 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." (Senate Report 1007, 74th Cong., July 2, 1935)

The provisions of the bill relating to this subject were amended in conference and the House conferees in their report stated:

"The conference agreement retains the provisions of the Senate amendment in substance as section 205 but instead of providing for a representative-at-large of the banks, it provides for 5 representatives to be elected as follows: 1 by the board of directors of the Boston and New York banks; 1 by the board of directors of the Philadelphia and Cleveland banks; 1 by the board of directors of the Chicago and St. Louis banks; 1 by the board of directors of the Richmond, Atlanta, and Dallas banks; and 1 by the board of directors of the Kansas City, Minneapolis and San Francisco banks. The conference agreement also eliminates the power of the Committee to make regulations with

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respect to the relations of the Federal Reserve System with foreign central or other foreign banks since this would be in conflict with the general authority over such matters which is granted to the Federal Reserve Board under existing law. This provision becomes effective March 1, 1936." (Report No. 1822, 74th Cong., August 17, 1935)

There were no further changes in this section and it was enacted (as part of the Banking Act of 1935) as recommended by the Conference, thus amending section 12A of the Federal Reserve Act to read as follows:

"Sec. 12A. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'Committee'), which shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected as hereinafter provided. Such representatives of the Federal Reserve banks shall be elected annually as follows: One by the boards of directors of the Federal Reserve Banks of Boston and New York, one by the boards of directors of the Federal Reserve Banks of Philadelphia and Cleveland, one by the boards of directors of the Federal Reserve Banks of Chicago and Saint Louis, one by the boards of directors of the Federal Reserve Banks of Richmond, Atlanta, and Dallas, and one by the boards of directors of the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco. An alternate to serve in the absence of each such representative shall be elected annually in the same manner. The meetings of said Committee shall be held at Washington, District of Columbia, at least four times each year upon the call of the chairman of the Board of Governors of the Federal Reserve System or at the request of any three members of the Committee.

"(b) No Federal Reserve banks shall engage or decline to engage in open-market operations under section 14 of this Act except in accordance with the direction of and regulations adopted by the Committee. The Committee shall consider, adopt, and transmit to the several Federal Reserve banks, regulations relating to the open-market transactions of such banks."

By the Act of July 7, 1942 (56 Stat. 647), section 12A was further amended so as to make it possible for the Federal Reserve Bank of Boston to have a member on the Open Market Committee when selected without depriving the Federal Reserve Bank of New York of representation.

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The House bill was reported without amendment by House Report 2282 (77th Cong.) on June 25, 1942, and the Senate bill was reported with Senate Report 1523 (77th Cong.) on June 25, 1942. The following statement was in the Senate report:

> "Section 1 of the bill provides for regrouping the Federal Reserve banks for the purpose of electing their five representatives on the Federal Open Market Committee. At present one representative of the Federal Open Market Committee is elected by the Boston and New York reserve banks, but in practice the Boston Reserve Bank has never had a representative serve as a member of the Committee but only as an alternate to the President of the New York Reserve Bank, who has served continuously. The effect of the change in existing law made by section 1 of the bill would be to require that a representative of the Federal Reserve Bank of New York be a member of the Committee at all times, and the regrouping provided for by such section also makes it possible for the president of the Federal Reserve Bank of Boston to serve from time to time as a member of the Committee, as do the presidents of the other Reserve banks. Your committee believe that it is desirable in the public interest that the changes contemplated by section 1 of the bill be made."

Subsection (a) of section 12A as thus amended now reads as follows:

> "Sec. 12A. (a) There is hereby created a Federal Open Market Committee (hereinafter referred to as the 'Committee'), which shall consist of the members of the Board of Governors of the Federal Reserve System and five representatives of the Federal Reserve banks to be selected as hereinafter provided. Such representatives shall be presidents or first vice presidents of Federal Reserve banks and, beginning with the election for the term commencing March 1, 1943, shall be elected annually as follows: One by the board of directors of the Federal Reserve Bank of New York, one by the boards of directors of the Federal Reserve Banks of Boston, Philadelphia, and Richmond, one by the boards of directors of the Federal Reserve Banks of Cleveland and Chicago, one by the boards of directors of the Federal Reserve Banks of Atlanta, Dallas, and St. Louis, and one by the boards of directors of the Federal Reserve Banks of Minneapolis, Kansas City, and San Francisco. In such elections each board of directors shall have one vote; and the details of such elections may be governed

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by regulations prescribed by the committee which may be amended from time to time. An alternate to serve in the absence of each such representative shall likewise be a president or first vice president of a Federal Reserve bank and shall be elected annually in the same manner. The meetings of said Committee shall be held at Washington, District of Columbia, at least four times each year upon the call of the chairman of the Board of Governors of the Federal Reserve System or at the request of any three members of the Committee."

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DIRECT PURCHASES OF UNITED STATES OBLIGATIONS

The Banking Act of 1935 (49 Stat. 705) amended Section 14(b) of the Federal Reserve Act so as to require that purchases and sales of Government securities be made by the Federal Reserve Banks only in the open market. This provision was first placed in the Bill which became the Banking Act of 1935 when it was pending in the Senate Banking and Currency Committee. Section 14(b) as thus amended provided as follows:

> "(b) To buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, country, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board: Provided, That any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities but only in the open market;"

During the debates in Congress on this provision, Senator Glass made the following statement (Cong. Rec., Vol. 79, Part 11, p. 11826):

> "In the operations of the open-market committee, as constituted under the bill, we provide that Government bonds may be purchased by the Federal Reserve banks, but only in the open market. The wisdom of that ought to be manifest to anyone. Such bonds should not be purchased, under the mandatory provision of the bill, directly from the Treasury.

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"Suppose, for example, the open-market quotation for Federal Reserve bonds is 10, or 20, or 25, or 30 percent below par, as once was the case. No one can conceive of any fair reason why a Federal Reserve bank should use the reserve funds of their member banks to purchase Government bonds at par directly from the Treasury when they could go into the open market and buy them at a greatly depreciated price. Therefore, we require that the purchases shall be in the open market."

In the report of the House Committee it was stated:

"Section 207 of the bill as it passed the House amended section 14 of the Federal Reserve Act, so as to make eligible for purchase by Federal Reserve banks without regard to maturities direct obligations of the United States or obligations which are fully guaranteed by the United States as to principal and interest. This provision has been modified by section 205 of the reported bill so as to provide that direct obligations of the United States and such guaranteed obligations may be purchased only in the open market. * * *" (House Report 1007, 74th Cong.)

The Second War Powers Act of 1942 (56 Stat. 176) amended this provision of law and authorized, for a limited time, direct purchases from the United States in an amount not exceeding $5,000,000,000 by all Federal Reserve Banks. The House Committee's report of February 9, 1942, gave the following explanation for this amendment:

"Title IV of the bill authorizes the Federal Reserve banks to purchase Government securities directly from the Government instead of limiting such purchases to the open market.

"During the last World War and until 1935, Federal Reserve banks had authority to make purchases of Government securities directly from the Government. In 1935 the Federal Open Market Committee, consisting of the members of the Federal Reserve Board and 5 representatives of the Federal Reserve banks, was empowered to control the purchases and sales of Government securities which were made by the 12 Federal Reserve banks. It was then felt desirable to restrict purchases of Government securities to purchases in the open market. In view of the war emergency and the huge amount of borrowing that will be necessary to finance the war, the Federal Reserve System must now be able to meet any situation which may arise.

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"The Chairman of the Federal Reserve Board advised this committee that it is essential for the Federal Reserve System to be given the power to purchase Government securities directly from the Government as well as in the open market in order to maintain a stable market for Government securities during the war. It was represented to this committee that this power will not be used as a substitute for the ordinary method of financing Government securities but will be used as an extraordinary power at times when the stability of the market might otherwise be impaired.

"The power is necessary to enable the Federal Reserve System to aid the Treasury Department, which concurs in the necessity for this amendment, to meet emergencies which may arise during the war, the exact nature of which cannot be foreseen at this time. It is a power now possessed by other central banks, such as the Bank of Canada and the Bank of England.

"The committee is of the opinion that this title is essential not only for the purpose of war financing, but as a protection to the holders of Government securities who may be disastrously affected if the Government securities market does not remain stable." (House Report 1765, 77th Cong.)

This authority has been extended from time to time with the addition of a requirement that the Board shall include detailed information on such purchases in its annual reports to Congress. The Senate Committee's report of March 24, 1947, contained the following statement which Mr. Eccles had presented to the Committee:

"As I have indicated, the authority existed for more than 20 years prior to 1935. It is more needed than ever today because of the size of the debt and the refinancing operations. The fact that tax collections are also very large, currently about 40 billions a year, means that quarterly withdrawals from the banking system are going to continue to be heavy, so that it will be desirable to have the authority to help in stabilizing the money market at tax dates.

"The direct purchase authority merely provides a line of available credit for use if needed. Without it, the Treasury would feel obliged to carry much larger cash balances, which means that it would have to borrow more and thereby increase the amount and cost of the public debt. In other words, having the authority, even though there may be no need

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to use it, enables the Treasury to carry smaller balances than would otherwise be possible and thus reduces interest charges. For every billion dollars of Treasury balance that can be saved in this way, interest costs would be reduced by at least $4,000,000.

"The purpose for which the direct purchase authority has always been used in the past and would be used in the future is simply one of meeting temporary needs of the Treasury which, if met in other ways, would entail either needless additional costs in managing the public debt or equally needless fluctuations in the securities and money markets for brief periods. What is involved in the proposed bill is not a question of monetary theory or policy, but simply a question of efficient, economical, and businesslike management of the public debt." (Senate Report 70, 80th Cong.)

The following excerpts from the Senate Committee's report of May 5, 1950, explained the purpose of this limited authority when the last extension was made:

"The direct purchase authority is a useful mechanism whereby the Treasury Department and the Federal Reserve System can coordinate financing requirements of the Treasury with the requirements of the Federal Reserve System in regulating bank reserves and the money market. The mechanism is important at periods when the Treasury has to meet large payments, such as the redemption of maturing debt, at a time when withdrawals from the banking system are unusually heavy, as in the case of withdrawals to meet quarterly tax payments. The authority thus provides an aid in stabilizing the securities and money markets without which the Treasury would feel obliged to carry larger cash balances to accomplish the same purpose, a procedure which would increase interest costs to the Government.

"The purpose for which the direct purchase authority has always been used in the past and would always be used in the future is simply to meet temporary needs which, if not met, would cause unnecessary fluctuations in the securities and money markets for brief periods, and which, if met in other ways, would entail unnecessary additional costs in managing the public debt. As used to date, this line of credit has been secured by special 1-day obligations on which the Government pays interest of only one-quarter of 1 percent per annum. Since it was granted in 1942, the direct purchase authority has been used on only 63 days, all of them just prior to times when large tax receipts were deposited.

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"The Treasury Department and the Board of Governors of the Federal Reserve System both recommended that the authority be made permanent; however, the committee agreed that it would be better to review the operation of this authority again in 2 years." (Senate Report 1537, 81st Cong.)

Section 14(b) of the Federal Reserve Act now reads as follows:

"(b) To buy and sell, at home or abroad, bonds and notes of the United States, bonds of the Federal Farm Mortgage Corporation having maturities from date of purchase of not exceeding six months, bonds issued under the provisions of subsection (c) of section 4 of the Home Owners' Loan Act of 1933, as amended, and having maturities from date of purchase of not exceeding six months, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Board of Governors of the Federal Reserve System: Provided, That, notwithstanding any other provision of this Act, (1) until July 1, 1952, any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities either in the open market or directly from or to the United States; but all such purchases and sales shall be made in accordance with the provisions of section 12A of this Act and the aggregate amount of such obligations acquired directly from the United States which is held at any one time by the twelve Federal Reserve banks shall not exceed $5,000,000,000; and (2) after June 30, 1952, any bonds, notes, or other obligations which are direct obligations of the United States or which are fully guaranteed by the United States as to principal and interest may be bought and sold without regard to maturities but only in the open market. The Board of Governors of the Federal Reserve System shall include in their annual report to Congress detailed information with respect to direct purchases and sales from or to the United States under the provisions of the preceding proviso."

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MARGIN REQUIREMENTS ON REGISTERED SECURITIES

In a message to Congress on February 9, 1934, the President recommended legislation to regulate the operations of exchanges dealing in securities and referred specifically to speculation in stocks on a margin basis. In accordance with the President's message, legislation was introduced in Congress which was eventually enacted on June 6, 1934, as the Securities Exchange Act of 1934 (48 Stat. 881).

Section 7 of this Act authorized the regulation of the amount of credit that might be extended on securities registered on national securities exchanges. During the consideration of this measure, a considerable difference of opinion developed as to whether the regulation of such credit, in other words, margin requirements on securities, should be placed under the authority (1) of the Board, (2) of the Federal Trade Commission or a new commission, or (3) partly of the Board and partly of a commission.

Section 6(a) of H. R. 9323 as passed by the House on May 4, 1934, placed the administration of the Act under the Federal Trade Commission and directed the Board to prescribe all margin requirements. The report of the House Committee on Interstate and Foreign Commerce stated:

> "Section 6 empowers the Federal Reserve Board to prescribe margins for both brokers and banks on securities registered on exchanges licensed under the bill (hereinafter referred to as registered securities)---both for the initial opening and for the maintenance or carrying of accounts. The Board is given complete legal authority to fix margins at any point. But a

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standard is included in the bill as an indication by Congress to the Board that from the standpoint of a general policy of utilization of national credit resources, the Board should control the credit available to the stock market to an amount roughly corresponding to such standard.

"To protect margin requirements from evasion brokers may lend only on listed securities excepting exempted securities. Banks are subject to margin limitations only on loans on registered equity securities in cases where the loan is sought for the purpose of purchasing or carrying securities. The Board is not required to fix the same margins for banks as for brokers and is given a free hand in fixing margins for maintenance as distinguished from margins for the initial opening of accounts.

"It has seemed necessary to empower the Board to fix margins for banks as well as for brokers (a) to prevent evasion of restrictions on brokers' margins through loans by banks; (b) to increase the powers of the Board over speculative loans by its member banks; and (c) to give the Board an effective power (it has no powers at present) over speculative loans by nonmember banks." (House Report 1383, 73rd Cong., April 27, 1934)

Section 7(a) of the bill H. R. 9323 as passed by the Senate on May 12, 1934, established an independent commission (the Securities and Exchange Commission) with general authority over margin requirements except in the case of member banks. The Board was authorized but not directed to prescribe margin requirements for loans by member banks on securities.

The Report of the Senate Banking and Currency Committee follows:

"The original bill (S. 2693) contained rigid provisions limiting the amount of credit which could be extended on a registered security to 40 percent of the current market price or 80 percent of the lowest price during the preceding 3 years. After due consideration, the committee does not recommend that statutory limitations be placed upon the extension or maintenance of credit. The bill authorizes the Commission to prescribe rules and regulations for the purpose of preventing the excessive use of credit for the purchasing, selling, carrying or trading in

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securities. Such rules and regulations need not be uniform throughout the United States, and hence local conditions requiring special treatment may be taken into consideration. To prevent sudden liquidation of existing margin accounts subsequent to the passage of the bill, it is provided that the rules and regulations prescribed by the Commission shall not be effective before June 30, 1936, as to any loan made prior to the enactment of the bill, or any renewal thereof.

"The foregoing provisions would be ineffectual to curb speculation unless they were supplemented by restrictions upon the power of others than brokers and dealers to extend credit, since loans to customers directly from banks and others could be arranged to evade margin requirements. The bill imposes manifold checks upon the employment of credit for speculative purposes: (1) It empowers the Commission to limit the amount of credit which a broker or dealer may extend upon a security; (2) it prohibits brokers and dealers from borrowing except through a member bank of the Federal Reserve System or in accordance with regulations of the Commission; (3) it empowers the Commission to limit the amount which brokers may borrow; (4) it authorizes the Federal Reserve Board to limit the amount which member banks may loan on securities; and (5) it empowers the Commission to regulate loans to brokers and dealers by corporations having securities listed on exchanges." (Senate Report 792, 73rd Cong., April 20, 1934)

When the bill was sent to conference the conferees accepted the Senate proposal for an independent commission to administer the Act, but agreed to the House proposal that the Board be directed to prescribe all margin requirements.

The Conference Report contained the following statement:

"The House bill (sec. 6) and the Senate amendment, in their provisions relating to margin requirements, differ principally in that (1) under the House bill a standard is included for the guidance of the Federal Reserve Board in prescribing its rules and regulations with respect to the amount of credit that may be initially extended on any registered security, subject to the power of the Board to prescribe higher or lower margin requirements in the case of the initial extension of credit if it finds that certain specified conditions prevail to warrant such action, and

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(2) the House bill places under the Federal Reserve Board the administration of all the margin provisions whereas the Senate bill places the administration of all such provisions under the Commission except insofar as they relate to member banks of the Federal Reserve System, and to this extent the Senate amendment provides that the margin provisions shall be under the jurisdiction of the Federal Reserve Board. The substitute follows rather closely the provisions of the House bill except that the provision granting authority to the Federal Reserve Board to lower or raise margin requirements in case of the initial extension of credit is applied as well to the maintenance of credit. The House bill gives authority to the Federal Reserve Board to lower or raise margin requirements with respect to 'all or specified securities or classes of securities, or classes of transactions.' The substitute modifies this provision so that such authority is also given with respect to 'specified transactions.' The House bill provides that the rules and regulations under the section relating to margin requirements shall not apply on or before January 31, 1939. The Senate amendment fixes the date in the corresponding provision in the Senate amendment at June 30, 1936. The substitute fixes the date at July 1, 1937." (Conference Report 1838, 73rd Cong., May 31, 1934)

Since the provisions of the Securities Exchange Act relating to this subject are somewhat lengthy, they will not be quoted in full at this point but the following is a brief summary of these provisions.

For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board was directed to prescribe rules with respect to the amount of credit that may be initially extended and maintained on any security registered on a national securities exchange. For this purpose, a certain formula was prescribed for the initial rules of the Board, but the Board was authorized from time to time to prescribe lower or higher margin requirements. It is unlawful for any member of an exchange or any broker or dealer transacting a

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business in securities through the medium of any such member to extend credit contrary to such regulations. The Board is also authorized to regulate the extension of credit by persons (such as banks) other than members, brokers, or dealers when such credit is for the purpose of purchasing or carrying registered securities. Members, brokers, and dealers are forbidden to borrow on registered securities except (1) from a member bank, (2) from a nonmember bank which has filed with the Board an agreement to comply with the Securities Exchange Act and related laws, or (3) in accordance with rules of the Board to permit loans between members, brokers, and dealers or to meet emergencies. (Sections 7 and 8 of Securities Exchange Act)

As additional background with respect to this matter, there is quoted below a statement issued by the Federal Reserve Board on July 5, 1934:

"At its recent conference with the chairmen and governors of the Federal Reserve banks the Federal Reserve Board considered the new responsibilities placed upon the System by the Securities Exchange Act of 1934. This act gives the Federal Reserve Board authority to determine the margins to be required by brokers and dealers in extending credit to their customers, and also empowers the Board, within certain limitations, to prescribe rules and regulations, including margin requirements, for loans extended by other persons, including banks, for the purpose of purchasing or carrying securities registered on national securities exchanges.

"Margin requirements do not become effective before October 1, 1934, and the Board's regulations on the subject will not be issued for several weeks.

"In the case of brokers the law lays down a standard of margins, which shall constitute the basis of the Board's regulations, although the Board is given authority to prescribe lower

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requirements, if it deems it necessary or appropriate for the accommodation of commerce and industry, with due regard to the general credit situation in the country, and to prescribe higher margins if it deems it necessary or appropriate in order to prevent the excessive use of credit to finance transactions in securities. In the case of other lenders on securities, including banks, no standard is specifically laid down in the law, the margins to be prescribed being left to the Board's discretion.

"The fundamental principle by which the Board is to be guided in determining margin requirements and in formulating its regulations is stated in the law. The Board is directed to enforce its new powers for the purpose of preventing the excessive use of credit for the purchase or carrying of securities. This principle is in line with the provisions of the Banking Act of 1933, which in several sections places special responsibility on the Federal Reserve banks and the Federal Reserve Board in connection with excessive use of bank credit in the security markets. The law imposes upon the Federal Reserve Board no duties in connection with the supervision of the stock exchanges or the prevention of undesirable practices among members of such exchanges. Responsibility for these matters is placed upon the Securities and Exchange Commission. The Federal Reserve Board's duty under this act relates chiefly to the determination of margins to be required on security loans, a power to be exercised as a part of the Federal Reserve System's general credit policy of controlling undue credit expansion in the security markets.

"Insofar as banks are concerned, the Federal Reserve Board's authority under this act relates to loans made for the purpose of purchasing or carrying securities registered on national securities exchanges. It does not apply, therefore, to loans made solely for industrial, agricultural, or commercial purposes, regardless of the question whether these loans are secured or unsecured, and, if secured, regardless of the character of the collateral. The determining factor is the purpose of the loan and not the nature of the security offered. If a loan is collateraled by stocks or other equity securities and is made for the purpose of purchasing or carrying securities registered on a national securities exchange, it comes under this section of the act; if it is made for any other purpose, then it is exempt. The Board's power under this section, furthermore, does not apply to loans on exempted securities, which are defined by the law as including among other securities obligations of the United States, or of any State or political subdivision, and

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such other securities as the Securities and Exchange Commission may declare to be exempted securities. The power of the Board is further limited by exempting bank loans on securities other than equity securities, which means in practice that it is not applicable to loans on bonds, except bonds such as those having conversion privileges, and there are certain other exemptions. In general, the law, insofar as it applies to control over banks, is intended to prevent the banks from being used for the purpose of circumventing the margin requirements prescribed for loans extended by brokers to their customers, and to prevent undue expansion of bank credit employed in the securities markets.

"General banking practices in relation to loans for industrial, agricultural, or commercial purposes are not affected by this act." (1934 Federal Reserve Bulletin 434-435)

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CONSUMER CREDIT REGULATION

Authority to regulate consumer credit was first placed in the Board of Governors of the Federal Reserve System by an Executive Order of the President, No. 8843, dated August 9, 1941 (Code of Fed. Reg., 1943 Cum. Supp., Title 3, p. 976). It was based on the provisions of section 5(b) of the Trading with the Enemy Act, originally enacted October 6, 1917 (40 Stat. 415). The most important provisions of Executive Order 8843 are as follows:

> "NOW, THEREFORE, by virtue of the authority vested in me by section 5(b) of the act of October 6, 1917, as amended, and by virtue of all other authority vested in me, and in order, in the national emergency declared by me on May 27, 1941, to promote the national defense and protect the national economy, it is hereby ordered as follows:
>
> "ADMINISTRATION
>
> "SECTION 1. (a) The Board of Governors of the Federal Reserve System (hereinafter called the Board) is hereby designated as the agency through which transfers of credit between and payments by or to banking institutions (as defined herein pursuant to section 5(b) of the aforesaid Act) which constitute, or arise directly or indirectly out of, any extension of credit of a type set out in section 2(a) of this order shall be investigated, regulated and prohibited.
>
> "(b) The Board shall, whenever it deems such action to be necessary or appropriate, take any lawful steps herein authorized and such other lawful steps as are within its power to carry out the purposes of this order, and may, in administering this order, utilize the services of the Federal Reserve Banks and any other agencies, Federal or State, which are available and appropriate.
>
> * * * * *
>
> "REGULATIONS
>
> "SECTION 2. (a) Whenever the Board shall determine that such action is necessary or appropriate for carrying out the

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purposes of this order, the Board shall prescribe regulations with respect to transfers and payments which constitute, or arise directly or indirectly out of, any extension of instalment credit for the purpose of purchasing or carrying any consumers' durable good except a residential building in its entirety; and the Board may in addition, to the extent deemed by it to be desirable and feasible in order to prevent evasion of such regulations as may be so prescribed or in order to control forms of credit the use of which might defeat the purposes of this order and such regulations, prescribe regulations with respect to transfers and payments which constitute, or arise directly or indirectly out of, (1) any other extension of instalment credit, or (2) any other extension of credit for the purpose of purchasing or carrying any consumers' durable good, or (3) any other extension of credit in the form of a loan other than a loan made for business purposes to a business enterprise or for agricultural purposes to a person engaged in agriculture. Such regulations may be prescribed by the Board at such times and with such effective dates as the Board shall deem to be in accordance with the purposes of this order."

The authority to regulate consumer credit under Executive Order 8843 continued until November 1, 1947, when it was terminated by the Act of August 8, 1947 (61 Stat. 921), which provided as follows:

"That after November 1, 1947, the Board of Governors of the Federal Reserve System shall not exercise consumer credit controls pursuant to Executive Order Numbered 8843, and no such consumer credit controls shall be exercised after such date except during the time of war beginning after the date of enactment of this joint resolution or any national emergency declared by the President after the date of enactment of this joint resolution."

The following excerpts from the Committee reports will show the reasons for this withdrawal of authority to regulate consumer credit:

"Regulation W of the Board of Governors of the Federal Reserve System which provides for consumer credit control rests upon the authority of Executive Order No. 8843 of August 9, 1941, issued by the President under the Trading with the Enemy Act. It was a wartime measure designed to reduce the demand for strategic materials necessary for the war effort and to reduce the inflationary pressure for goods and services in general and at the same time build up a backlog of purchasing power for postwar use.

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"The restriction bears most heavily on persons of limited income and in many cases undoubtedly effectively excludes them from these markets. It gives to the man of financial means, in effect, priority of rights to buy whatever he wants and whenever he is willing to pay the price. It denies to the individual of limited sources the right to use his credit on the best terms he can secure for the purpose of buying these necessities.

* * * * *

"Mass consumption goes hand in hand with mass production and consumer credit is essential to mass consumption. American industry has an enormous productive capacity. Both consumer credit and producer credit are essential to a sustained prosperity.

"It is normal for consumer credit to expand in good times because people feel free to obligate themselves when they are reasonably confident of being able to liquidate their debts. The grantors of credit in their own self-interest are opposed to overextension of credit because they are lending their own money or funds for which they are obligated. Both the lenders and borrowers are interested in maintaining sound budget borrowing. Regulation W interposes an interference with the sound ordinary buying habits of a vast segment of the buying public." (House Report 746, 80th Congress) See also Senate Report 473, and House Report 1075, 80th Congress.

From the expiration of the power on November 1, 1947, until August 16, 1948, there was no authority to regulate consumer credit. However, by the Joint Resolution of August 16, 1948 (62 Stat. 1291), the Board was given specific statutory authority by Congress to regulate consumer instalment credit in accordance with Executive Order 8843, with the stipulation that this authority should terminate on June 30, 1949.

The following are the provisions of the Joint Resolution of August 16, 1948, relating to this matter:

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"That in order to protect the Nation's monetary, banking, and credit structure, and interstate and foreign commerce, against increased inflationary pressures, the Board of Governors of the Federal Reserve System are authorized, notwithstanding the Act of August 8, 1947 (Public Law 386, Eightieth Congress), to exercise, up to and including June 30, 1949, consumer-credit controls in accordance with and to carry out the purposes of Executive Order Numbered 8843 (August 9, 1941) insofar as it relates to installment credit.

"All the present provisions of sections 21 and 27 of the Securities Exchange Act of 1934, as amended (relating to investigations, injunctions, jurisdictions, and other matters), shall be as fully applicable with respect to the exercise by the Board of Governors of consumer installment credit controls as they are now applicable with respect to the exercise by the Securities and Exchange Commission of its functions under that Act, and the Board shall have the same powers in the exercise of such consumer installment credit controls as the Commission now has under the said sections."

The legislation which became the Joint Resolution of August 16, 1948, had been introduced by Senator Maybank in November 1947, as S. J. Res. 157. In testifying before the Senate Banking and Currency Committee with reference to this proposal, Governor Evans, member of the Reserve Board, stated:

"The need for regulation is acute at the present time but the need is not merely a temporary one. Experience has shown that the excessive expansion and subsequent contraction of consumer installment credit contributes substantially to economic instability. Its role in instability is increasing as the years go by, with the growing importance of consumers' durable goods in the economy. It is recognized that the development of this type of credit has gone hand in hand with the unparalleled industrial development of the Nation. Yet, it is equally significant that when competition takes the form of relaxing credit terms and is carried to extremes, it is a symptom and cause of economic unsoundness. Millions of people are encouraged to overpledge future income. This inevitably entails instability because the excessive credit extended during a business boom accentuates the boom and then

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has to be liquidated out of current income on the downswing, which accentuates depression. The fact that current income has to be used to pay off excessive installment debt created during the business boom necessarily diverts that income from the channels of consumer expenditures in the depression, especially in the important sector of consumers' durable goods.

"Voluntary efforts have been made from time to time by foresighted retailers, sales finance companies, banks, and other lenders to prevent down payments from becoming excessively small and repayment periods from becoming overextended in times of credit expansion. These efforts, however, have always been ineffective because of the aggressive competition of those who will not voluntarily cooperate in this objective. Since the end of Regulation W, only 3 weeks ago, for example, and notwithstanding efforts by many to hold the line, installment credit terms have been growing more and more liberal in many fields. Credit terms, in fact, have already become too easy for these boom times.

* * * * *

"The Board feels that this type of regulation, which is of a selective character, serves a useful purpose which cannot be reached by the exercise of any powers over bank credit in general. The regulation is needed, therefore, as a supplement to, and not a substitute for, general credit control powers. Each instrument has its proper place in a well-rounded anti-inflation program." (Hearings before Senate Banking and Currency Committee on S. J. Res. 157, November-December 1947, pages 2, 3 and 4.)

Also in testifying on this proposal, Chairman Eccles of the Reserve Board stated:

"The difficulty is that when the income of the consumers seems to be the greatest, and when they ought to be getting out of debt, ought to be living upon their income, is the very time when they make the greatest number of commitments for future payments, and it is at the same time that they get less value for their dollars. They pay higher prices for what they get. Then you get a deflationary period, they are on part time, or the overtime work is over, their wages are cut, they are out of work, and their ability to meet these payments becomes very greatly impaired and they therefore curtail on their other expenditures, and that adds to the deflationary pressures, just

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as their expansion of consumer credit on the up side adds to the inflationary pressure. Installment credit at a time like the present is definitely inflationary." (Hearings before Senate Banking and Currency Committee on S. J. Res. 157, November-December 1947, pages 190 and 191.)

The existing authority to regulate consumer credit is contained in the Defense Production Act of 1950 (Public Law 774, 81st Cong.), and reads as follows:

"Sec. 601. To assist in carrying out the objectives of this Act, the Board of Governors of the Federal Reserve System is authorized, notwithstanding the provisions of Public Law 386, Eightieth Congress (61 Stat. 921), to exercise consumer credit controls in accordance with and to carry out the provisions of Executive Order Numbered 8843 (August 9, 1941) until such time as the President determines that the exercise of such controls is no longer necessary, but in no event beyond the date on which this section terminates."

When the House Banking and Currency Committee made its report on this legislation under date of July 28, 1950, it cited the necessity for further regulation of consumer credit:

"Authority for restrictions on consumer and real estate credit should be provided for use to the extent necessary as an essential part of the program for conserving resources for defense and protecting the economy against inflation. This authority would help to prevent current and potential demand from exceeding supply in the areas affected. Accordingly, it would help to reduce inflationary pressure upon prices in these areas. It would help to make materials and manpower more readily available for the national defense and military effort, including the materials and manpower necessary to expand our total productive capacity.

"The present international situation not only increases greatly the Government's demand for the goods and services of our economy, but at the same time accelerates private demand. These two additional factors of demand are imposed on a condition of already very high demand, employment, and prices. * * *

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"Unless prompt action is taken, the country will face serious problems of gray markets and spiraling prices. Not only would this situation upset our economic balance but it would add to the difficulty in procuring the manpower and materials necessary for the military effort. * * *

"Expansion of consumer and mortgage credit contributes not only to the current demand for labor and materials that go into housing and durable consumer goods, but also augments the demand for all other goods. The purchasing power created by consumer and mortgage credit enters the income stream where it adds to the competition for goods, including materials vital to the national defense.

"If mortgage and consumer credit is appropriately limited now it will be in a better position to play a necessary and desirable role whenever adequate productive capacity is once more available to meet freely consumer demands." (House Report 2759, 81st Congress)

The Senate Banking and Currency Committee, in its report of August 7, 1950 on the proposed Defense Production Act, stated:

"Your committee was extremely concerned by the extent to which inflationary pressures have mounted in the last several weeks, * * *. Some of the current inflationary pressures may be temporary and may subside as the fear of imminent war subsides. It is certainly to be hoped that a resumption of normal buying habits by all consumers will soon lessen substantially the current inflationary tendencies. Nevertheless, it is imperative that we be prepared to take the necessary steps if these hopes are not realized.

"In regard to consumer credit, your committee decided that it would be better to reinstitute the controls on durable goods by invoking provisions similar to those of regulation W which were in effect during World War II, rather than grant such controls in broad new general terms. This follows the general principle of not exceeding the powers exercised during the past war in the particular areas of control which the bills cover. These consumer-credit controls are assigned to the Federal Reserve Board in view of their familiarity with credit problems and their highly successful administration of regulation W." (Senate Report 2250, 81st Congress)

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REAL ESTATE CREDIT REGULATION

Authority to regulate real estate credit was vested in the President by the Defense Production Act of 1950, approved September 8, 1950. This authority was delegated by the President to the Board of Governors of the Federal Reserve System by Executive Order No. 10161 of September 9, 1950, with the requirement that the Board obtain the concurrence of the Housing and Home Finance Administrator with reference to regulations of real estate construction credit involving residential property.

The President had recommended in his message to Congress on July 19, 1950 (Document No. 646) that authority be granted to regulate real estate credit. On page 10 of this message he stated:

> "As a further important safeguard against inflation, we shall need to restrain credit expansion. I recommend that the Congress now authorize the control of consumer credit and credit used for commodity speculation. In the housing field, where Government credit is an important factor, I have directed that certain available credit restraints be applied, and I recommend that further controls be authorized, particularly to restrain expansion of privately financed real-estate credit. These actions will not only reduce the upward pressure on prices, but will also reduce the demand for certain critical materials which are required for the production of military equipment."

The Defense Production Act was introduced in the House as H. R. 9176 and in the Senate as S. 3936. In its report on the bill the House Committee on Banking and Currency stated:

> "Authority for restrictions on consumer and real estate credit should be provided for use to the extent necessary as an essential part of the program for conserving resources for defense and protecting the economy against inflation. This authority would help to prevent current and potential demand

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from exceeding supply in the areas affected. Accordingly, it would help to reduce inflationary pressure upon prices in these areas. It would help to make materials and manpower more readily available for the national defense and military effort, including the materials and manpower necessary to expand our total productive capacity." (House Report 2759, 81st Cong., July 28, 1950.)

The Senate Banking and Currency Committee stated in its report (Senate Report 2250, 81st Cong., August 7, 1950), that the control of real estate credit was "designed to curb inflationary tendencies and to conserve materials and facilities needed for national defense".

The pertinent provisions of the Defense Production Act relating to control of real estate credit are as follows:

"Sec. 602. (a) To assist in carrying out the purposes of this Act, the President is authorized from time to time to prescribe regulations with respect to such kind or kinds of real estate construction credit which thereafter may be extended as, in his judgment, it is necessary to regulate in order to prevent or reduce excessive or untimely use of or fluctuations in such credit. Such regulations may, among other things, prescribe maximum loan or credit values, minimum down payments in cash or property, trade-in or exchange values, maximum maturities, maximum amounts of credit, rules regarding the amount, form, and time of various payments, rules against any credit in specified circumstances, rules regarding consolidations, renewals, revisions, transfers, or assignments of credit, and rules regarding other similar or related matters. Such regulations may classify persons and transactions and may apply different requirements thereto, and may include such administrative provisions as in the judgment of the President are reasonably necessary in order to effectuate the purposes of this section or to prevent evasions thereof.

"In prescribing and suspending such regulations, including changes from time to time to take account of changing conditions, the President shall consider, among other factors, (1) the level and trend of real estate construction credit and the various kinds thereof, (2) the effect of the use of such credit upon (i) purchasing power and (ii) demand for real property and improvements thereon and for other goods and services, (3) the need in the national economy for the maintenance of sound credit conditions, and (4) the needs for increased defense production.

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"(b) No person shall extend or maintain any real estate construction credit, or renew, revise, consolidate, refinance, purchase, sell, discount, or lend or borrow on, any obligation arising out of any such credit, or arrange for any of the foregoing, in contravention of any regulation prescribed by the President pursuant to this section. Any person who extends or maintains any such credit, or renews, revises, consolidates, refinances, purchases, sells, discounts, or lends or borrows on, any obligation arising out of any such credit, or arranges for any of the foregoing, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, under oath or otherwise, as the President may by regulation require as necessary or appropriate in order to effectuate the purposes of this section; and such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time to such reasonable periodic, special, or other examinations by examiners or other representatives of the President as the President may deem necessary or appropriate. The requirements of this section apply whether a person is acting as principal, agent, broker, vendor, or otherwise.

"(c) To assist in carrying out the purposes of this section, the President by regulation may require transactions or persons or classes thereof subject to this section to be registered; and, after notice and opportunity for hearing, the President by order may suspend any such registration for violation of this section or any regulation prescribed by the President pursuant to this section. The provisions of section 25 of the Securities Exchange Act of 1934, as amended, shall apply in the case of any such order of the President in the same manner that such provisions apply in the case of orders of the Securities and Exchange Commission under that Act. In carrying out this section, the President may act through and may utilize the services of the Board of Governors of the Federal Reserve System, the Federal Reserve banks, and any other agencies, Federal or State, which are available and appropriate.

"(d) For the purposes of this section, unless the context otherwise requires, the following terms shall have the following meanings, but the President may in his regulations further define such terms and, in addition, may define technical, trade, accounting, and other terms, insofar as any such definitions are not inconsistent with the provisions of this section:

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"(1) 'Real estate construction credit' means any credit which (i) is wholly or partly secured by, (ii) is for the purpose of purchasing or carrying, (iii) is for the purpose of financing, or (iv) involves a right to acquire or use, new construction on real property or real property on which there is new construction. As used in this paragraph the term 'new construction' means any structure, or any major addition or major improvement to a structure, which has not been begun before 12 o'clock meridian, August 3, 1950. As used in this paragraph the term 'real property' includes leasehold and other interests therein. Notwithstanding the foregoing provisions of this paragraph, the term 'real estate construction credit' shall not include any loan or loans made, insured, or guaranteed by any department, independent establishment or agency in the executive branch of the United States, or by any wholly owned Government corporation, or by any mixed-ownership Government corporation as defined in the Government Corporation Control Act, as amended.

"(2) 'Credit' means any loan, mortgage, deed of trust, advance, or discount; any conditional sale contract; any contract to sell or sale or contract of sale, of property or services, either for present or future delivery, under which part or all of the price is payable subsequent to the making of such sale or contract; any rental-purchase contract, or any contract for the bailment, leasing, or other use of property under which the bailee, lessee, or user has the option of becoming the owner thereof, obligates himself to pay as compensation a sum substantially equivalent to or in excess of the value thereof, or has the right to have all or part of the payments required by such contract applied to the purchase price of such property or similar property; any option, demand, lien, pledge, or similar claim against, or for the delivery of property or money; any purchase, discount, or other acquisition of, or any credit under the security of, any obligation or claim arising out of any of the foregoing; and any transaction or series of transactions having a similar purpose or effect.

"Sec. 603. Any person who willfully violates any provision of section 601 or 602 or any regulation or order issued thereunder, upon conviction thereof, shall be fined not more than $5,000 or imprisoned not more than one year, or both.

"Sec. 604. All the present provisions of sections 21 and 27 of the Securities Exchange Act of 1934, as amended (relating to investigations, injunctions, jurisdictions, and other matters), shall be as fully applicable with respect to the exercise by the

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Board of Governors of the Federal Reserve System of credit controls under section 601 as they are now applicable with respect to the exercise by the Securities and Exchange Commission of its functions under that Act, and the Board shall have the same powers in the exercise of such credit controls as the Commission now has under the said sections 21 and 27.

"Sec. 605. To assist in carrying out the objectives of this Act the President may at any time or times, notwithstanding any other provision of law, reduce, for such period as he shall specify, the maximum authorized principal amounts, ratios of loan to value or cost, or maximum maturities of any type or types of loans on real estate which thereafter may be made, insured, or guaranteed by any department, independent establishment, or agency in the executive branch of the United States Government, or by any wholly owned Government corporation or by any mixed-ownership Government corporation as defined in the Government Corporation Control Act, as amended, or reduce or suspend any such authorized loan program, upon a determination, after taking into consideration the effect thereof upon conditions in the building industry and upon the national economy and the needs for increased defense production, that such action is necessary in the public interest: Provided, That in the exercise of these powers, the President shall preserve the relative credit preferences accorded to veterans under existing law."

The pertinent provisions of Executive Order No. 10161, which delegated authority to the Board of Governors, are as follows:

"PART V. REAL ESTATE CREDIT

"Section 501. (a) Subject to the provisions of section 501(b) of this Executive order, the functions conferred upon the President by section 602 of the Defense Production Act of 1950 are hereby delegated to the Board of Governors of the Federal Reserve System.

"(b) The said Board shall obtain the concurrence of the Housing and Home Finance Administrator with respect to provisions relating to real estate construction credit involving residential property before prescribing, changing, or suspending any real estate construction credit regulation pursuant to the authority of section 602 of the Defense Production Act of 1950.

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"Section 502. (a) The functions conferred upon the President by section 605 of the Defense Production Act of 1950, to the extent that such functions relate to loans on real estate involving residential property, are hereby delegated to the Housing and Home Finance Administrator.

"(b) In carrying out the functions delegated by section 502(a) of this Executive order, and under the authority so delegated or under authority vested in him by any applicable law, the Administrator shall from time to time issue such regulations and take such other action as may be necessary to insure (1) that the restrictions imposed on real estate construction credit by the provisions of the regulations issued from time to time by the Board of Governors of the Federal Reserve System (with the concurrence of the Housing and Home Finance Administrator in the provisions of such regulations relating to credit involving residential property) under the authority delegated by section 501 of this Executive order shall be applicable to the fullest extent practicable with respect to loans on real estate (of the types referred to in section 605 of the Defense Production Act of 1950) involving residential property, and (2) that the relative credit preferences accorded to veterans under existing law are preserved in accordance with the provisions of section 605 of the Defense Production Act of 1950."

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VOLUNTARY AGREEMENTS FOR RESTRAINT OF CREDIT

Section 708 of the Defense Production Act of 1950 vested the President with authority to consult with representatives of financing interests with a view to encouraging the making of voluntary agreements or programs to further the objectives of that Act and provided that such agreements or programs entered into in accordance with the requirements of the statute would be exempt from the prohibitions of the antitrust laws. This authority was delegated to the Board of Governors by the President in Executive Order No. 10161 of September 9, 1950.

The Defense Production Act was introduced in the House as H.R. 9176 and in the Senate as S. 3936. As introduced, however, the provisions of the bills relating to this general subject did not extend to agreements or programs entered into by financing institutions.

The House Committee on Banking and Currency stated in its report on the bill:

> "The experience of World War II has shown that voluntary cooperation on the part of industry can accomplish much to promote the national defense, where protection is given against the danger of prosecution under the antitrust laws and the Federal Trade Commission Act. Section 508 of the bill contains such an exemption for acts taken at the request of the President. However, in view of the possibility that such voluntary programs might involve activities inconsistent with free competition, or might established patterns of conduct which would continue after the expiration of the authority granted under the bill, provision is made for consultation with the Attorney General before action is taken under this section, and the committee has amended the section to make it clear that the immunity provided does not extend beyond the duration of the act. It is the understanding and intention of the committee that full consideration be given to small business enterprises in connection with any such program." (House Report 2759, 81st Cong., July 28, 1950)

The Senate Banking and Currency Committee in executive session amended the provision in S. 3936 so as to broaden it to include voluntary agreements or programs of financing institutions. The Committee stated

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in its Report:

"Your committee is of the opinion that, by and large, the country is anxious and willing to support the national defense program on a voluntary basis. This support must be turned into useful and helpful channels. One of the problems which arises in connection with any voluntary efforts on the part of industry is the risk that it runs of unintended violations of the antitrust laws or the Federal Trade Commission Act. In order to protect those who are willing to undertake these voluntary programs and agreements from suffering penalties under these laws and equally important in orde to insure that these voluntary agreements and programs are so conducted as to reduce to the minimum the danger that serious and permanent harm to our free competitive enterprise will result from these cooperative efforts provisions have been included providing for exemptions from the antitrust laws and Federal Trade Commission Act for actions taken at the request of the President in order to promote the national defense. Your committee recognizes the dangers inherent in these programs and urges that the greatest of care be exercised in carrying them out. On the other hand the committee recognizes the benefit to the national defense which can properly result from such programs and urges that they be vigorously promoted in order to make the maximum use of the patriotic cooperation of industry and the public generally." (Senate Report 2250, 81st Cong., Aug. 7, 1950)

The Senate amendment was adopted in conference, and a further amendment was adopted requiring that the prior approval of the Attorney General be obtained for any request under which exemption would be granted in accordance with the provisions of the subsection. (See page 38 of House Report 3042, 81st Cong., August 31, 1950)

The pertinent provisions of the Defense Production Act relating to voluntary agreements are as follows:

"SEC. 708. (a) The President is authorized to consult with representatives of industry, business, financing, agriculture, labor, and other interests, with a view to encouraging the making by such persons with the approval by the President of voluntary agreements and programs to further the objectives of this Act.

"(b) No act or omission to act pursuant to this Act which occurs while this Act is in effect, if requested by the President pursuant to a voluntary agreement or program approved under

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subsection (a) and found by the President to be in the public interest as contributing to the national defense shall be construed to be within the prohibitions of the antitrust laws or the Federal Trade Commission Act of the United States. A copy of each such request intended to be within the coverage of this section, and any modification or withdrawal thereof, shall be furnished to the Attorney General and the Chairman of the Federal Trade Commission when made, and it shall be published in the Federal Register unless publication thereof would, in the opinion of the President, endanger the national security.

"(c) The authority granted in subsection (b) shall be delegated only (1) to officials who shall for the purpose of such delegation be required to be appointed by the President by and with the advice and consent of the Senate, unless otherwise required to be so appointed, and (2) upon the condition that such officials consult with the Attorney General and with the Chairman of the Federal Trade Commission not less than ten days before making any request or finding thereunder, and (3) upon the condition that such officials obtain the approval of the Attorney General to any request thereunder before making the request. For the purpose of carrying out the objectives of title I of this Act, the authority granted in subsection (b) of this section shall not be delegated except to a single official of the Government.

"(d) Upon withdrawal of any request or finding made hereunder the provisions of this section shall not apply to any subsequent act or omission to act by reason of such finding or request.

"(e) The Attorney General is directed to make, or request the Federal Trade Commission to make for him, surveys for the purpose of determining any factors which may tend to eliminate competition, create or strengthen monopolies, injure small business, or otherwise promote undue concentration of economic power in the course of the administration of this Act. The Attorney General shall submit to the Congress and the President within ninety days after the approval of this Act, and at such times thereafter as he deems desirable, reports setting forth the results of such surveys and including such recommendations as he may deem desirable."

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GOVERNMENT OBLIGATIONS AS SECURITY FOR FEDERAL RESERVE NOTES

Before 1932, Federal Reserve notes were required to be secured by collateral in the form of gold or gold certificates or commercial paper eligible for discount or purchase by the Federal Reserve Banks. There was also a requirement for a 40 per cent gold reserve against Federal Reserve notes, although this reserve could consist in whole or in part of gold or gold certificates pledged as collateral for Federal Reserve notes. During the depression of the early 30's, there was very little commercial paper that could be used as collateral for Federal Reserve notes, and abnormal gold exports had considerably reduced the amount of so-called "free gold" held by the Reserve Banks. Accordingly, to enable the Federal Reserve Banks to meet the credit needs of the country, the second paragraph of section 16 of the Federal Reserve Act was amended by the Glass-Steagall Act of February 27, 1932 (47 Stat. 56), to provide for the use of direct obligations of the United States as collateral security for Federal Reserve notes for a temporary period of one year. As amended by this Act, the second paragraph of section 16 read as follows: (New text underscored; omitted text stricken through)

> "Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section ~~thirteen~~ <u>13</u> of this Act, or bills of exchange indorsed by a member bank of any Federal reserve district and purchased under the provisions of section ~~fourteen~~ <u>14</u> of this Act, or bankers' acceptances purchased under the provisions of said section ~~fourteen~~ <u>14</u>, or gold or gold certificates~~;~~ ~~but~~: <u>Provided, however, That until March 3, 1933, should the Federal Reserve Board deem it in the public interest, it may, upon the affirmative vote of not less than a majority of its members, authorize the Federal reserve banks to offer, and the</u>

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Federal reserve agents to accept, as such collateral security, direct obligations of the United States. On March 3, 1933, or sooner should the Federal Reserve Board so decide, such authorization shall terminate and such obligations of the United States be retired as security for Federal reserve notes. In no event shall such collateral security~~, whether gold, gold certificates, or eligible paper,~~ be less than the amount of Federal reserve notes applied for. The Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it."

The authority for the use of Government obligations as collateral for Federal Reserve notes was successively extended by the Acts of February 3, 1933 (47 Stat. 794), March 6, 1934 (48 Stat. 398), March 1, 1937 (50 Stat. 23), June 30, 1939 (53 Stat. 991), June 30, 1941 (55 Stat. 395), and May 25, 1943 (57 Stat. 85). The authority was made permanent legislation by the Act of June 12, 1945 (59 Stat. 237). Since that time, the provision of law has read as follows:

"Any Federal Reserve bank may make application to the local Federal Reserve agent for such amount of the Federal Reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal Reserve agent of collateral in amount equal to the sum of the Federal Reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, drafts, bills of exchange, or acceptances acquired under the provisions of section 13 of this Act, or bills of exchange endorsed by a member bank of any Federal Reserve district and purchased under the provisions of section 14 of this Act, or bankers' acceptances purchased under the provisions of said section 14, or gold certificates, or direct obligations of the United States. In no event shall such collateral security be less than the amount of Federal Reserve notes applied for. The Federal Reserve agent shall each day notify the Board of Governors of the Federal Reserve System of all issues and withdrawals of Federal Reserve notes to and by the Federal Reserve bank to which he is accredited. The said Board of Governors of the Federal Reserve System may at any time call upon a

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Federal Reserve bank for additional security to protect the Federal Reserve notes issued to it."

The purpose of the original 1932 legislation is indicated by the following statements contained in the Committee reports on that Act:

"The bill is not intended nor should it be used for undue inflation of the currency. One important temporary provision, covering a period of 12 months after approval of the act, authorizes, for that time, the Federal Reserve Board, should it deem such action to be in the public interest, to use the direct obligations of the United States as a basis for currency issues, against which there must be a gold reserve of 40 per cent. This will enable the Federal reserve banks to maintain a desirable volume of what is known as 'free gold,' which means gold in excess of the 40 per cent statutory requirement and not including 'ear-marked' gold. This would fortify the gold status of the Federal Reserve banks in this period of extraordinary disturbance. It is suggested, and is altogether probable, that the Federal reserve banks may not find it necessary to make use of this authorization." (Senate Report 237, 72nd Cong.)

"Section 3 of the bill provides that for a period of one year the Federal Reserve Board shall be authorized to use direct obligations of the United States as a basis for the issue of currency. Federal reserve notes issued under this authority must be protected by a gold reserve of 40 per cent. Federal reserve notes now outstanding have something like 80 per cent of gold held against them for the reason that commercial paper which may be used as a basis for Federal reserve notes has shrunk to a point that requires this excess use of gold. It was never contemplated that more than 40 per cent of gold should be required in support of Federal reserve notes. The substitution of Government obligations for commercial paper simply carries out the policy expressed in the original Federal reserve act." (House Report 475, 72nd Cong.)

When the authority was extended in 1933, the basis for the extension was much the same as in 1932, namely, to enable the Reserve Banks to continue to pursue an easy-money policy and assist in business recovery. This is evidenced by the following excerpts from the Committee reports on the Act of February 3, 1933:

"Under section 3 of the Glass-Steagall Act the Federal Reserve Board was granted for one year the power to permit the

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use of United States Government securities as collateral against Federal reserve notes. Having received this authority, the Federal reserve banks were in a position, through the purchase of United States Government securities, to enable member banks to meet the demands upon them arising from gold exports and currency withdrawals and at the same time to reduce their indebtedness to the reserve banks. Between February 27 and July 20, 1932, the Federal reserve banks bought $1,100,000,000 of Government securities.

"If section 3 were not continued in force, the Federal reserve banks probably would be obliged to sell large amounts of the United States Government securities held by them. While the committee is advised that it is not possible at this time to determine how large the sales would have to be, it appears likely that they would amount to several hundreds of millions of dollars. When the necessary operations were concluded the member banks would have practically no, or greatly reduced, excess reserves and possibly a heavier indebtedness to the reserve banks. The pressure on the member banks exerted by excess reserves in the direction of greater activity would be lifted and a pressure toward contraction would be exerted by increased indebtedness. As a consequence, the banks would be more reluctant to lend money to business or to make investments. That this change would greatly retard business recovery is beyond question.

"In the judgment of the committee, it is vitally important, under conditions such as those that now prevail, that the Federal reserve banks be adequately equipped to meet any emergency that may arise. If section 2 be not renewed, the Federal reserve banks would not be in position to extend to member banks that may have exhausted their eligible collateral the service they have been able to render under that section during the past year. If section 3 be not extended, the reserve banks would not be in a position to relieve their member banks from the pressure resulting from increased indebtedness in case domestic hoarding were resumed or a large export movement of gold should occur. Clearly, therefore, it would be in the public interest to extend these provisions for at least a year beyond March 3, 1933." (House Report 1928, 73rd Cong.)

At the time of the further extension of the authority by the Act of March 6, 1934 (48 Stat. 398), the House Committee on Banking and Currency stated:

"The legislation has been of considerable assistance in carrying forward policies of recovery and its continuance may be

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highly essential in financing the rehabilitation program upon which the Government has embarked." (House Report 860, 73rd Cong.)

In 1937, the situation had changed because of economic recovery and large gold imports; but it was considered desirable for the authority to be continued in order that the Reserve Banks would be in a position to meet the situation if the conditions of 1932 should again recur. Prior to the extension of the authority by the Act of March 1, 1937 (50 Stat. 23), Chairman Eccles of the Federal Reserve Board made the following statement during hearings before the House Banking and Currency Committee:

"As a consequence of large gold imports in recent years there are now enough gold certificates held by the 12 Federal Reserve banks combined to enable them to provide a 100-percent cover for all outstanding Federal Reserve notes. While this is true in the aggregate for the 12 banks, however, it is not true in the case of some of the individual Reserve banks. More important is the fact that in case gold should leave the country in large amounts, as it has on previous occasions, notably in 1931 and 1932, the Federal Reserve System, in the absence of authority to pledge United States Government obligations for Federal Reserve notes, might find itself compelled to adopt a restrictive credit policy at a time when such a policy might start a disastrous deflationary development, or aggravate one that was under way. In 1931 the System had the experience of being unable, owing to lack of authority to pledge Government obligations against Federal Reserve notes, to adopt an active policy of combating a deflation. A large outward movement of gold might reduce the gold-certificate holdings of the Federal Reserve banks below the amount necessary to provide cover for outstanding Federal Reserve notes, and, without authority to pledge Government securities for this purpose, the Federal Reserve banks, in order to get the necessary collateral to take the place of gold certificates held against outstanding Federal Reserve notes, would have to sell Government obligations to the point where member banks would be forced to borrow from the Federal Reserve banks. Such borrowings, in turn, might cause member banks to tighten their lending policies and to contract credits, with a consequent rise in money rates and serious restraint on business activity. It is clearly not in the public interest to run the risk of such a development by permitting the authority to pledge Government securities against Federal Reserve notes to lapse." (Hearings on S. 417, February 16, 1937)

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For similar reasons, the authority was again extended by the Act of June 30, 1939 (53 Stat.991), at which time the House Committee on Banking and Currency made the following statement in its report:

"* * *There are now enough gold certificates owned by the Federal Reserve banks to enable them to provide 100-percent cover for all outstanding Federal Reserve notes without the use of direct obligations of the United States for this purpose; but, in the event that gold should leave the country in large amounts, the Federal Reserve System, without this authority, might find itself compelled to adopt a restrictive credit policy at a time when such a policy might start a disastrous deflationary development or aggravate one which was under way. In the event of a large outward movement of gold, Federal Reserve banks, in order to get the necessary eligible paper to take the place of gold certificates, might have to sell Government obligations to the point where member banks would be forced to borrow from the Reserve banks. Indebtedness by member banks in turn would cause them to tighten their lending policies and to contract credit, with a consequent rise in money rates and possibly serious restraint on business activity." (House Report 975, 76th Cong.)

On the occasion of the further extension of the authority in 1941, Chairman Eccles stated before the House Banking and Currency Committee:

"No United States Government securities have been pledged with the Federal Reserve agents since May 28, 1938, and so long as conditions remain substantially as at present it will not be necessary for the Federal Reserve banks to use United States Government securities as collateral for Federal Reserve notes issued to them by the Federal Reserve agents. There is no assurance, however, particularly in times like the present, that conditions will not change rapidly. In 1931 the System had the experience of being unable, owing to lack of authority to pledge United States Government obligations against Federal Reserve notes, to adopt an active policy of combating a deflation. It is clearly not in the public interest to run the risk of such a development happening again by permitting the authority to pledge Government securities against Federal Reserve notes to lapse. (Hearings on S. 1471, June 23, 1941)

During World War II, the authority was again extended in view of the war financing program, the expansion of currency, and

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lack of commercial paper; and the following statement was contained in the report of the House Committee on Banking and Currency:

"The act makes no change whatever in the law, except to put direct Government obligations in the same category with commercial paper and other obligations that are eligible as security for Federal Reserve notes. In view of the unprecedented financing program incident to the war, the need for the legislation is more emphatic than was the case when the original act was passed. There is a constantly increasing expansion of currency but no substantial amount of commercial paper, and it is neither desirable nor practical to supply 100 percent collateral for Federal Reserve notes in the form of gold certificates. The legislation is highly essential to the conduct of the war." (House Report 444, 78th Cong.)

Finally, in 1945, the authority was made permanent for the reasons stated in both the Senate and House Banking and Currency Committees reports as follows:

"Pledging of United States Government securities against Federal Reserve notes.--In conditions prevailing today, with Federal Reserve notes outstanding in an amount of 22.5 billion dollars and deposit liabilities of the Federal Reserve banks in an amount of 16.6 billion, it is imperative to extend the power to pledge United States Governments as collateral for Federal Reserve notes. Without this authority the Federal Reserve banks would be obligated to engage in a series of operations for the sole purpose of obtaining other assets that would be eligible as collateral for Federal Reserve notes in place of United States Government securities which would not be eligible. They would have to sell a large enough volume of Government securities to make it necessary for banks to borrow as much as 10 billion dollars from the Federal Reserve banks at this time and possibly as much as 18 billions by the end of the year. The manner in which this would work is that the Reserve banks would sell the securities in the open market; payment for them would take out an equivalent amount of funds from the market; and member banks would have to borrow this amount from the Federal Reserve banks in order to replenish their reserves. The promissory notes of member banks at the Reserve banks would be eligible under the law as collateral for Federal Reserve notes. No public interest would be served, but in the process the market for United States Government war obligations would be disrupted at a time when the Treasury must still raise vast sums to finance the war. It is clear that this must not occur and that, therefore, the power to pledge Government securities against Federal Reserve notes must be continued.

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"The committee believes that no time limit should be placed on this authorization. In view of the fact that the Federal Reserve banks' assets, other than gold certificates, consist at present almost entirely of Government securities, most of which were acquired during the war, and the improbability that these banks will have any considerable volume of other earning assets in the foreseeable future, it would be in the public interest to make permanent the authority to use United States securities as backing for notes.

"When the collateral provisions for Federal Reserve notes were first formulated there were practically no Government securities in the market, member banks had a large volume of so-called eligible commercial paper, and were expected to borrow on that paper when they required additional reserves or currency. The situation has radically changed since then. There is now an enormous public debt which constitutes a large part of the earning assets of member banks; the total volume of eligible paper has declined, and many banks have practically no such paper. Banks are also reluctant to borrow from the Reserve banks and, if they should borrow in considerable volume, this would result in a tightening of credit conditions with disturbing effects on the price of Government securities. Furthermore, if they borrowed, they would borrow on their promissory notes secured by Government obligations. Consequently, what would be back of the notes would still be United States Government securities--but with an endorsement by a member bank. An obligation of the United States Government is not improved in credit standing by endorsement of some member bank.

"Collateral requirements are not an effective limitation on credit expansion by the Federal Reserve banks. Open-market operations of these banks are governed by considerations of the public interest and not of Federal Reserve bank earnings. When the Reserve banks purchase United States Government securities they pay for them by deposit credit. Once these deposit liabilities have been incurred the Federal Reserve banks are obliged to permit their withdrawal in currency. The public demand for currency, in turn, depends on business conditions, activity of trade, the volume of wage payments, the price level, and the extent of the people's wish to hold their liquid assets in the form of cash rather than bank deposits or Government securities. Member banks, to avoid insolvency, must permit their customers to withdraw their deposits in currency; Federal Reserve banks in turn must permit the member banks to obtain the currency by drawing on their balances with the Reserve banks. Consequently, the Reserve banks have no choice in the matter because they have little control over the demand for currency. It serves no useful purpose to encumber these unavoidable operations by legal restric-

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tions which inevitably must give way as soon as they would actually restrict.

"In any case Federal Reserve notes have a prior lien on all assets of the Federal Reserve banks and are obligations of the United States Government. By authorizing the pledging of Government securities as collateral for Federal Reserve notes the collateral requirement is extended to practically all the assets of the Reserve banks and ceases to be an interference with the performance of their duties and the discharge of their responsibilities. The bill therefore provides that this extension be made a permanent part of the law." (Senate Report 124 and House Report 441, 79th Cong.)

By the Emergency Banking Act of March 9, 1933 (48 Stat. 6), Congress had authorized the Federal Reserve Banks to issue Federal Reserve Bank notes on the security of direct obligations of the United States and paper eligible for discount by the Federal Reserve Banks. This authority had been conferred for much the same reason that the use of Government obligations as collateral for Federal Reserve notes had been authorized - that is, to provide for an additional supply of currency during a period of banking and economic emergency. However, the Act of June 12, 1945, which made permanent the authority to use Government obligations as collateral for Federal Reserve notes, terminated the authority for the issuance of Federal Reserve Bank notes. In explaining the reasons for the termination of that authority, the Committee Reports contained the following statement:

"Termination of authority to issue Federal Reserve bank notes. — Issue of Federal Reserve bank notes in their present form was authorized by the Emergency Banking Act of March 1933, and the authority will expire when the President declares that the emergency is over. The purpose of the law was to provide for a supply of additional currency during the banking crisis of that year. It is unnecessary because Federal Reserve notes can be issued against the deposit of Government bonds, a power which is made permanent in this bill. Furthermore, the difference between Federal Reserve notes (which provide the bulk of our currency) and Federal Reserve bank notes is not readily understood, and it would be simpler and less confusing to the public if Federal Reserve currency hereafter issued were all of one kind." (Senate Report 124 and House Report 441, 79th Cong.)

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RESERVES OF FEDERAL RESERVE BANKS AGAINST DEPOSITS AND FEDERAL RESERVE NOTES

Until 1945, each Federal Reserve Bank was required by section 16 of the Federal Reserve Act to maintain reserves of not less than 35 per centum against its deposits and 40 per centum against its Federal Reserve notes in actual circulation. By Act of June 12, 1945 (59 Stat. 237), these requirements were reduced to 25 per centum. The provision of section 16, as thus amended and now in effect, is as follows:

> "Every Federal Reserve bank shall maintain reserves in gold certificates of not less than 25 per centum against its deposits and reserves in gold certificates of not less than 25 per centum against its Federal Reserve notes in actual circulation: Provided, however, That when the Federal Reserve agent holds gold certificates as collateral for Federal Reserve notes issued to the bank such gold certificates shall be counted as part of the reserve which such bank is required to maintain against its Federal Reserve notes in actual circulation. * * *"

At the same time, section 11(c) of the Federal Reserve Act was amended so as to reduce correspondingly the graduated tax to be prescribed by the Board whenever reserves against Federal Reserve notes fall below the statutory limitation. Section 11(c), as thus amended and now in effect, provides as follows:

> "(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirements specified in this Act: Provided, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: And provided further, That when the reserve held against Federal Reserve notes falls below 25 per centum, the Board of Governors of the Federal Reserve System shall establish a graduated tax of not more than 1 per centum per annum upon such deficiency until the reserves fall to 20 per centum, and when said reserve falls below 20 per centum, a tax at the rate increasingly of not less than 1-1/2 per centum per annum upon

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each 2-1/2 per centum or fraction thereof that such reserve falls below 20 per centum. The tax shall be paid by the Reserve bank, but the Reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Board of Governors of the Federal Reserve System."

The President's Budget Message to Congress of January 3, 1945, contained the following paragraph:

"Management of the public debt has become one of the major financial operations of the Government. To assure effective discharge of these responsibilities and, in particular, to maintain the present low rates of interest, ample powers must be available to the monetary authorities. I shall later recommend legislation reducing the present high gold-reserve requirements of the Federal Reserve banks."

On January 24, 1945, the Board of Governors addressed letters to the Senate and House Banking and Currency Committees enclosing drafts of proposed legislation to accomplish this purpose. With these letters there was enclosed a statement explaining the measure and the need for its enactment. Bills were promptly introduced and the following excerpts from Committee reports recommending this legislation follow closely the Board's statement:

"Conditions arising out of the war have caused the reserve ratio of Federal Reserve banks to decline from 91 percent at the end of 1941, soon after our entry into the war, to 49 percent at the end of 1944. If developments continue at the rate of recent months the ratio will fall almost to the legal minimum by the end of the present calendar year. If gold exports or currency withdrawals or both should be greater than in 1944, the legal minimum will be reached sooner. * * *

"It will be seen from this table that the decline in the reserve ratio has been due to a reduction in Federal Reserve bank reserves and to increases in Federal Reserve note and deposit liabilities. Reduction of reserves has reflected the fact that most of this country's exports have been on lend-lease, while our imports have been in a cash basis. Countries that have sold commodities to the United States

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have not been able to buy goods here, on account of war restrictions, and have either withdrawn or earmarked gold against the time when goods will once more be available for sale.

"Growth of Federal Reserve note circulation has been a part of the general expansion of currency which has accompanied war activity in every country in the world. Expansion of both notes and deposits has reflected growth of Government war expenditures, enlargement of national money income, and advancement of pay rolls and trade at higher prices. So long as the Federal Reserve banks continue to do their part, as they surely must, to assist the Treasury in Government financing and in maintaining stable conditions in the market for United States Government securities, these banks cannot be restricted by an arbitrary reserve ratio.

* * * * *

"Reduction of the required ratio as provided in the bill is consistent with the changes in conditions which have occurred since the ratio was first established by the Congress. The original purposes of the ratio were (1) to assure adequate resources for the Reserve banks to meet demands for gold or lawful money by depositors and note holders; (2) to limit the expansion of Federal Reserve bank credit; and (3) to assure the public that there was at least 40 percent in gold back of the Federal Reserve notes which were then being introduced for the first time.

"The first purpose is no longer compelling, since gold redemption is now not permitted for domestic use, and gold can be exported only under license. While the country's aggregate gold reserves are ample to meet any conceivable foreign demand, a reserve ratio high enough to meet possible demands for both domestic and foreign use is no longer appropriate under present conditions. The second purpose—limitation of Federal Reserve bank credit expansion—is not relevant at a time when expansion by the Reserve banks is essential to the needs of war finance. Thirdly, confidence in Federal Reserve notes is well established, and it is believed that the change recommended will in no way impair this confidence.

"War conditions have caused all belligerents to reduce or abolish central bank reserve requirements. Mechanical limitations on the ability of a central banking organization to extend credit must inevitably give way in time of war to the paramount obligation to support the war effort.

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"A reduction to 25 percent is provided in the bill because it would be sufficient, in the judgment of the Board of Governors of the Federal Reserve System, for all foreseeable contingencies. It would enable the Reserve banks to meet such additional demands for currency by the public and for reserve balances by member banks as are likely to occur. The currency supply and the bank-deposit structure could nearly double before the legal minimum would be reached.

"It is important to recognize that the proposed reduction in the requirement as to the reserve percentage does not bring about any reduction in the amount of reserves or any expansion in Reserve bank credit. The amount of reserves of Federal Reserve banks depends upon conditions existing at the time and not upon the percentage which is prescribed as the legal minimum. The amount of Reserve bank credit in use will depend upon the demands for such credit and upon the policies adopted by the system in supplying those demands. These policies are based upon the needs of commerce and industry and the maintenance of a sound credit system and not upon the amount of reserves which the Reserve banks may hold in excess of requirements.

"The bill provides for elimination of the distinction made in the present law between reserves required against notes and against deposits both as to percentage and as to composition of the reserves. Since the two liabilities are interconvertible at the option of the owners, the same requirements should apply to both. The provision in the bill that legal reserves should consist only of gold certificates would also eliminate controversy as to what constitutes lawful money, and whether the Federal Reserve banks could use notes which they themselves issued as reserves against their own deposits. A uniform requirement of gold-certificate reserves of 25 percent against both notes and deposits appears to be a desirable simplification of the law.

"In conformity with the proposed reduction of the ratio to 25 percent the bill decreases proportionately the levels of the ratio at which the imposition of the different penalty rates provided in the law when reserves are suspended would be prescribed." (House Report 441, 79th Cong.; substantially same in Senate Report 124)

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PAYMENT OF INTEREST ON DEPOSITS

Until enactment of the Banking Act of 1933 (48 Stat. 181), there was no provision in the Federal Reserve Act pertaining to the payment of interest on deposits. The 1933 Act added the following new paragraphs to section 19 of the Federal Reserve Act:

"No member bank shall, directly or indirectly by any device whatsoever, pay any interest on any deposit which is payable on demand: Provided, That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract heretofore entered into in good faith which is in force on the date of the enactment of this paragraph; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this paragraph, and every member bank shall take such action as may be necessary to conform to this paragraph as soon as possible consistently with its contractual obligations: Provided, however, That this paragraph shall not apply to any deposit of such bank which is payable only at an office thereof located in a foreign country, and shall not apply to any deposit made by a mutual savings bank, nor to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, with respect to which payment of interest is required under State law.

"The Federal Reserve Board shall from time to time limit by regulation the rate of interest which may be paid by member banks on time deposits, and may prescribe different rates for such payment on time and savings deposits having different maturities or subject to different conditions respecting withdrawal or repayment or subject to different conditions by reason of different locations. No member bank shall pay any time deposit before its maturity, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement." (12 U.S. Code, Secs. 371a, 371b.)

The Banking Act of 1935 (49 Stat. 705), amended these provisions to read as follows: (New text underscored; omitted text stricken through)

"No member bank shall, directly or indirectly, by any device whatsoever, pay any interest on any deposit which is

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payable on demand: Provided, That nothing herein contained shall be construed as prohibiting the payment of interest in accordance with the terms of any certificate of deposit or other contract ~~heretofore~~ entered into in good faith which is in force on the date ~~of-the-enactment~~ on which the bank becomes subject to the provisions of this paragraph; but no such certificate of deposit or other contract shall be renewed or extended unless it shall be modified to conform to this paragraph, and every member bank shall take such action as may be necessary to conform to this paragraph as soon as possible consistently with its contractual obligations: Provided, ~~however~~ further, That this paragraph shall not apply to any deposit of such bank which is payable only at an office thereof located ~~in-a-foreign-country,~~ outside of the States of the United States and the District of Columbia: Provided further, That until the expiration of two years after the date of enactment of the Banking Act of 1935 this paragraph ~~and~~ shall not apply (1) to any deposit made by a savings bank as defined in section 12B of this Act, as amended, or by a mutual savings bank, ~~nor~~ or (2) to any deposit of public funds made by or on behalf of any State, county, school district, or other subdivision or municipality, or to any deposit of trust funds if the payment of interest with respect ~~to-which-payment-of interest~~ to such deposit of public funds or of trust funds is required ~~under~~ by State law. So much of existing law as requires the payment of interest with respect to any funds deposited by the United States, by any Territory, District, or possession thereof (including the Philippine Islands), or by any public instrumentality, agency, or officer of the foregoing, as is inconsistent with the provisions of this section as amended, is hereby repealed.

"The ~~Federal-Reserve~~ Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and ~~may~~ shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. No member bank shall pay any time deposit before its maturity~~,~~ except upon such conditions and in accordance with such rules and regulations as may be prescribed by the said Board, or waive any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement~~.~~: Provided, That the provisions of this paragraph shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia."

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The Banking Act of 1935 also amended the first paragraph of section 19 of the Federal Reserve Act to read as follows:

> "The Board of Governors of the Federal Reserve System is authorized, for the purposes of this section, to define the terms 'demand deposits', 'gross demand deposits', 'deposits payable on demand', 'time deposits', 'savings deposits' and 'trust funds', to determine what shall be deemed to be a payment of interest, and to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof; Provided, That, within the meaning of the provisions of this section regarding the reserves required of member banks, the term 'time deposits' shall include 'savings deposits'." (12 U.S. Code, Sec. 461)

In addition, the Banking Act of 1935 amended section 12B of the Federal Reserve Act (deposit insurance provisions) by adding a new paragraph (8) to subsection (v) providing as follows:

> "(8) The board of directors [of the FDIC] shall by regulation prohibit the payment of interest on demand deposits in insured nonmember banks and for such purpose it may define the term 'demand deposits'; but such exceptions from this prohibition shall be made as are now or may hereafter be prescribed with respect to deposits payable on demand in member banks by section 19 of this Act, as amended, or by regulation of the Board of Governors of the Federal Reserve System. The board of directors shall from time to time limit by regulation the rates of interest or dividends which may be paid by insured nonmember banks on time and savings deposits, but such regulations shall be consistent with the contractual obligations of such banks to their depositors. For the purpose of fixing such rates of interest or dividends, the board of directors shall by regulation prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. The board of directors shall by regulation define what constitutes time and savings deposits in an insured nonmember bank. Such regulations shall prohibit any insured nonmember bank from paying any time deposit before its maturity except upon such conditions and in accordance with such rules and regulations as may be prescribed by the board of directors, and from waiving any requirement of notice before payment of any savings deposit except as to all savings deposits having the same requirement. For each

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violation of any provision of this paragraph or any lawful provision of such regulations relating to the payment of interest or dividends on deposits or to withdrawal of deposits, the offending bank shall be subject to a penalty or[1] not more than $100, recoverable by the Corporation for its use."

None of these provisions has been amended since 1935, although section 12B has been withdrawn from the Federal Reserve Act and is now a separate Federal Deposit Insurance Act.

The Committee Reports on the Banking Act of 1933 (Senate Report 77, 73d Congress, of May 17, 1933, on S. 1631, and House Report 150, 73d Congress, of May 19, 1933, on H. R. 5661) throw no light on this subject, merely stating the substance of the proposed legislation without indicating the reasons therefor. However, reference to the debates in Congress disclose the statements by Senator Glass (Cong. Rec., Vol. 77, Pt. 4, page 3729) that "The payment of interest on demand deposits has resulted for years and years in stripping the country banks of all their spare funds, which have been sent to the money centers for stock speculative purposes." and "We confide to the Federal Reserve Board authority which it does not now possess in this connection to regulate interest on time deposits in order to put a stop to the competition between banks in payment of interest, which frequently induces banks to pay excessive interest on time deposits and has many times over again brought banks into serious trouble. But that is a matter purely for regulation of the Federal Reserve Board." Also, Mr. Connally, on page 4170, stated that "We are trying to circumvent the process by which the big banks will bid for the deposits of the small ones, in order that they may not drain to the great centers the resources of the small banks:".

1 So in original.

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The Committee Reports on the Banking Act of 1935 did not set forth the purpose of this legislation. However, the following statement appears on page 22 of House Report No. 742 (74th Congress) of April 19, 1935, on H. R. 7617:

> "The section is also amended to make more flexible the Federal Reserve Board's power to classify time and savings deposits and limit the rates of interest to be paid thereon. The absolute prohibition against the payment of time deposits before maturity is relaxed to permit such payments under conditions prescribed by the Board; * * *"

and on page 20 of Senate Report No. 1007 (74th Congress) of July 2, 1935, on H. R. 7617, it was stated:

> "* * * In conformity with the House provision, the amendment makes more flexible the power of the Board of Governors of the Federal Reserve System to classify time and savings deposits and prescribe the rates of interest to be paid thereon. The absolute prohibition against payment of time deposits before maturity is relaxed under conditions to be prescribed by the Board, * * *".

No statements on this subject were made in Congress when the 1935 amendments were being considered as they were included in parts of the Banking Act of 1935 which contained noncontroversial, clarifying amendments.

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ADVANCES TO MEMBER BANKS ON OTHER THAN "ELIGIBLE PAPER"

(Section 10(b) of the Federal Reserve Act)

Prior to 1932, Federal Reserve Banks were authorized to grant credit to member banks of the Federal Reserve System only through discounting or on the security of "eligible paper", i.e., short-term paper arising out of commercial, industrial, or agricultural transactions or short-term paper secured by Government obligations. The first authority for Federal Reserve Banks to make advances to their member banks secured by other than eligible paper was contained in the Glass-Steagall Act of February 27, 1932 (47 Stat. 56). This Act added section 10(b) to the Federal Reserve Act in the following form:

> "SEC. 10. (b) Until March 3, 1933, and in exceptional and exigent circumstances, and when any member bank, having a capital of not exceeding $5,000,000, has no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations through rediscounting at the Federal reserve bank or any other method provided by this Act other than that provided by section 10(a), any Federal reserve bank, subject in each case to affirmative action by not less than five members of the Federal Reserve Board, may make advances to such member bank on its time or demand promissory notes secured to the satisfaction of such Federal reserve bank: Provided, That (1) each such note shall bear interest at a rate not less than 1 per centum per annum higher than the highest discount rate in effect at such Federal reserve bank on the date of such note; (2) the Federal Reserve Board may by regulation limit and define the classes of assets which may be accepted as security for advances made under authority of this section; and (3) no note accepted for any such advance shall be eligible as collateral security for Federal reserve notes.
>
> "No obligations of any foreign government, individual, partnership, association, or corporation organized under the laws thereof shall be eligible as collateral security for advances under this section."

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The Glass-Steagall Act also added section 10(a) to the Federal Reserve Act providing for advances by Federal Reserve Banks to groups of five or more member banks upon certain conditions, but the authority in section 10(a) has proved impracticable and has not been used.

Section 10(b) of the Federal Reserve Act was extended by the Act of February 3, 1933 (47 Stat. 794), to March 3, 1934. This section was entirely rewritten by the Emergency Banking Act of March 9, 1933 (48 Stat. 7), to read as follows:

> "SEC. 10(b). In exceptional and exigent circumstances, and when any member bank has no further eligible and acceptable assets available to enable it to obtain adequate credit accommodations through rediscounting at the Federal reserve bank or any other method provided by this Act other than that provided by section 10 (a), any Federal reserve bank, under rules and regulations prescribed by the Federal Reserve Board, may make advances to such member bank on its time or demand notes secured to the satisfaction of such Federal reserve bank. Each such note shall bear interest at a rate not less than 1 per centum per annum higher than the highest discount rate in effect at such Federal reserve bank on the date of such note. No advance shall be made under this section after March 3, 1934, or after the expiration of such additional period not exceeding one year as the President may prescribe."

The provisions of section 10(b) were again extended by Presidential proclamation of February 16, 1934 (20 Fed. Reserve Bulletin 182), for one year after March 3, 1934. Section 10(b) expired on March 3, 1935, but the Banking Act of August 3, 1935 (49 Stat. 705), re-enacted the section and provided a permanent authority for the making of advances on notes having a maturity of not more than four months which are secured to the satisfaction of the Federal Reserve Bank, subject to a requirement of a rate of interest at least one-half of one per cent higher than the discount rate. The section as thus reenacted and as it exists today is as follows:

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"SEC. 10(b). Any Federal Reserve bank, under rules and regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve bank. Each such note shall bear interest at a rate not less than one-half of 1 per centum per annum higher than the highest discount rate in effect at such Federal Reserve bank on the date of such note." (12 U.S. Code, sec. 347b)

The purpose of the provision on this subject as contained in the Glass-Steagall Act of 1932, was explained by Governor Meyer of the Federal Reserve Board in his testimony on the bill before the House Banking and Currency Committee on February 12, 1932. He stated:

"The second section is designed to meet a situation which occurs occasionally even under normal conditions, but is particularly frequent at this time, on account of withdrawals of deposits which have been general. Some banks, particularly in certain locations, either because of unsatisfactory business conditions, or through unusual withdrawals of deposits, have reached the point where their remaining paper, although good, is ineligible for rediscount. The second section, 10 (b), is designed to permit the Federal reserve banks in such cases to make advances on paper which is technically ineligible, but which would be adequate and safe security. Banks generally will gain greater confidence and greater assurance through the existence of that provision. The benefits will not be confined to banks that avail themselves of the privilege. The question what is going to happen to a bank when it sees its supply of paper which is eligible for rediscount reduced in order to meet withdrawals will cease to be the threatening factor which causes other banks to curtail their loans and to worry about their own condition. This will be a confidence-inspiring factor." (Hearings on H.R. 9203, Feb. 12, 1932)

Testimony to a similar effect was presented by Secretary of the Treasury Mills at the same hearing.

As indicated above, after several extensions of the original authority enacted in 1932, the authority contained in section 10(b) in a revised form was made permanent by the Banking Act of 1935. The House Committee Report on the Banking Act of 1935 (H.R. 7617) gave the following reasons for the provisions of this section:

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"The purpose of this provision is to relax or remove stringent technical limitations on the character of paper that can be used as a basis of borrowing from the Federal Reserve banks, and thus to give member banks the assurance they need so that it will be possible for them to meet the needs of their communities for both short-time and long-time funds.

"Existing limitations had to be suspended during the emergency, but this was accomplished only after they had done a great deal of harm and after many banks had failed because of a lack of assets technically eligible for obtaining accommodation at a Federal Reserve bank. Since in practice existing restrictions must be relaxed whenever they become really restrictive, it is best not to have them in the law, but to place full regulatory responsibility on the Board, which is always in session and in a position to take prompt action when it is required.

"Changes in the country's economic life, notably in the methods of financing business enterprise, have materially reduced the volume of short-term self-liquidating paper of the classes to which the discount privileges of the Reserve banks are largely restricted by law. In times of stress, therefore, when the help of the Federal Reserve System has been most urgently needed, many banks, though holding sound assets in their portfolios, have been devoid of the particular kinds of paper available under the law for borrowing at the Reserve banks.

"This amendment, by removing many of the technical restrictions of the present law, will enable the Federal Reserve banks to render better service to their member banks in times of need. This will not only make membership in the Federal Reserve System much more attractive but will encourage the member banks to invest their savings deposits, which are essentially capital funds, in longer-term loans, a course that would greatly facilitate business recovery.

"This amendment will also make it possible for banks, without relaxing prudence or care, to meet local needs both for short-time and for long-time funds, and to be assured that in case of need they can obtain advances from the Reserve banks on the basis of all their sound assets, regardless of their form or of the nature of the collateral. Soundness of assets (a term which is here for the first time introduced into the Federal Reserve Act) is a greater safeguard to the banks than short maturity of loans or the particular form of the underlying transaction." (House Report 742, 74th Cong.)

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Mr. Steagall, Chairman of the Banking and Currency Committee of the House, in commenting on the provisions of section 10(b) during the House debates on the bill, said:

"Mr. Chairman, I want to call attention to another provision which is of far-reaching importance.

"I call attention to the provision which liberalizes the discount facilities and lending powers of the Federal Reserve banks. Heretofore, except under the Emergency Act of 1933, which was a temporary emergency measure, no discounts or advances could be made by a Federal Reserve bank for a member bank except upon eligible paper. Eligible paper consists of 90-day commercial obligations or 9 months on agricultural paper. Under this bill the Federal Reserve Board is given power to define anew what eligible paper is and a broad provision would authorize the Federal Reserve Banks to make advances to member banks on their notes secured by any sound assets. There is a very small portion of the security held in the portfolios of the Federal Reserve banks in this country that is eligible under the strict provisions of the rule of eligibility. At the present it amounts to only about $2,000,000,000, or less than 8 percent of the resources of the banks.

"I desire to say that this provision of the bill is one of the most important of all contained in the entire measure. I attach importance to this particular provision of the bill because we all know what it means and what to expect under its operation." (79 Cong. Record, Part 6, page 6717, May 1, 1935)

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INDUSTRIAL LOANS BY FEDERAL RESERVE BANKS

During the depression of the early 1930's, in order to meet a widespread need on the part of business enterprises for credit which could not be obtained at that time from the commercial banks of the country, Congress by the Act of June 19, 1934 (48 Stat. 1105) authorized both the Federal Reserve Banks and the RFC to make loans to industrial and commercial businesses.

In the report of the House Banking and Currency Committee, it was stated:

> "* * * It is believed that such extension of credit for capital funds to established commercial and industrial firms will maintain and increase employment, and that the temporary loaning powers of the Reconstruction Finance Corporation * * * and the permanent loaning powers of the Federal Reserve Banks * * * will supplement each other in relieving the distress of industry and business."
> (House Report 1719, 73rd Cong.)

The authority granted to the Federal Reserve Banks was set forth in a new section 13b which was incorporated in the Federal Reserve Act. That section has not since been changed except in one minor particular and as now in force the more important provisions of the section are as follows:

> "(a) In exceptional circumstances, when it appears to the satisfaction of a Federal Reserve bank that an established industrial or commercial business located in its district is unable to obtain requisite financial assistance on a reasonable basis from the usual sources, the Federal Reserve bank, pursuant to authority granted by the Board of Governors of the Federal Reserve System, may make loans to, or purchase obligations of, such business, or may make commitments with respect thereto, on a reasonable and sound basis, for the purpose of providing

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it with working capital, but no obligation shall be acquired or commitment made hereunder with a maturity exceeding five years.

"(b) Each Federal Reserve bank shall also have power to discount for, or purchase from, any bank, trust company, mortgage company, credit corporation for industry, or other financing institution operating in its district, obligations having maturities not exceeding five years, entered into for the purpose of obtaining working capital for any such established industrial or commercial business; to make loans or advances direct to any such financing institution on the security of such obligations; and to make commitments with regard to such discount or purchase of obligations or with respect to such loans or advances on the security thereof, including commitments made in advance of the actual undertaking of such obligations. Each such financing institution shall obligate itself to the satisfaction of the Federal Reserve bank for at least 20 per centum of any loss which may be sustained by such bank upon any of the obligations acquired from such financing institution, the existence and amount of any such loss to be determined in accordance with regulations of the Board of Governors of the Federal Reserve System: Provided, That in lieu of such obligation against loss any such financing institution may advance at least 20 per centum of such working capital for any established industrial or commercial business without obligating itself to the Federal Reserve bank against loss on the amount advanced by the Federal Reserve bank: Provided, however, That such advances by the financing institution and the Federal Reserve bank shall be considered as one advance, and repayment shall be made pro rata under such regulations as the Board of Governors of the Federal Reserve System may prescribe.

"(c) The aggregate amount of loans, advances, and commitments of the Federal Reserve banks outstanding under this section at any one time, plus the amount of purchases and discounts under this section held at the same time, shall not exceed the combined surplus of the Federal Reserve banks as of July 1, 1934, plus all amounts paid to the Federal Reserve banks by the Secretary of the Treasury under subsection (e) of this section, and all operations of the Federal Reserve banks under this section shall be subject to such regulations as the Board of Governors of the Federal Reserve System may prescribe.

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"(d) For the purpose of aiding the Federal Reserve banks in carrying out the provisions of this section, there is hereby established in each Federal Reserve district an industrial advisory committee, to be appointed by the Federal Reserve bank subject to the approval and regulations of the Board of Governors of the Federal Reserve System, and to be composed of not less than three nor more than five members as determined by the Board of Governors of the Federal Reserve System. * * *

"(e) In order to enable the Federal Reserve banks to make the loans, discounts, advances, purchases, and commitments provided for in this section, the Secretary of the Treasury, on and after June 19, 1934, is authorized, under such rules and regulations as he shall prescribe, to pay to each Federal Reserve bank not to exceed such portion of the sum of $139,299,557 as may be represented by the amount paid by each Federal Reserve bank for stock of the Federal Deposit Insurance Corporation, upon the execution by each Federal Reserve bank of its agreement (to be endorsed on the certificate of such stock) to hold such stock unencumbered and to pay to the United States all dividends, all payments on liquidation, and all other proceeds of such stock, for which dividends, payments, and proceeds the United States shall be secured by such stock itself up to the total amount paid to each Federal Reserve bank by the Secretary of the Treasury under this section. * * * "

In recent years, a number of proposals have been made either to repeal section 13b of the Federal Reserve Act or to modify the restrictions of that section in order to make it more effective. The most important of these proposals was embodied in a bill (S. 408) in the 80th Congress which was favorably reported by the Senate Banking and Currency Committee on April 28, 1947. (Senate Report 145, 80th Cong.) That bill would have authorized the Federal Reserve Banks to guarantee, up to 90 per cent, loans made by chartered banking institutions to business enterprises with maturities of not more than 10 years. While this and other proposals have received consideration, no legislation on this subject has been enacted by Congress.

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V-LOAN GUARANTEES

By Executive Order No. 9112, issued on March 26,1942, pursuant to provisions of Title II of the First War Powers Act of 1941, the War and Navy Departments and the Maritime Commission were authorized to guarantee loans made by financing institutions for the purpose of financing war production contracts; and the Federal Reserve Banks were authorized to act as agents on behalf of the guaranteeing agencies in the making of such guarantees, subject to the supervision of the Board of Governors of the Federal Reserve System. In a press statement issued at the time of the issuance of the Executive Order, the President stated:

> "The basic purpose of the Order is to put working capital financing on a war basis. Up to now peacetime restrictions on banks and credit agencies have made it difficult for them to finance war production although the banks have been anxious to use their resources for prosecution of the war.
>
> "Under the Order, the War Department, the Navy Department, and the Martime Commission may guarantee or make loans when they are needed for war production. These guarantees will support the operations of the banks, the Federal Reserve System, the Reconstruction Finance Corporation, and other credit agencies. They will not be made under peacetime credit rules. They will be made by production men, wherever additional financing is essential for additional production. Peacetime restrictions on credits cannot hold up production of war supplies needed by the armed forces."

The so-called V-loan program provided for by that Executive Order was extended by the Contract Settlement Act of 1944 (58 Stat. 657) to cover guarantees of loans to finance war contractors pending settlement of their terminated war contracts.

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Section 301 of the Defense Production Act of 1950 (Pub. Law 774, 81st Cong.) reinstituted the V-loan program as a means of facilitating the financing of defense production contractors in connection with the current defense program. The President was empowered to authorize the Departments of the Army, Navy, Air Force, and Commerce, and such other agencies as he might designate to guarantee loans made by financing institutions for the purpose of financing contractors, subcontractors, or other persons in connection with contracts or other operations deemed by the guaranteeing agencies to be necessary to the national defense. The Federal Reserve Banks were authorized to act as fiscal agents on behalf of such guaranteeing agencies.

Pursuant to the statute, the President by Executive Order No. 10161, of September 9, 1950, designated as guaranteeing agencies the Departments of the Army, Navy, Air Force, Commerce, Interior, and Agriculture, and the General Services Administration; authorized the Federal Reserve Banks to act as fiscal agents on behalf of the guaranteeing agencies; and delegated to the Board of Governors of the Federal Reserve System authority, after consultation with the guaranteeing agencies, to prescribe regulations, fix rates and fees, and prescribe forms and procedures to be utilized in connection with such guarantees.

In explanation of the objectives of section 301 of the Defense Production Act of 1950, the report of the House Banking and Currency Committee contained the following statement:

> "Section 301 of the bill would authorize the President to reinstitute a guaranty program similar to the V-loan program operated by the Federal Reserve System during World War II. The proposed program would be confined to the guaranty by the national defense

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procurement agencies of loans made by banks and other financial institutions to contractors to finance the production of defense materials needed by the United States in the present emergency.

"The financing problems of contractors engaged in defense production, particularly where they are small and medium size, are unique in character. The loan guaranty mechanism here proposed provides an effective solution of these problems. Contracts for essential defense materials often require much larger financing by contractors than they are able to command under ordinary financing practices. It can make possible maximum participation by numerous small business enterprises in the Government's defense production program, particularly those who do not themselves have direct Government contracts but whose work as subcontractors is essential for prompt performance on the larger prime contracts. It can also make practical the awarding of more Government contracts, requiring unusually large working capital or expansion in plant and facilities, directly to relatively small and medium-size concerns. Without such financing these concerns would not be able to make a full contribution to defense production. Finally, where great speed is essential in the performance of Government contracts, the mechanism can serve to expedite the consummation of loans with a promptness which is not always possible under usual procedures.

"The loan guaranty proved to be an eminently successful means of encouraging the extension of private credit for facilitating production under Government contracts during World War II. The guaranty program of that period -- the so-called V-loan program referred to earlier -- was instituted under Executive order of the President in March 1942. Under that program, loans for war production were guaranteed by the armed services through the agency of the Federal Reserve System. The 12 regional Federal Reserve banks and 24 branches, with experienced personnel and close daily contacts with financial institutions, afforded an already existing and well-adapted organization for making such guaranties promptly available to contractors throughout the country. The Board of Governors in Washington acted as the coordinating agency in the administration of the program.

"During the course of the V-loan program, bank loans to war contractors, both large and small, amounting to about $10-1/2 billion were approved for guaranties. Over 90 per cent of the number and one-third of the amount of these guaranties were on loans to small and medium-size businesses; that is, businesses with total assets of less than $5 million. Notwithstanding the great volume of loans handled, the program was self-supporting;

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receipts of the Treasury from the program exceeded expenses and losses by $23 million by the end of 1949. Without the program, the production of war materials would have required more Government financing through direct lending and other means.

"The committee believes that the authority contained in this section of the bill for the establishment of similar machinery for the making of guaranteed loans is an essential part of the over-all program of the Government for expediting deliveries under defense production contracts." (House Report 2759, 81st Cong.)

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NATIONAL ADVISORY COUNCIL ON

INTERNATIONAL MONETARY AND

FINANCIAL PROBLEMS

The Bretton Woods Agreements Act approved July 31, 1945 (59 Stat. 512) made provision for the Federal Reserve Banks to act as depositories or fiscal agents for the International Monetary Fund and the International Bank for Reconstruction and Development under the supervision of the Board of Governors. In addition, the Chairman of the Board of Governors was made a member of the National Advisory Council on International Monetary and Financial Problems. This Council has the responsibility, among others, of coordinating the policies and operations of the United States representatives on the International Bank and Fund with those of all agencies of the Government which engage in foreign financial, exchange or monetary transactions.

The Bretton Woods Agreements Act was introduced as H.R. 3314. The House Committee on Banking and Currency stated in its report on the bill:

"In addition to the need for harmony in the formulation of policies by the two institutions, it is important that the policies to be followed by the American representatives be worked out by the officials responsible for American activities that will affect and be affected by the operations of the fund and bank. It is equally important to coordinate the activities of those Government agencies making or participating in foreign loans or engaging in foreign financial, exchange, or monetary transactions.

"The committee believes that these purposes can be accomplished through enactment of section 4 of the bill, which establishes a Council consisting of the Secretary of the Treasury, as Chairman, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve

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System, and the Chairman of the Board of Trustees of the Export-Import Bank of Washington. These officials will be familiar with the objectives of the United States in the fields where the fund and the bank operate and will, therefore, be in a position to see whether the representatives of the United States on the fund and bank exercise their authority in accordance with the best interests of the United States.

"The Council's chief function will be to provide continuing contact between the representatives of the United States on the fund and bank and the appropriate officials of the United States Government and especially the Congress. It will recommend to the President general policy directives for the guidance of the United States representatives on the fund and the bank; advise and consult with the President and the American representatives on the major problems arising in the administration of the fund and bank; coordinate the policies and operations of the representatives of the United States on the fund and bank, the policies and operations of the Export-Import Bank and other Government agencies to the extent that they make or participate in foreign loans or engage in foreign financial, exchange, or monetary transactions; and transmit, at least simiannually, reports to the President and the Congress.

"Under the general direction of the President, the Council will also give or refuse the approval, consent, or agreement of the United States to proposed actions of the fund and bank when such approval, consent or agreement is required, but in exercising this power the Council will be limited by the prohibitions contained in section 5. In addition, the American representatives must obtain the Council's approval before they vote in favor of a waiver of the conditions under which a member can purchase exchange from the fund, or before they vote in favor of a declaration of the United States dollar as a scarce currency.

"The committee has recognized the possibility that the experience we will have with the fund and the bank may reveal adjustments that can be made in this Nation's cooperation with other countries on monetary and financial problems. The Council, therefore, is required to transmit to the President and the Congress every 2 years a special report on the operations and policies of the fund and bank.

"Each report will cover and include: The extent to which the fund and the bank have achieved the purposes for which they were established; the extent to which the operations and policies of the fund and the bank have adhered to, or departed from, the general policy directives formulated by the council, and the council's recommendations in connection therewith; the extent to which the operations and policies of the fund and the

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bank have been coordinated, and the council's recommendations in connection therewith; recommendations on whether the resources of the fund and the bank should be increased or decreased; recommendations as to how the fund and the bank may be made more effective; recommendations on any other necessary or desirable changes in the articles of agreement of the fund and of the bank or in this act; and an over-all appraisal of the extent to which the operations and policies of the fund and the bank have served, and in the future may be expected to serve, the interests of the United States and the world in promoting sound international economic cooperation and furthering world security.

"In order that the council may properly carry out its responsibilities, the representatives of the United States on the fund and the bank, the Export-Import Bank and other affected agencies, are required to provide the council with such information concerning their activities as the council requires." (House Report 629, 79th Cong., May 30, 1945)

The Senate Banking and Currency Committee, in reporting H.R. 3314, stated:

"Section 4: A National Advisory Council on International Monetary and Financial Problems is created by section 4. The Secretary of the Treasury will be Chairman of the Council and its other members will be the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Trustees of the Export-Import Bank of Washington. The Council's chief function will be to keep the Congress fully informed and to insure close and continuous consultation between American representatives on the fund and bank and the appropriate officials of the United States Government.

"The Council will recommend general policy directives to the President for the guidance of the United States representatives; it will advise and consult with the American representatives and the President on the major problems connected with the work of the fund and bank; it will coordinate the policies and operations of the representatives of the United States on the fund and bank, Export-Import Bank, and the other Government agencies which participate in foreign loans or engage in foreign financial, exchange, or monetary transactions. The Council will transmit reports on its work to the President and Congress at least semi-annually.

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"The Council under the general direction of the President is empowered by section 4 to give or refuse the approval, consent, or agreement of the United States to proposed actions of the fund and bank where this is required under the Articles of Agreement. In exercising its power the Council will be limited by the prohibitions of section 5 of the bill. The American representatives must also obtain the Council's approval before they vote in favor of the waiver of conditions under which a member can purchase foreign exchange from the fund, or before they vote in favor of a declaration of the United States dollar as a scarce currency.

"Every 2 years the Council will submit to Congress a special report which will cover and include: The extent to which the fund and bank have achieved the purposes for which they were established; the extent to which the operations and policies of the fund and bank have adhered to, or departed from, the general policy directives formulated by the Council, and the Council's recommendations in connection therewith; the extent to which the operations and policies of the fund and bank have been coordinated, and the Council's recommendations in connection therewith; recommendations on whether the resources of the fund and bank should be increased or decreased; recommendations as to how the fund and bank may be made more effective; recommendations on any other necessary or desirable changes in the Articles of Agreement of the fund and bank or in this act; and an over-all appraisal of the extent to which the operations and policies of the fund and bank have served, and in the future may be expected to serve, the interests of the United States and the world in promoting sound international economic cooperation and in furthering world security.

"The Export-Import Bank and other affected agencies must provide the Council with such information concerning their activities as the Council requires to carry out its responsibilities." (Senate Report 452, 79th Cong., July 6, 1945)

The pertinent provisions of the Bretton Woods Agreements Act relating to the National Advisory Council are as follows:

"SEC. 4. (a) In order to coordinate the policies and operations of the representatives of the United States on the Fund and the Bank and of all agencies of the Government which make or participate in making foreign loans or which engage in foreign financial, exchange or monetary transactions, there is hereby established the National Advisory Council on International Monetary and Financial Problems (hereinafter referred to as the 'Council'), consisting of the Secretary of the Treasury, as Chairman, the Secretary of State, the Secretary of Commerce, the Chairman of the Board of Governors of the Federal Reserve System, and the Chairman of the Board of Trustees of the Export-Import Bank of Washington.

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"(b) (1) The Council, after consultation with the representatives of the United States on the Fund and the Bank, shall recommend to the President general policy directives for the guidance of the representatives of the United States on the Fund and the Bank.

"(2) The Council shall advise and consult with the President and the representatives of the United States on the Fund and the Bank on major problems arising in the administration of the Fund and the Bank.

"(3) The Council shall coordinate, by consultation or otherwise, so far as is practicable, the policies and operations of the representatives of the United States on the Fund and the Bank, the Export-Import Bank of Washington and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions.

"(4) Whenever, under the Articles of Agreement of the Fund or the Articles of Agreement of the Bank, the approval, consent or agreement of the United States is required before an act may be done by the respective institutions, the decision as to whether such approval, consent, or agreement, shall be given or refused shall (to the extent such decision is not prohibited by section 5 of this Act) be made by the Council, under the general direction of the President. No governor, executive director, or alternate representing the United States shall vote in favor of any waiver of condition under article V, section 4, or in favor of any declaration of the United States dollar as a scarce currency under article VII, section 3, of the Articles of Agreement of the Fund, without prior approval of the Council.

"(5) The Council from time to time, but not less frequently than every six months, shall transmit to the President and to the Congress a report with respect to the participation of the United States in the Fund and the Bank.

"(6) The Council shall also transmit to the President and to the Congress special reports on the operations and policies of the Fund and the Bank, as provided in this paragraph. The first report shall be made not later than two years after the establishment of the Fund and the Bank, and a report shall be made every two years after the making of the first report. Each such report shall cover and include: The extent to which the Fund and the Bank have achieved the purposes for which they were established; the extent to which the operations and policies

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of the Fund and the Bank have adhered to, or departed from, the general policy directives formulated by the Council, and the Council's recommendations in connection therewith; the extent to which the operations and policies of the Fund and the Bank have been coordinated, and the Council's recommendations in connection therewith; recommendations on whether the resources of the Fund and the Bank should be increased or decreased; recommendations as to how the Fund and the Bank may be made more effective; recommendations on any other necessary or desirable changes in the Articles of Agreement of the Fund and of the Bank or in this Act; and an over-all appraisal of the extent to which the operations and policies of the Fund and the Bank have served, and in the future may be expected to serve, the interests of the United States and the world in promoting sound international economic cooperation and furthering world security.

"(7) The Council shall make such reports and recommendations to the President as he may from time to time request, or as the Council may consider necessary to more effectively or efficiently accomplish the purposes of this Act or the purposes for which the Council is created.

"(c) The representatives of the United States on the Fund and the Bank, and the Export-Import Bank of Washington (and all other agencies of the Government to the extent that they make or participate in the making of foreign loans or engage in foreign financial, exchange or monetary transactions) shall keep the Council fully informed of their activities and shall provide the Council with such further information or data in their possession as the Council may deem necessary to the appropriate discharge of its responsibilities under this Act."

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