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MONETARY, CREDIT, AND FISCAL POLICIES

A COLLECTION OF STATEMENTS SUBMITTED TO THE SUBCOMMITTEE ON MONETARY, CREDIT, AND FISCAL POLICIES BY GOVERNMENT OFFICIALS, BANKERS, ECONOMISTS, AND OTHERS

JOINT COMMITTEE ON THE ECONOMIC REPORT

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LETTER OF TRANSMITTAL

November 7, 1949.

Hon. Joseph C. O'Mahoney,
Chairman, Joint Committee on the Economic Report,
United States Senate, Washington, D. C.

Dear Senator O'Mahoney: Transmitted herewith is a collection of statements on monetary, credit, and fiscal policies that have been submitted to the subcommittee by Government officials, bankers, economists, and others. The publication of these statements before the opening of public hearings will serve several purposes: First, it will make available to the committee in usable form a large amount of information on these subjects; second, it will point up issues that require further study and discussion; and, third, it will apprise every witness, even the first ones to appear, of the points of view expressed by others, thereby adding to the value of the testimony at the hearings.

The materials presented here do not necessarily represent the views of the subcommittee, of its individual members, or of its staff.

Sincerely,

Paul H. Douglas

Chairman, Subcommittee on Monetary, Credit, and Fiscal Policies.

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MONETARY, CREDIT, AND FISCAL POLICIES

INTRODUCTION

In its report to the Congress on March 1 of this year, the joint committee pointed to the need for a study of monetary, credit, and fiscal policies, stating "It is the plan of this committee to appoint a subcommittee to make a thorough study and report on our monetary policy, on the machinery for monetary policy formulation and execution, and in general on the problem of coordinating monetary, credit, and fiscal policies with general economic policy." (S. Rept. No. 88, p. 16.) The authority and means for this study, as well as for three others, were provided by Senate Concurrent Resolution 26, which was approved in May. This resolution authorized and directed the Joint Committee on the Economic Report, or any duly authorized subcommittee of it, "to conduct a full and complete study and investigation into the problem of the effectiveness and coordination of monetary, credit, and fiscal policies in dealing with general economic policy." A subcommittee to conduct the study was appointed in early July and soon thereafter began its work.

This volume contains most of the statements that have been submitted to the subcommittee up to this time. Its contents fall into three general parts: (1) Replies to questionnaires sent to officials occupying responsible positions in governmental and quasi-governmental agencies; (2) replies to a general questionnaire sent to a large number of bankers, economists and others; and (3) two statements that deal with Federal expenditure and revenue policies which were drawn up and unanimously approved by a group of the country's leading university economists. A few words about each of these sections will clarify its purpose and content.

As noted above, the first general part is made up of responses by governmental and quasi-governmental officials to the questionnaire sent to them in August by the subcommittee. It includes statements by the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, the presidents of the 12 Federal Reserve banks, the Comptroller of the Currency, the Chairman of the Federal Deposit Insurance Corporation, the Chairman of the Board of Directors of the Reconstruction Finance Corporation, the Administrator of the Housing and Home Finance Agency, the Governor of the Farm Credit Administration, and the Director of the Bureau of the Budget.

The second part includes replies and digests of replies to a general questionnaire which was sent out in August to more than 450 people, including about 150 bankers, 150 economists, the 48 State bank supervisors, officials of a number of insurance companies and other financial institutions, and representatives of business, agricultural,

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and labor organizations. The number of questionnaires sent out had to be limited in order to hold down to a reasonable level the work of compiling and analyzing the replies, but the sample covered a broad area. For example, questionnaires were sent to banks in every geographic region, to National and State banks, to member and nonmember banks, to insured and noninsured banks, and to banks of many sizes. Similarly, the list of economists receiving the questionnaire included individuals in every section of the country, both older and younger persons, economists with widely differing shades of opinion, general economists, and specialists in a number of fields, such as money, banking, Government finance, and business finance. A few replies had to be omitted from this volume either because they were received so long after the dead line (September 15) that it was impossible to process them in time, or because they were much too long for inclusion even after being digested. But the number of replies omitted is quite small; most of the replies received are included here in either complete or digest form.

The third part includes two statements on Federal expenditure and revenue policies that were drawn up and unanimously approved by a group of outstanding economists meeting in Princeton, N. J. under the auspices of the National Planning Association. The statements were prepared during the period September 16 to 18 and presented to the subcommittee on September 23.

It is believed that the publication of these materials in advance of the opening of public hearings will serve a number of highly useful purposes. In the first place, it will make available to the committee and to others in a convenient form a large amount of information on subjects in the field of money, credit, and fiscal operations. In the second place, it will bring out widely varying points of view and indicate areas requiring further discussion and investigation. And in the third place, it will enable every witness, before his appearance at the hearings, to become thoroughly familiar with the information and points of view presented by others. This should add to the fruitfulness of the hearings.

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CHAPTER I

REPLY BY JOHN W. SNYDER, SECRETARY OF THE TREASURY

MY DEAR MR. CHAIRMAN: This is in reply to your letter dated August 22, 1949, in which you enclosed a questionnaire which you asked me to answer in connection with a comprehensive study relating to the effectiveness and coordination of monetary, credit, and fiscal policies, which has been undertaken by the Joint Committee on the Economic Report, by direction of Congress.

The subject matter of the questions falls into several main categories. All of the questions are answered; but, since much of the material would be repetitive if each question were answered separately, I have taken the liberty of answering the questions by groups rather than question by question.

The first eight questions relate to the monetary and debt-management policies of the Treasury and their coordination with the policies of the Federal Reserve System. The questions are as follows:

1. What are the principal guides and objectives of the Treasury in formulating its monetary and debt-management policies? What attention is paid to the interest costs on the Federal debt; to the prices of outstanding Government obligations; to the state of employment and production; to the behavior of price levels in general; to other factors?
2. To what extent and by what means are the monetary and debt-management policies of the Treasury coordinated with those of the Federal Reserve? Describe in detail the procedures followed for these purposes.
3. What were the principal reasons for the particular structure of interest rates maintained during the war and the early postwar period?
4. To what extent, if at all, would a monetary and debt-management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?
5. When there are differences of opinion between the Secretary of the Treasury and the Federal Reserve authorities as to desirable support prices and yields on Government securities, whose judgment generally prevails?
6. What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury policies in the field of money, credit, and debt management?
7. What would be the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board? On balance, would you favor such a provision?

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8. What are the advantages and disadvantages of offering for continuous sale savings bonds of the E, F, and G series with their present yields, maturities, and limitations on the annual amount to be purchased by each buyer? Does this policy lessen the supply of private savings for equity capital and riskier private loans? What are the advantages and disadvantages of promoting the sale of these securities during periods of recession? Should the terms of these securities and the amount that each buyer may purchase be varied with changes in economic conditions?

The primary concern of the Treasury in formulating its monetary and debt-management policies is to promote sound economic conditions in the country. When I took office as Secretary of the Treasury, the country had only started the tremendous task of converting the economy from a wartime to a peacetime basis. Federal expenditures, which had raised the output of the United States to the highest levels on record during the war years, had been cut back sharply as soon as the war ended. In the fiscal year 1945, Federal expenditures had been just under $100,000,000,000, and had accounted for nearly one-half of the gross national product; in the fiscal year ending June 30, 1946, they dropped to a little over $60,000,000,000. This prompt cut in Federal expenditures after the close of the war was necessary and desirable; but it left the Nation facing the problem of replacing the production which had gone for war purposes with civilian production as rapidly as possible. There were many who felt that the reconversion could be achieved only after the country had experienced serious unemployment and severe economic dislocation. Government and business, farmers and labor, were all worried about many factors on the economic scene.

Not the least of the economic factors which were causing concern was the size of the public debt—which had increased more than fivefold during the war years. It was difficult at the time to forecast how so large a debt might be handled. The size was unprecedented, both in terms of the dollar amount involved and of the debt's relation to the economy of the country. On February 28, 1946, at its post-war peak, the Federal public debt stood at nearly $280,000,000,000. It constituted over 60 percent of all outstanding debt, public and private. At the end of 1939, before the United States started its defense and war finance program, the total public debt had stood at $48,000,000,000. This was only 23 percent of the entire debt of the country.

At the end of the war, the public debt was widely held. This broad ownership made it possible for the debt to play its part in the flexible fiscal policy which was necessary to promote economic stability in the post-war period. The particular composition of the debt was the result of conscious planning by the Treasury as a part of its policy of fitting Government securities to the needs of various types of investors. Practically all of the securities sold to commercial banks, for example, have been short term, in order that the portfolios of banks would be kept highly liquid. This was essential if banks were to be in a position to finance reconversion needs. Business corporations likewise have been provided with short-term securities for the temporary investment of their reserve funds. Insurance companies and savings banks, on the other hand, have held longer-term securities, largely with maturi-

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ties over 10 years. Savings bonds have been, of course, the principal type of Government security held by individuals. At the same time, however, that broad ownership of the debt contributed to easing the problems of post-war debt management, it made good debt management particularly vital, since every segment of the economy was affected.

When I became Secretary of the Treasury, total Government security holdings of individuals, including marketable as well as nonmarketable issues, amounted to $64,000,000,000—a significant change from the situation prior to the war, when they owned only about $10,000,000,000 of Government securities. Over $43,000,000,000 of the Government securities held by individuals were savings bonds. Other nonbank investors also held large amounts of Government securities. Financial institutions had a substantial proportion of their assets invested in the public debt issues of the Federal Government. For mutual savings banks, it amounted to 11½ billion dollars—about 64 percent of their total assets. All insurance companies—life, fire, casualty, and marine—held 25½ billion dollars of Government securities. Life insurance companies alone had holdings of $22,000,000,000—over 46 percent of their total assets. Federal agencies and trust funds, which are by law required to invest their accumulated funds in Government securities, held $29,000,000,000. Other nonbank investors, which include business corporations, State and local governments, and other small groups of investors, held $32,000,000,000.

The commercial banking system held $108,000,000,000 of Government securities. Commercial banks held 84½ billion dollars of the total. This comprised 71 percent of their earning assets. The balance, 23½ billion dollars, was held by the Federal Reserve banks.

It was obvious that the decisions which had to be made with respect to a public debt which was so large, and which was interwoven in the financial structure of the entire economy, would significantly affect the economic and financial welfare of the country. It was essential, under these circumstances, that debt management be directed toward promoting and maintaining a stable and smoothly functioning economy. In the nature of things, the Federal Government must exercise firm control of debt management as long as the debt remains so large and so important. In the course of formulating debt-management policies, I have consulted with advisory committees representing a cross section of American business, for an exchange of views and information. These consultations have been helpful in determining the soundest possible debt-management policies; but, in the final analysis, the responsibility for these policies belongs to the Secretary of the Treasury and under the law cannot be delegated.

As I have said, the overriding consideration in debt-management policy is the economic welfare of the country. The Secretary of the Treasury has many responsibilities; but his primary one is that of maintaining confidence in the credit of the United States Government. In addition, in prosperous years such as we have enjoyed since the end of the war, it is important to reduce the total amount of the public debt and to reduce bank ownership of Federal securities and widen the distribution of the debt. Accordingly, these have been the principal objectives of the Treasury's debt-management program during the post-war period.

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1. *To maintain confidence in the credit of the United States Government.*—It is for this reason that stability in the Government bond market has been a continuing policy during the postwar period. Stability in the Government bond market during the transition period has been of tremendous importance to the country. It contributed to the underlying strength of the country's financial system and eased reconversion, not only for the Government but also for industrial and business enterprises. This is in marked contrast to the situation after the First World War, when the severe decline in the prices of Government securities contributed to the business collapse that occurred within 2 years after the war's end.

The particular structure of interest rates maintained during World War II was, with only minor variations, the one which existed at the time we began our defense and war finance program. It was apparent almost from the beginning of this program that it would require a large increase in the public debt; and an important consideration was the cost of the borrowed funds. It was especially fortunate, therefore, that interest rates were at a relatively low level. It made it possible to finance the war cheaply without disrupting the financial structure of the country.

Stability in the Government bond market since the end of the war has been achieved through the cooperative efforts of the Federal Reserve System and the Treasury Department. Some of the stabilizing measures—notably, of course, the operations of the Federal Open Market Committee—have been primarily the responsibility of the Federal Reserve System. Others have been primarily the responsibility of the Treasury Department.

In maintaining stability in the Government bond market, flexibility in adapting policies to changing economic conditions has been essential. It has been necessary at times to take steps to prevent too sharp a rise in Government security prices; and, at other times, declining prices have been halted.

Beginning in the spring of 1947, the Federal Reserve and the Treasury took action to control an incipient boom in the Government bond market. Long-term bonds were sold from some of the Government investment accounts, the investment series of bonds was offered to institutional investors, and interest rates on short-term Government securities were increased. All of these operations combined to take upward pressure off the market. When conditions changed, and a downward pressure on bond prices developed, the market was stabilized through purchases of long-term bonds. Short-term interest rates—which had been permitted to rise beginning in mid-1947—were held steady from the fall of 1948 until this summer. Then, in mid-September of this year, they were reduced.

All of these actions have been taken with a view toward promoting confidence in the Nation's business and financial structure and the attainment of a high level of employment and production in the economy.

2. *To reduce the amount of the debt.*—In the statement which I made when I took office as Secretary of the Treasury in June 1946, I said:

> * * * It is the responsibility of the Government to reduce its expenditures in every possible way, to maintain adequate tax rates during this transition period, and to achieve a balanced budget—or better—for 1947.

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During the first two fiscal years after I took office, the Federal Government operated with a budget surplus. In the fiscal year 1948, the surplus was, in fact, the largest in the history of the country. Starting in March 1946, the large cash balances that had remained at the end of the Victory loan were applied to the reduction of the public debt. These balances were largely expended during the calendar year 1946, and subsequent debt reduction was effected through pay-offs from the budget surpluses of the fiscal years 1947 and 1948. At its postwar peak on February 28, 1946, the public debt stood at 279.8 billion dollars; on June 27 of this year, it reached a postwar low of 251.3 billion dollars.

There is no longer a budget surplus, however, largely because of the tax reductions enacted by Congress in 1948, over the President's veto. As a result, the debt has been rising steadily in recent months; and at the end of September, it stood at 256.7 bilion dollars. Both President Truman and I have stressed the importance of continuing debt reduction in years of prosperity such as we have enjoyed since the end of the war. This was one of the reasons why the President on three occasions vetoed measures reducing taxes at a time when the economic condition of the country permitted continued retirement of the debt.

3. *To reduce bank ownership of Federal securities and widen the distribution of the debt.*—Strong inflationary pressures existed during most of the postwar period. In order that debt reduction would have the greatest possible anti-inflationary effect, under these circumstances, it was concentrated on debt held by the commercial banking system. The concentration of debt reduction in bank holdings was facilitated by the Treasury's policy of fitting the debt to the needs of investors, which had placed a large volume of short-term debt in the hands of the banking system. The reduction in the public debt held by the commercial banking system has actually been greater than the reduction in the total debt.

The total public debt was reduced 28.5 billion dollars from its postwar peak of 279.8 billion dollars to the postwar low of 251.3 billion dollars. During the same period, bank-held debt was reduced by approximately $34,000,000,000. This came about because the Treasury was able to increase the Government security holdings of nonbank investors. Funds from the sale of savings bonds and other nonmarketable issues to nonbank investors were available for the retirement of maturing issues of bank-held debt, in addition to the budget surpluses of the fiscal years 1947–48. There has been an increase of 5.4 billion dollars in the debt, however, since the low point was reached in June of this year; and at the end of September, the total amount of debt outstanding was 256.7 billion dollars. Bank holdings have increased approximately $2,000,000,000 since the end of June, so that the net reduction in these holdings from February 1946 to the end of September totals $32,000,000,000.

Because of the social and economic benefits of broad ownership of public debt securities, the maintenance of the widespread distribution of the debt has been an essential part of the Treasury's postwar debt-management policies. It has been one of the principal objectives in the continued promotion of savings bond sales. Broad ownership of the public debt is good for the purchasers of Government securities and it is good for the country. It gives to the people a greater

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sense of economic security and an enhanced feeling of personal dignity. It causes them to take an increased interest in national issues. It gives them a direct stake in the finances of the United States.

Another postwar objective of savings bond sales was to combat inflationary pressures. The sale of savings bonds was a two-edged weapon against inflation. It took purchasing power directly out of the hands of consumers; and the funds obtained from the sale of savings bonds were available for the retirement of the bank-held debt, thereby reducing the money supply to that extent.

We have continued actively to promote the sale of savings bonds to encourage thrift on the part of Americans. Thrift is a vital factor in our present-day life.

The total amount of savings bonds outstanding at the end of September was over 56½ billion dollars, an increase of nearly 8½ billion dollars since the end of 1945. The success of the postwar savings bond program is especially notable since it was generally expected that a flood of savings bond redemptions would be one of the major debt-management problems as soon as the war ended.

Actually, the savings bond redemption experience has been better than the turn-over rate on other comparable forms of savings. For example, during 1949, average monthly redemptions of series E bonds have amounted to 0.91 percent of the total of series E bonds outstanding. For other forms of savings the ratios of withdrawals to total deposits have been as follows: Postal-savings accounts, 3.57 percent; savings banks (in New York State), 2.32 percent; insured savings and loan associations, 2.30 percent; savings accounts in commercial banks, 4.86 percent (1948 figure). Moreover, the trend of savings bond redemptions when related to the total amount outstanding has been downward since the end of the war, whereas the percentage trend of withdrawals in most other forms of savings has been upward.

The sale of savings bonds has not, however, been at the expense of other types of savings. During the period in which we were using the savings bond program as an anti-inflationary weapon, the whole tone of our advertising was to encourage personal savings in any practical form—not just to encourage the sale of savings bonds. Individuals have increased their holdings of savings bonds by 13 percent since the end of 1945. But, in this same period, individuals increased their shareholdings in savings and loan associations by over 60 percent; their life insurance by 30 percent; their deposits in mutual savings banks by 25 percent; their savings accounts in commercial banks by 15 percent; their checking accounts by about 10 percent; and their postal-savings accounts by about 10 percent. Of the various forms of liquid savings, only currency holdings in the hands of individuals declined.

The reasons for offering series E savings bonds are, of course, not the same as those for offering series F and G bonds. A small savings bond program was instituted in 1935 for the purpose of providing a risk-free investment for small investors. When it was decided early in the war to sell as large a portion as possible of the wartime security offerings of the Federal Government to nonbank investors, and especially to individuals, series E savings bonds became the keystone of that policy. This was done in order to prevent a repetition of the post-World War I experience. After the war, the prices of Government bonds dropped precipitously—one of the Liberty bond issues

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sold below 82—and small investors, inexperienced in the operations of security markets, were the greatest losers. Series F and G bonds, which are intended for larger investors than those reached by the series E bonds, were introduced early in 1941 as a part of the Treasury policy of shaping offerings of Government securities to meet the needs of various investor classes.

The savings bond program, like other parts of the debt-management policies of the Treasury Department, has been adapted to changing conditions in the economy. You asked whether the terms of savings bonds and limitations on purchases should be varied with economic conditions. We have done this to the extent that seemed necessary. On March 18, 1948, the limitation on holdings of series E savings bonds purchased in any one calendar year was raised from $5,000 (maturity value) for each individual to $10,000 (maturity value), effective beginning in the calendar year 1948. In the fall of 1947, the Treasury offered the investment series bond—a savings bond type of issue—to certain institutional investors. Again in order to meet the needs of these investors, we raised the limitation on purchases of series F and G bonds, for the period from July 1 through July 15, 1948.

Achievement of the debt-management objectives of the Treasury Department requires day-to-day attention to debt operations. Decisions are made continuously.

There is, for example, the matter of refunding maturing issues. This is one of the constantly recurring duties of the Department. There is a Treasury bill maturity each week. There are frequent maturities of certificates of indebtedness; and, in the postwar years, there have been several note and bond maturities each year. In addition, there are savings bond and savings note maturities—and redemptions of these issues before maturity. The volume of refunding, carried through each year has amounted to approximately $50,000,000,000—in itself a task of considerable magnitude. It exceeds the total of all security refunding engaged in by all other borrowers in the country during the past 25 years.

The interest cost of the debt to taxpayers is another of the many considerations which must be taken into account in debt-management policies. It is estimated that the interest charge on the public debt during the fiscal year 1950 will be $5,450,000,000. This item represents over 13 percent of the Federal budget for the year. The interest cost is likely to grow over a period of time—in the absence of substantial debt reduction—because the rate of interest on savings bonds increases as the bonds are held to maturity, and because an increasingly large proportion of the debt represents the accumulation of trust funds invested at rates set forth in the law which are higher than the present average interest rate on the debt.

A general rise in interest rates would bring about a further rise in the budget charge for interest payments. An increase of as little as one-half of 1 percent in the average interest paid on the debt would add about $1,250,000,000 to this charge. The Treasury was able to finance the last war at an average borrowing cost of less than one-half the borrowing cost of World War I. If this had not been done, the interest charge at the present time would be more than $10,000,000,000 a year instead of $5,000,000,000 a year. It is clearly evident that this $5,000,000,000 annual saving in the taxpayers' money is a highly important factor in the budget picture of the Federal Government.

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It has been argued that if the Government had permitted higher interest rates on its long-term securities at the end of the war—that is, had permitted Government bond prices to drop below par—inflationary pressures would have been lessened.

Fiscal-monetary weapons have only limited effectiveness in combating inflationary pressures. They operate against inflation in an overall fashion. They can be used to cut down the total spending power of the economy and so are effective—and, in fact, indispensable—in periods of general price rise. Any curtailment of general spending power drastic enough, however, to bring special price situations into line, might set off a severe deflationary spiral. High prices in special areas are most effectively dealt with by specific measures applied directly to those areas; and it was with this in mind that President Truman repeatedly asked Congress to enact appropriate legislation to deal with special areas of inflationary pressures.

The Government's fiscal policy from January 1946 to late 1948 did, however, have a direct counterinflationary effect. Federal Government expenditures were cut rapidly and sharply from their wartime peak, while revenues were maintained at high levels. I have mentioned that President Truman on three occasions vetoed tax measures designed to cut revenues because he recognized the urgency of reducing the debt during this period. Debt reduction by the use of a surplus of receipts over expenditures was, in fact, the most potent anti-inflationary fiscal measure available to the Government. A surplus of Federal receipts over expenditures takes purchasing power directly out of the hands of consumers; and by using this surplus to reduce bank-held debt, the Treasury to a large extent offset the increase in the money supply due to other factors. I have already noted also the promotion of savings bond sales as an anti-inflationary measure; and that short-term interest rates were permitted to rise, starting in the summer of 1947.

The policy of stabilizing the Government bond market in itself made a substantial contribution to economic stability. I do not agree with those who believe that if the support prices of Government securities had been lowered below par, sales of these securities to the Federal Reserve would have been stopped and inflationary pressures would have been lessened. It seemed to me that, under the circumstances which existed, we would have taken the risk of impairing confidence in the Government's credit if the prices of Government bonds had been permitted to go below par; and that as a result the Federal Reserve might have had to purchase more bonds below par than at a par-support level. This, of course, would have increased bank reserves and to that extent would have been inflationary rather than anti-inflationary.

During the postwar period, the country has enjoyed a level of prosperity never before achieved in peacetime. Personal income has reached the highest level on record, and has remained near that level. Civilian employment likewise attained the highest peak in our history, and today there are nearly 60,000,000 persons employed. There is no doubt that the successful management of the public debt and the maintenance of a continued period of stability in the Government bond market have contributed materially to the economic well-being of the country during this period.

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In the execution of its monetary and debt-management policies, the Treasury consults with the Federal Reserve. The Chairman of the Board of Governors of the Federal Reserve System and I discuss policy matters thoroughly and arrive at decisions which are mutually satisfactory. It does not seem to me that statutory directives to increase the degree of coordination of Federal Reserve and Treasury policies are needed. In my opinion, such policies can best be coordinated as they are at the present time, by discussions between the Secretary of the Treasury and the Chairman of the Board of Governors of the Federal Reserve System.

Neither would there be any particular advantage in providing that the Secretary of the Treasury should be a member of the Federal Reserve Board. The Secretary of the Treasury did serve as a member of the Federal Reserve Board from its inception until February 1, 1936. There is no evidence that the coordination of Federal Reserve and Treasury policies was carried out any more effectively during that period than it has been subsequently.

The Secretary of the Treasury is the chief fiscal officer of the Government. It seems to me that any proposal to make him a member of the Board of Governors of the Federal Reserve System for the express purpose of bringing about better coordination of Federal Reserve and Treasury policies would appear to subordinate the responsibility of the Treasury Department in fiscal-monetary matters. In the final analysis, the principal responsibility in the fiscal-monetary area must rest with the President and his fiscal officers, who are accountable to the electorate for their actions.

Questions 9, 10, and 11 are concerned with the monetary system of the United States. The questions are as follows:

> 9. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished?
>
> 10. Under what conditions and for what purposes, if any, should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effects would an increase in the price of gold have on the effectiveness of general monetary and credit policies? On the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?
>
> 11. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

I do not think that conditions require an alteration in the monetary system. As the committee undoubtedly knows, I am on record as being opposed to any change in the price of gold; and the Treasury Department is firmly of the view that a gold-coin standard should not be reestablished in the United States.

The Department has considered the latter proposal in connection with a number of bills which have been introduced in the Congress. For example, in the last session of Congress, we submitted a report to the Senate Banking and Currency Committee on bills S. 13 and S. 286. A copy of our report on those bills is attached.

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The present monetary policy of the United States relative to silver is laid down in three acts of Congress; namely, the Silver Purchase Act of 1934, section 4 of the act of July 6, 1939, and the act of July 31, 1946, which has largely superseded the 1939 act. Under the third act, domestic silver mined since July 1, 1946, may be delivered, at the owner's option, to United States mints for a return of 90.5 cents per ounce. The Treasury has no discretion under this legislative provision. Since this price is considerably higher than the open market price (now between 73 and 74 cents per ounce), the effect of this act is to divert to the United States Treasury at the 90.5-cent price substantially all of the current production of silver in the United States. On previous occasions, the Treasury has stated that it would interpose no objection if Congress wished to repeal all the provisions relating to acquisitions of silver in the above-named acts.

Question 12 relates to the coordination of the lending and loan insuring and guaranteeing policies of the various Government agencies. The question is as follows:

> 12. To what extent and by what methods does the Treasury coordinate the activities of the various Government agencies that lend and insure loans to private borrowers? In what ways, if at all, should the Treasury's powers in this field be altered?

The Treasury does not, of course, have statutory authority to coordinate the activities of the various Government agencies that lend and insure loans to private borrowers. The Department has been instrumental, however, in furthering consultations between the heads of these agencies, with a view to coordinating lending, insuring, and guaranteeing policies. In the final analysis, it seems to me that this voluntary type of consultation is perhaps the best method of coordinating these policies. The heads of the lending, insuring, and guaranteeing agencies are responsible to the President; and the decisions which they make must be made in accordance with his policies. Furthermore, the policies and operations of these agencies are subject to annual review by the Congress in connection with their annual budgets.

Such limited authority as the Treasury has with respect to the lending, insuring, and guaranteeing policies of Government agencies is restricted almost entirely to the methods employed by the agencies in borrowing funds which they, in turn, are authorized to lend to private borrowers. For example, under the Government Corporation Control Act, "All bonds, notes, debentures, and other similar obligations which are * * * issued by any wholly owned or mixed-ownership Government corporation and offered to the public shall be in such forms and denominations, shall have such maturities, shall bear such rates of interest, shall be subject to such terms and conditions, shall be issued in such manner and at such times and sold at such prices as have been or as may be approved by the Secretary of the Treasury" except that any mixed-ownership Government corporation from which Government capital has been entirely withdrawn is exempt from this provision during the period it remains without Government capital. In addition, the Federal intermediate credit banks, the production credit corporations, the Central Bank for Cooperatives, the regional banks for cooperatives, and the Federal land banks are specifically exempted from this provision, but are required to consult with

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the Secretary of the Treasury prior to issuing securities; and, in the event an agreement is not reached on the terms of the securities, the Secretary of the Treasury may make a report in writing to the corporation involved, to the President, and to the Congress, stating the grounds for his disagreement.

There are only a few cases in which the Treasury has any direct control over lending operations of Government agencies. Reconstruction Finance Corporation loans on the nonassessable preferred stock of insurance companies can be made only upon certification by the Secretary of the Treasury of the necessity for such loans to increase the capital funds of the companies concerned. Also, under section 103 of Public Law 901, Eightieth Congress, the Administrator of Veterans' Affairs has the authority, with the approval of the Secretary of the Treasury, to raise the permissible rate of interest on loans guaranteed or insured under title III of the Servicemen's Readjustment Act of 1944, from the rate specified in the law, namely, 4 percent, to a maximum of 4½ percent. In addition, the Secretary of the Treasury, or an officer of the Treasury designated by him, is a member of the Board of Directors of the Federal Farm Mortgage Corporation.

In the field of foreign loans, there is in existence a coordinating and policy-determining agency. The Secretary of the Treasury is Chairman of the National Advisory Council on International Monetary and Financial Problems, established by the Congress in the Bretton Woods Agreements Act, approved July 31, 1945. Among other things, the statute directs the Council to coordinate the policies and operations of the representatives of the United States on the International Monetary Fund and the International Bank for Reconstruction and Development, 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."

Question 13 asks my opinion on the Hoover Commission proposal that supervision of the Federal Deposit Insurance Corporation be vested in the Secretary of the Treasury. The question is as follows:

> 13. What would be the advantages and disadvantages of adopting the Hoover Commission proposal that supervision of the operations of the FDIC be vested in the Secretary of the Treasury? On balance, do you favor this proposal?

The recommendation that the supervision of the operations of the FDIC be vested in the Secretary of the Treasury has been carefully considered. There is much to be said for the independent status which this agency now enjoys. Its policies are, in many cases, governmental policies which have been set after consultation with the President and other Cabinet members; and the agency can, therefore, function independently. However, it could also function as a part of the Treasury.

Question 14 asks my opinion with respect to the establishment of a National Monetary and Credit Council of the type proposed by the Hoover Commission. The question is as follows:

> 14. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If such a council were established,

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what provisions relative to its composition, powers, and procedures would make it function most satisfactorily?

I am not opposed to the establishment of a National Monetary and Credit Council of the type proposed by the Hoover Commission. The establishment of such a council would not of itself, however, solve any fundamental problem. But if such a council were established, the Treasury Department would be happy to contribute the accumulated knowledge and earnest efforts of its various staff groups.

Questions 15 and 16 relate to Federal budget policy. The questions are as follows:

> 15. What, in your opinion, should be the guiding principles in determining, for any given period, whether the Federal budget should be balanced, should show a surplus, or should show a deficit? What principles should guide in determining the size of any surplus or deficit?
>
> 16. Do you believe it is possible and desirable to formulate automatic guides for the Government's over-all taxing-spending policy? If so, what types of guides would you recommend? What are the principal obstacles to the successful formulation and use of such guides?

The general economic welfare of the country should be the guiding principle in determining for any given period whether the Federal budget should be balanced, should show a surplus, or should show a deficit, and in determining the size of any surplus or deficit.

Since I took office as Secretary of the Treasury in June 1946 I have continuously urged a Federal budget that would permit debt retirement. Both President Truman and I have stated on a number of occasions that it is essential to reduce the public debt in years of prosperity, such as we have enjoyed since the end of the war. This was one of the reasons why the President on three occasions vetoed tax-reduction measures. This has also been a major reason why the President has constantly limited budget expenditures to the minimum amount necessary to carry out the defense program and other essential domestic and international programs.

I do not believe that it is feasible to attempt to formulate automatic guides for the Government's over-all taxing-spending policy. The economic and social variants which should determine the policy in any given period are so numerous and for different periods are present in such different combinations that taxing-spending policy can be determined only after the most careful consideration of the situation existing at any given time. Budget receipts and expenditures for each fiscal period must be examined item by item with due regard to their relative need and public service. This is a responsibility which can be discharged properly only by Congress.

One of the most frequently mentioned possibilities along these lines is that automatic guides can be established based on levels of national income. It obviously is not possible to say that under all circumstances the budget should be balanced when the national income is at any particular level; and it is not possible to provide by statute exemptions to cover all the cases when exemptions would be necessary. In my opinion, policy formulation and action must, of necessity, be left to the responsible authorities to be made in accord-

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ance with their best judgment in view of economic developments as they occur.

Questions 17, 18, and 19 are concerned with the commercial banking system. The questions are as follows:

17. What were the aggregate amounts of interest payments by the Treasury to the commercial banking system during each year since 1940?

18. What changes, if any, should be made in the ownership of the Federal Reserve banks? In the dividend rates on the stocks of the Federal Reserve banks?

19. What changes, if any, should be made in the laws relating to the disposal of Federal Reserve profits in excess of their dividend requirements?

The following table shows the estimated distribution of interest payments on the public debt, by class of recipient, for the calendar years 1940 through 1948:

[Billions of dollars]

Calendar year	Total interest [1]	Banks			Nonbank investors			
		Total	Commercial banks	Federal Reserve banks	Total	Individuals	U. S. Government investment accounts	Other investors
1940	1.1	0.3	0.3	(2)	0.8	0.3	0.2	0.3
1941	1.1	.3	.3	(2)	.8	.3	.2	.3
1942	1.5	.5	.4	0.1	1.0	.4	.3	.3
1943	2.2	.8	.7	.1	1.4	.5	.3	.6
1944	3.0	1.1	1.0	.1	1.9	.7	.4	.8
1945	4.1	1.4	1.3	.1	2.7	1.1	.5	1.1
1946	5.0	1.5	1.4	.1	3.5	1.4	.7	1.5
1947	5.0	1.4	1.2	.2	3.6	1.5	.7	1.4
1948	5.4	1.4	1.1	.3	3.9	1.6	1.0	1.4

[1] Actual payments on the basis of daily Treasury statements.
[2] Less than $50,000,000.

NOTE.—Figures will not necessarily add to totals, due to rounding.

Interest payments to commercial banks amounted to approximately 27 percent of the total interest paid on the debt in 1940, but amounted to only 20 percent in 1948. Payments to the entire commercial banking system, that is, to commercial banks and Federal Reserve banks—which amounted to about $350,000,000 in 1940 and $1,450,000,000 in 1948—similarly showed a decline as a percentage of total interest payments during this period.

Interest earnings on Federal Reserve bank holdings of Government securities increased from $42,000,000 in 1940 to $299,000,000 in 1948, as a result of the wartime credit and currency needs of the country. The Board of Governors of the Federal Reserve System took the initiative in turning over a part of the Reserve banks' relatively high earnings to the Federal Government, by invoking its authority to levy an interest charge on Federal Reserve notes issued by the banks. In its announcement on April 24, 1947, the Board stated that the purpose of the charge was to pay into the Treasury approximately 90 percent of the net earnings of the Federal Reserve banks in excess of their dividend requirements. Payments to the

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Treasury as a result of this action amounted to $75,000,000 in 1947 and $167,000,000 in 1948.

If Congress wishes, it can, of course, set forth specific statutory directives for the disposal of Federal Reserve bank profits in excess of their dividend requirements.

With respect to the matter of stock ownership of the Federal Reserve banks and the dividend rate on this stock, I do not believe that there is any urgent need to deal with these questions at this time.

Very truly yours,

JOHN W. SNYDER,
Secretary of the Treasury.

Attachment:

MAY 4, 1949.

Hon. BURNET R. MAYBANK,
Chairman, Committee on Banking and Currency,
United States Senate, Washington, D. C.

MY DEAR MR. CHAIRMAN: This is in further reply to your letters of April 25, 1949, stating that your committee intends to begin hearings on S. 13 and S. 286 on May 5 and requesting the report of the Department on these bills prior to the date of the hearing.

Both bills specifically authorize the acquisition, trading, and export by members of the public of any gold mined in the United States or imported into the United States after their enactment. S. 286 would also repeal sections 3 and 4 of the Gold Reserve Act of 1934. Since these sections contain the authority to regulate transactions in gold in the United States, their repeal would permit a free market for all gold. In substance, S. 13 would also result in a free market for all gold since it would not be possible to distinguish newly mined or imported gold from other gold.

The Treasury is strongly opposed to the enactment of these bills. They would create serious risks to our national monetary and banking structure and would result in a weakening of the present strong and stable position of the dollar in its relation to gold. At the same time, the advantages expected by their advocates appear to be based on misunderstandings and illusory hopes.

1. Enactment of either S. 13 or S. 286 would amount to a reversal of the decision made by the Congress in the Gold Reserve Act of 1934, that gold should be held by the Government as a monetary reserve and that it should not be available for private use for other than legitimate industrial, professional, or artistic purposes. We believe that the United States should continue to follow the principle that the most important use of gold is for the domestic and international monetary functions of the Government and that gold should not be held by private individuals as a store of wealth.

2. The existence of a free market for gold in the United States with a fluctuating price determined by private demand and supply would have exceedingly unfortunate consequences for our domestic economy. In fact, the Secretary of the Treasury is required by statute to maintain all forms of United States money at a parity with the gold dollar. Since the gold dollar contains one-thirty-fifth of an ounce of gold, this means that the Treasury should maintain the price of gold at $35 an ounce in legal gold markets in the United States. Therefore, the Treasury would hardly have any alternative if the proposed

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bills were enacted other than to sell gold to the extent necessary to maintain the market price at $35 an ounce. Thus, the rise in the price of gold which appears to be contemplated by the proponents of these bills would not take place.

If the Treasury did not take measures to stabilize the market at $35, the shifting of the price of gold could not fail to confuse and disturb the public. The common interpretation of such fluctuations would be that something was wrong with the dollar and that the value of the dollar and all savings stated in dollars were going up and down with each fluctuation.

Such prices for gold, however, would probably be the result of a relatively trifling volume of transactions. No significant determination of the value of the whole world supply of gold could be made with the United States Treasury, which is the main factor in the gold market, left out of the balance. Because of popular misconceptions, prices determined by an insignificant volume of transactions would be interpreted as applying to all gold, including the $24,300,000,000 in gold held by the United States Treasury. Thus, the public misinterpretation of the quotations in the so-called free market might cause a loss of confidence in the dollar and be extremely damaging to our economic welfare.

If the Treasury let the price of gold in the United States fluctuate, it would be defeating the very purposes which have led us to acquire over $24,000,000,000 worth of gold. The Treasury has paid out those billions of dollars for gold in order to keep stable the relation between gold and the dollar. There would be no clear reason why we should have bought this gold in the past or should continue in the future to buy gold at $35 an ounce if we were not also to be ready to sell it at the same price for any legitimate purpose in order to maintain that stability.

It would be exceedingly improvident for the United States to sell gold at $35 an ounce to foreign governments if such gold or other gold could be resold in the United States at premium prices. On the other hand, the Treasury believes it to be of the highest monetary importance to the United States that it continue to sell gold to foreign governments and central banks at $35 an ounce whenever the balance of international payments turns in their favor and they ask for settlement in gold. To refuse to make such sales at $35 would be equivalent to a devaluation of the dollar and an abandonment of our adherence to a gold standard. Moreover, if the United States should not continue to buy and sell gold freely for international settlements at $35 an ounce, we could not meet our obligations to the International Monetary Fund without adopting a system of exchange controls to prevent transactions in foreign currencies in the United States at other than official rates.

It should not be assumed, however, that it is at all certain that the proposed free market in gold would result in a marked rise in the price of gold for any extended period even if the Treasury should not stabilize the market at $35. Expectations of substantial increases in price are based on widespread exaggeration of the significance of various premium quotations abroad and inadequate appreciation of the degree to which prices of gold everywhere depend on the readiness of the United States to buy at $35 virtually all gold which is offered to the Treasury. There is also inadequate appreciation of the extent

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to which gold imports and trading are restricted in every important country in the world and the valid reasons for such restrictions.

3. The international monetary relations and obligations of the United States would also be prejudiced if gold were authorized to be exported and imported freely. One of the dangers of permitting exportations of gold from the United States without restriction is that much of the gold would flow to black markets abroad. In some countries the gold markets are illegal; in others, gold imports or dollar payments for gold are prohibited. These restrictions are designed to conserve urgently needed dollars to finance essential imports. Permitting gold exports to these markets would work directly against our efforts to restore Europe to financial solvency through the European recovery program.

In this connection, the International Monetary Fund has expressed its concern that international gold transactions at premium prices tend to divert gold from central reserves into private hoards. The fund has asked its members to take effective action to prevent premium price transactions in gold with other countries or with the nationals of other countries. The existence of a free market in the United States with a fluctuating price for gold, coupled with the repeal of authority to control the export of gold would make it impossible for the United States to cooperate with the fund in achieving this objective.

4. Treasury sales of gold to the extent necessary to maintain a $35 price in a free market created by the enactment of either of these bills would in effect mean that any holder of dollars or dollar obligations would be able to convert them into gold. While this would be preferable to an erratic movement in gold prices in the United States, it would force this Government to a course of action which might have extremely serious consequences.

Internal gold convertibility is likely to exert critical pressure at the most dangerous and damaging times and to do little good at other times. It threatened the foundations of our financial structure during the depression and it might have done so again during the last war, yet it has proven of no use either to prevent inflationary booms or serve other desirable purposes at other times. When left in a centralized reserve, our gold stock gives impregnable international strength to the dollar. If our gold stock, on the other hand, were dissipated into immobilized private holdings, our power to maintain the position of the dollar might be critically weakened.

The problems of financing the last war would have been tremendously magnified if private citizens had been free to draw down our gold reserves. The prosecution of the war, for example, would have been critically hampered if Government and business borrowing had been limited because gold hoarders had left no excess reserves in the banking system.

Even our $24,000,000,000 of gold holdings would be completely inadequate to meet a serious run on gold from the $27,000,000,000 of United States currency in circulation, over $140,000,000,000 of bank deposits, and scores of billions of dollars of Government securities, not to mention other relatively liquid assets. Conversion of around 5 or 6 percent of these Government and bank obligations would be enough to bring the Federal Reserve banks below their legal minimum gold reserve.

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Even in a letter of this length it is not possible to state all the considerations which cause the Treasury to oppose these bills. We believe, however, that the foregoing will give you a general indication of the difficulties and problems which the Treasury considers would arise from the enactment of either of them.

The Bureau of the Budget has advised that there would be no objection to the submission of this report to your committee since the proposed legislation is not in accord with the program of the President.

Very truly yours,

William McC. Martin, Jr.,
Acting Secretary.

Appendix to Chapter I

August 1949.

QUESTIONNAIRE ADDRESSED TO THE SECRETARY OF THE TREASURY

1. What are the principal guides and objectives of the Treasury in formulating its monetary and debt management policies? What attention is paid to the interest costs on the Federal debt? To the prices of outstanding Government obligations? To the state of employment and production? To the behavior of price levels in general? To other factors?

2. To what extent and by what means are the monetary and debt management policies of the Treasury coordinated with those of the Federal Reserve? Describe in detail the procedures followed for these purposes.

3. What were the principal reasons for the particular structure of interest rates maintained during the war and the early postwar period?

4. To what extent, if at all, would a monetary and debt management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?

5. When there are differences of opinion between the Secretary of the Treasury and the Federal Reserve authorities as to desirable support prices and yields on Government securities, whose judgment generally prevails?

6. What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury policies in the field of money, credit, and debt management?

7. What would be the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board? On balance, would you favor such a provision?

8. What are the advantages and disadvantages of offering for continuous sale savings bonds of the E, F, and G series with their present yields, maturities, and limitations on the annual amount to be purchased by each buyer? Does this policy lessen the supply of private savings for equity capital and riskier private loans? What are the advantages and disadvantages of promoting the sale of these securities during periods of recession? Should the terms of these securities and

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the amount that each buyer may purchase be varied with changes in economic conditions?

9. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished?

10. Under what conditions and for what purposes, if any, should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effects would an increase in the price of gold have on the effectiveness of general monetary and credit policies? On the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

11. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

12. To what extent and by what methods does the Treasury coordinate the activities of the various Government agencies that lend and insure loans to private borrowers? In what ways, if at all, should the Treasury's powers in this field be altered?

13. What would be the advantages and disadvantages of adopting the Hoover Commission proposal that supervision of the operations of the FDIC be vested in the Secretary of the Treasury? On balance, do you favor this proposal?

14. What would be the advantages and disadvantages of establishing a national monetary and credit council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If such a council were established, what provisions relative to its composition, powers, and procedures would make it function most satisfactorily?

15. What, in your opinion, should be the guiding principles in determining, for any given period, whether the Federal budget should be balanced, should show a surplus, or should show a deficit? What principles should guide in determining the size of any surplus or deficit?

16. Do you believe it is possible and desirable to formulate automatic guides for the Government's over-all taxing-spending policy? If so, what types of guides would you recommend? What are the principal obstacles to the successful formulation and use of such guides?

17. What were the aggregate amounts of interest payments by the Treasury to the commercial banking system during each year since 1940?

18. What changes, if any, should be made in the ownership of the Federal Reserve banks? In the dividend rates on the stocks of the Federal Reserve banks?

19. What changes, if any, should be made in the laws relating to the disposal of Federal Reserve profits in excess of their dividend requirements?

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CHAPTER II

REPLY BY THOMAS B. McCABE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Hon. PAUL H. DOUGLAS,
Chairman, Subcommittee on Monetary, Credit, and Fiscal Policies, Senate Office Building, Washington, D. C.

DEAR SENATOR DOUGLAS: In submitting these answers to your questionnaire of August 22 on monetary, credit, and fiscal policies, I would like to express my sincere appreciation of your consideration in granting me the few days of extra time to prepare them.

I had no idea of the magnitude of the task involved until I sat down with our staff and began to analyze the length and breadth of these most penetrating questions. In my judgment, if everyone to whom these questions have been addressed catches the constructive spirit of the inquiry and frames answers in a spirit of objectivity, you will have in your possession a most significant contribution to better understanding of this vital subject.

Although I had the benefit of the wealth of experience of the other members of the Board of Governors and of our very able staff, the final answers are my own. I have not asked the Board to share the responsibility of any of the conclusions.

With warmest regards,

Sincerely,

THOMAS B. MCCABE, *Chairman.*

I. OBJECTIVES OF FEDERAL RESERVE POLICY

> 1. What do you consider to be the more important purposes and functions of the Federal monetary and credit agencies? Which of these should be performed by the Federal Reserve?

The principal purposes and functions of the various Federal monetary and credit agencies, taken collectively, may be stated broadly as follows:

(1) To accommodate commerce, industry, and agriculture by assuring an adequate but not excessive volume of money and credit at rates of interest appropriate to the general welfare of the economy.

(2) To preserve confidence, so far as these agencies can contribute to that end, in the country's money and in the financial institutions in which the savings of the people are invested.

(3) To maintain a valid rate of foreign exchange appropriate to the position of the American economy in the world economy.

(4) To foster continued strengthening of the democratic system and its related economic institutions by encouraging maximum reliance on private banking and other lending institutions.

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(5) To promote active and effective competition among lenders.

(6) To assist in formulating and carrying out Government economic policies which are consistent with the Employment Act of 1946.

(7) To contribute, through participating in the formulation of international economic policies, to the solution of international monetary and economic problems.

The Federal Reserve

Among the various Federal monetary and credit agencies the only one whose primary purpose is monetary is the Federal Reserve; the others (see final section of this answer) are not charged with statutory responsibility for general monetary policy, althought some of them have functions of a monetary nature.

Monetary functions are those concerned directly with regulating the supply, availability, and cost of money. The most important responsibility of the Federal Reserve is that of determining policies with respect to these functions in accordance with the broad objectives of public policy, notably that of contributing to sustained progress of this economy (except in time of war, when other objectives supervene) toward the accepted goals of high employment and rising standards of living. Though not always stated by responsible authorities in just these terms, this purpose has been dominant throughout the life of the Federal Reserve. A recent statement of it appears in the 1946 annual report of the Board of Governors of the Federal Reserve System [italics supplied]:

> It is the Board's belief that the implicit, predominant purpose of Federal Reserve policy is to contribute, insofar as the limitations of monetary and credit policy permit, to an economic environment favorable to the *highest possible degree of sustained production and employment.*

A similar statement, indicating that the same concept was held by the founders of the System, was made in 1913 by the chairman of the Senate Committee on Banking and Currency in discussing the bill to establish the Federal Reserve System [italics supplied]:

> Senate bill No. 2639 is intended to establish an auxiliary system of banking, upon principles well understood and approved by the banking community, in its broad essentials, and which, it is confidently believed, will tend *to stabilize commerce and finance*, to prevent future panics, and place the Nation upon an era of *enduring prosperity.*

The Federal Reserve banks hold the reserve balances that member banks are required by law to maintain against their deposits, and issue most of the currency that is put into circulation in response to the public's demand for cash money. Federal Reserve policies influence the supply, availability, and cost of money by adding to or subtracting from the supply of funds available to banks for extending credit or for meeting currency needs without depleting their reserves below the required level. The principal instruments employed by the Federal Reserve for this purpose are:

(1) Open market and discount operations, which—

(*a*) add to or subtract from the supply of available funds, and

(*b*) establish rates of interest at which such funds may be obtained; and

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(2) The raising or lowering of the reserve requirements of member banks.

The System also has certain selective instruments which may be said to influence the availability of credit in particular sectors of the economy. The various instruments of policy used by the System are discussed further in answers to the questions in part IV.

The Federal Reserve has a responsibility for adjusting the money market effects of international movements of funds and for helping to maintain the foreign exchange position of the dollar.

Monetary management in the public interest is the cardinal concern of the Federal Reserve System. It has the responsibility of advising the Government as a whole with respect to monetary matters, particularly as to the contributions of monetary and credit policy to general economic policy. It has an obligation through educational work to foster public understanding of monetary policies and the relation of money and credit to economic conditions and development. It collects and analyzes economic information to facilitate the attainment of the System's objectives. Together with the Treasury and the Government generally, the Federal Reserve System shares responsibility for maintaining universal confidence in our money and in our financial and economic institutions.

The System also has (or shares with other agencies) certain supervisory functions, including supervision not only of many banks but also affiliates and holding company affiliates of banks. It also performs certain important service functions such as supplying currency, facilitating the clearance of checks, and performing fiscal agency services for the United States Government. These functions are essential to the operation of the economy and require large staffs at the Federal Reserve banks. The System also makes or guarantees loans to businesses in certain limited circumstances, as brought out elsewhere in this set of answers.

As I have indicated, the responsibilities of the Federal Reserve are not exclusively domestic. Movements of money into and out of this country affect, and in turn may be affected by, the operations of the Federal Reserve. This was notably true in the period when capital movements were not restricted by official controls. Federal Reserve policies influence the availability of funds for international loans and they may also offset or absorb the effects of international movements of funds on domestic money markets. The Federal Reserve System also has certain nondomestic operational functions, such as holding balances and acting as correspondent for foreign central banks and governments, making advances to foreign central banks, and passing judgment on applications by member banks and certain banking corporations to establish foreign branches and regulating their activities in foreign countries. In addition, as more fully described in the answer to question III–1, the Federal Reserve System performs important advisory functions in the international field, both with respect to United States foreign financial policy and to financial problems arising in foreign countries.

As a general principle, I think that the Federal Reserve should perform those functions which are of a strictly monetary nature. How far functions which are not altogether of this nature should be confided to the Federal Reserve is discussed in the answers to other

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questions in this questionnaire, particularly to some of those in parts II and III and to questions VI–2 and VI–5.

Other Federal agencies

Other Federal agencies whose primary spheres of activity affect monetary and credit policy are of a different category from the Federal Reserve. They include the Department of the Treasury and, in addition, a number of more specialized agencies of which the principal ones are the Reconstruction Finance Corporation, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the Housing and Home Finance Agency, the Farm Credit Administration (each of the last two embraces a group of agencies) the Rural Electrification Administration, the Veterans' Administration, the Export-Import Bank, and the Economic Cooperation Administration.

The Treasury has important monetary powers, such as those to purchase and sell gold and silver, to regulate the holding and the export of gold, and to mint coins and issue certain types of currency. In addition, it has important responsibilities for the international monetary and financial operations of this country.

Other Treasury functions have an important influence upon monetary developments, particularly the handling of its cash balance and public-debt management. These relations are discussed in answer to the questions in part II.

The other agencies are charged with responsibility for dealing with specific aspects of the credit situation; the operations of many of them take the form of granting credit to the public directly or of facilitating through guarantee and similar procedures, credit extension by others (as is brought out in the answers to question VI–4 and VI–5). In some cases, their use of the credit mechanism is incidental to their primary purpose, which may be to aid agriculture, veterans, home owners, etc. Since the operations of all the specialized agenices have an influence on the general monetary and credit situation, even though none of these agencies is charged with responsibility for general monetary policy, there is need for some means (consistent with the responsibility of each agency) of bringing about a closer relationship between these operations and general monetary and credit policies. This problem is discussed elsewhere in this set of answers, particularly in the answers to questions I–4, II–6, VI–4, VI–5, and VI–6.

2. What have been the guiding objectives of Federal Reserve credit policies since 1935? Are they in any way inconsistent with the objectives set forth in the Employment Act of 1946?

For the period since 1935, to which this question specifically relates, the credit policies of the Federal Reserve can best be described by dividing the period into four parts—before the war, during the war, the period of postwar inflation, and the recent period of abatement of inflationary pressures.

For the period from 1935 to the outbreak of the war in 1939, when the country was still in process of recovering from a deep depression, the Federal Reserve maintained a policy of monetary ease. The heavy gold inflow created a very large volume of bank reserves especially excess reserves, and led to the lowest interest rates in history. The Federal Reserve recognized that under conditions of the period an abundant supply of money at low rates was fully justified but at the same time was aware that the available supply of bank reserves was far

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in excess of any foreseeable needs in a peacetime economy. Accordingly steps were taken in 1936 and early 1937 to absorb some of the redundant reserves in order to forestall their subsequent use for excessive or unsound credit expansion. The over-all policy of monetary ease, however, was maintained.

During the war period, including for this country the period of defense preparation, Federal Reserve credit policies were in keeping with the Nation's war requirements and at the same time were designed to help (along with more direct measures such as price regulation) to restrain inflation. During this period the objectives of Federal Reserve policy were: (1) To assure at all times an ample supply of funds available for financing whatever part of the defense and war effort was not financed through taxes and through the sale of Government securities to nonbank investors; (2) to maintain orderly conditions in the Government security market; and (3) to help maintain, in close collaboration with the Treasury, a structure of interest rates at approximately the levels existing at the beginning of the war—which had an anti-inflationary purpose to the extent that it would tend to induce nonbank investors to put money into Government securities instead of holding off in the expectation of higher rates. Anti-inflationary pressures were also exerted by the Board's regulation of consumer credit and stock-market credit.

The war left the country with an unprecedented inflation potential which became active as reconversion proceeded, and continued until the end of 1948. In this period the objective of Federal Reserve policy was to apply as much restraint to inflation as could be applied without occasioning or risking so sharp a decline in the market for Government securities as might disorganize the capital markets. Pursuit of the second element of this composite objective involved providing support for the Government securities market so as to maintain relatively stable prices and yields. Pursuit of the first element included at one stage or another raising margin requirements to a maximum, elimination of a wartime preferential discount rate on short-term Government securities, discontinuance of a very low buying rate on Treasury bills and other measures conducive to increasing interest rates on Treasury bills and certificates, absorption of some bank reserves by open market operations, such as permitting maturing holdings to be retired for cash, some lowering of support prices on Treasury bonds, reimposition of consumer credit regulation, and some increases in member bank reserve requirements.

More recently, as inflation began to abate and signs of some slackening in business began to appear, the policy of restraint was promptly moderated—initially by relaxation of restraint on consumer credit and stock-market credit—and then, during the second quarter of 1949, replaced by a policy of monetary ease, exemplified in particular by several successive reductions in member bank reserve requirements. The flexibility that is inherent in the structure and organization of the Federal Reserve System was never better demonstrated than in this most recent period.

Federal Reserve credit policies for all these periods—and related policies—are discussed more fully (and in broader context) in the answers to questions in part II. It will be evident from this brief review, however, that for the entire period since 1935 Federal Reserve credit policies have been altogether in conformity with the objectives

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stated in the Employment Act of 1946.[1] Review of a longer period would show that throughout the System's existence Federal Reserve objectives have been in harmony with these broad purposes.

> 3. Cite the more important occasions when the powers and policies of the System have been inadequate or inappropriate to accomplish the purposes of the System.

It is well recognized that the policies pursued by the Federal Reserve System, over the 35 years of its existence, have not always been adequate or appropriate to accomplish fully the purposes which such an agency is designed to serve. How far this has been a result of inadequate or inappropriate legal powers, however, is a matter on which competent students of the subject do not seem to have come into general agreement. Remedial legislation has been enacted to take care of many of the problems which have arisen. The more important cases where it has not are treated in other sections of these answers, particularly in parts II, IV, and V.

> 4. Would it be desirable for the Congress to provide more specific legislative guides as to the objectives of Federal Reserve policy? If so, what should the nature of these guides be?

Whether Congress should provide more specific legislative guides as to the objectives of Federal Reserve policy is a question that has taken different forms at different times. Before the adoption of the Employment Act of 1946, with its declaration of a national policy to govern all Federal agencies, there were recurrent proposals that the Federal Reserve be given some very specific legislative mandate (such as one that would require the System to maintain a constant general price level). To these proposals the Board made vigorous objection, but on grounds which do not apply at all to the policy declaration set forth in the Employment Act of 1946. That declaration recognizes, as the Board had long maintained, that sustained national prosperity is not something that can be achieved by any single Government agency or by monetary means alone, or through using any narrowly defined guides to policy.

The carefully considered statement of objectives which is set forth in the Employment Act of 1946, since it applies to the Federal Reserve as well as to other Federal agencies, seems to be specific enough to serve the needs of the country in the monetary field. With that statement the directives to the Federal Reserve that are contained in existing legislation, though adopted earlier and sometimes in less specific terms, are entirely consistent.

This question is not taken to suggest that the Federal Reserve in pursuing the objectives of the Employment Act of 1946, should be specifically required to base policy decisions on some particular formula or some particular statistical guide (such as an index of general prices or the level of employment). Such a guide would not only

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[1] The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

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traverse the principle recognized in the Employment Act of 1946 but would be likely to be so rigid as to defeat its purpose, since the making of decisions on monetary policy calls at all times for the weighing of a great many different factors and for the attaching of different weights to the same factor at different times. Such decisions must always be a matter of judgment, based on the fullest and widest information respecting all phases of the national economy.

II. Relation of Federal Reserve Policies to Fiscal Policies and Debt Management

Monetary and credit policies are closely interwoven with fiscal and debt-management policies. These interrelationships have become increasingly important and binding as a result of the tremendous wartime expansion of the public debt to a dominant position in the over-all financial structure. It is essential that there be a high degree of coordination of decisions and actions and close cooperation on the part of the authorities operating in these fields.

Fiscal policies are in the final analysis determined by Congress in authorizing appropriations and legislating taxes, although the President and the various executive agencies of the Government have a major influence upon these policies in their recommendations for legislation and in carrying out the measures voted by the Congress. The Treasury has a primary responsibility for recommendations as to tax policy, as well as for the collection of taxes, and it has important discretionary authority with reference to the management of the public debt, which includes decisions as to the timing and nature of borrowing and of debt retirement. The Treasury possesses certain monetary powers. Among these are the holding of monetary gold and silver stocks, the issuance of currency against them, and the minting of coins. The Treasury also has important responsibility with reference to the international financial operations of the Government. These various Treasury operations have a direct bearing on and are affected by conditions in the money market, with which the Federal Reserve is concerned.

The functions of the Federal Reserve are primarily monetary. As explained in answers to questions in part I, most of the country's circulating currency is issued by the Federal Reserve banks, and the System has primary responsibility for influencing the supply, availability, and cost of bank reserves, which provide the basis for the bulk of the country's supply of money and credit. Federal Reserve authorities, by exercising an influence on the cost and availability of reserves, can affect not only the level of interest rates but also the ability and willingness of banks to lend and invest. These policies necessarily impinge upon public-debt operations. The Treasury can affect the supply of bank reserves to a limited extent through the exercise of its powers with reference to gold or currency or through the handling of its cash balances. Moreover, the magnitude of public debt offerings (or retirements), the rates of interest paid by the Treasury, and the maturities and other features of the various issues are reflected in the demands for credit and can thereby influence the supply of money and the demands upon the Federal Reserve.

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The rates of interest which the Treasury finds it necessary to offer on new issues of securities are to a substantial degree affected by the Federal Reserve's influence on the money market. Obviously if the Treasury and the Federal Reserve were preoccupied solely with the question of rates, they would sacrifice all other considerations to this end. Both of course must take account of the many broad aspects of their respective policies and the effects upon the entire economic structure. Because measures adopted by either agency must be taken into consideration by the other in determining its policies, it is most essential that the Federal Reserve and the Treasury cooperate in the effort to direct their respective policies toward common broad objectives of national policy. It is my view, as pointed out in answers to specific questions, that a splendid degree of cooperation now exists between the Treasury and the Federal Reserve.

1. To what extent and by what means are the monetary policies of the Federal Reserve and the fiscal, debt management, and monetary powers of the Treasury coordinated?

Coordination of Treasury and Federal Reserve policies is effected by frequent consultation between policy-making and operating officials of the two agencies. It is customary for Treasury and Federal Reserve officials to consult before decisions are made by the Treasury with respect to (1) the day-to-day variations in the Treasury's balance at the Federal Reserve banks and calls on balances with other depositaries (these transactions temporarily affect the supply of bank reserves); (2) any changes in the usual amounts or terms of weekly offerings of Treasury bills; (3) periodic offerings of new issues of other marketable securities and refunding or retirement of maturing securities, with reference to amounts, rates, and terms; and (4) changes from time to time in the nature of offerings of nonmarketable securities. Purchases and sales of marketable securities by the Treasury for the account of Government agencies and trust funds are handled through the Federal Reserve banks, acting as fiscal agents for the Treasury, and Federal Reserve officials are consulted as to monetary effects of such operations.

In connection with the consultations of the Secretary of the Treasury with Federal Reserve officials prior to the adoption of financing programs, the System's representatives have taken the opportunity to give the Secretary their best judgment about market conditions and about the preference of banks and other investors for particular kinds of securities. In this way representatives of the Federal Reserve System have made available the benefit of their close contacts with the market and have endeavored to be helpful in the solution of the technical market problems of financing the Government.

Beyond giving advice and assistance as to the details of financing, the Federal Reserve System has a vital interest from the point of view of its own responsibilities in the broader economic and financial consequences and implications of Treasury financing. The securities offered, particularly to banks, have an important bearing upon the maintenance of an effectively operating money market, of sound banking conditions, and of freedom to pursue flexible monetary and credit policies appropriate to changing conditions.

Because of the economic effects of fiscal and debt-management operations and policies, Federal Reserve officials frequently offer sug-

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gestions to the Treasury regarding various aspects of these policies, either those of a current nature or longer-term programs. Likewise the Secretary of the Treasury is customarily asked by the Federal Reserve for his views with respect to action contemplated by the System to effectuate its monetary and credit policies.

2. Cite the more important occasions since 1935 when Federal Reserve policies have been adjusted to the policies and needs of the Treasury.

(*a*) What were the principal areas of agreement and what were those of conflict between the two agencies?

(*b*) In what way were the differences adjusted?

(*c*) When there were differences of opinion between the Secretary of the Treasury and the Federal Reserve authorities as to desirable support prices and yields on Government securities, whose judgment generally prevailed?

3. What were the principal reasons for the particular structure of interest rates maintained during the war and the early postwar period?

4. Would a monetary and debt-management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?

These questions can best be answered as a group by describing the principal developments with respect to Federal Reserve policies and operations that were particularly influenced by, or had a bearing upon, Treasury policies and needs during the period. I want to point out in advance that I was not directly connected with the determination of these policies until the last 18 months of this period and, therefore, the discussion of events before that is based upon the available record.

In the 15 years since 1935, the growth of the public debt and its management have been dominant elements in financial developments in the United States. During the early years of this period Government deficits resulted from expenditures to counteract depression and unemployment; later, financing of the war required unprecedented borrowings; and, finally, the problem of refunding and retiring parts of the vast public debt were of prime importance. Treasury needs were largely the result of taxation-and-expenditure policies determined by Congress and the executive authorities, first to combat depression and later to conduct a war. These situations required close contact between the Treasury and the Federal Reserve System.

It may be said that in general during this entire period the Treasury and the Federal Reserve were guided by the same broad objectives and there was a reasonable degree of consultation and coordination, with consideration on the part of each agency of the views and interests of the other. Such differences of opinion as appeared between the Treasury and the Federal Reserve were chiefly with reference to procedures to carry out common broad objectives. They reflected principally differences of judgment of the kind that might reasonably be expected. Even now when they can be viewed in retrospect, it is frequently difficult to judge as between them.

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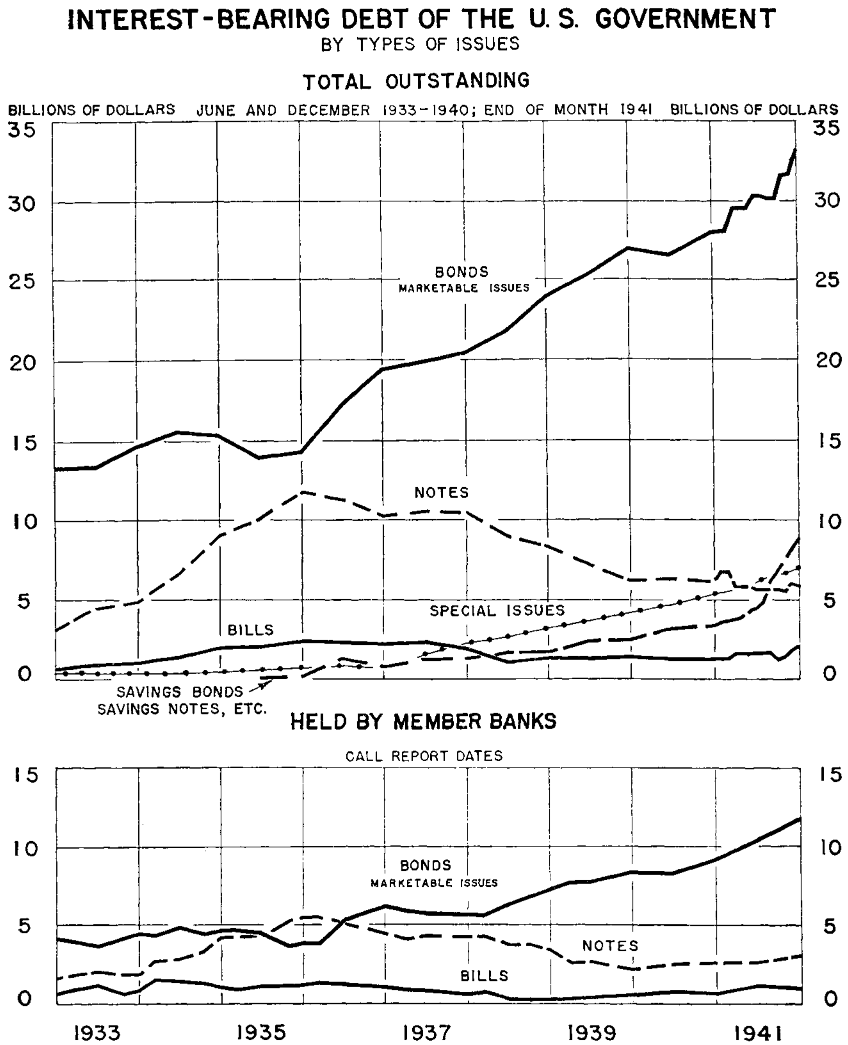

Growing importance of public debt in prewar period

During the period from 1935 to 1940 continued budget deficits and the consequent growth in the public debt accompanied a relatively small amount of private credit demands and an expansion in the supply of bank reserves resulting from gold inflows. This combination of developments caused banks to expand greatly their holdings of Government securities and gave increased importance to market fluctuations in prices and yields of Government securities. The expansion in the public debt took the form mainly of bonds. As shown in the chart, the volume of short-term Government securities outstanding actually decreased from 1936 to 1941 while bonds increased. These movements were reflected in bank portfolios where holdings of United States Government bonds increased while those of short-term securities declined. Treasury financing needs and operations, as well

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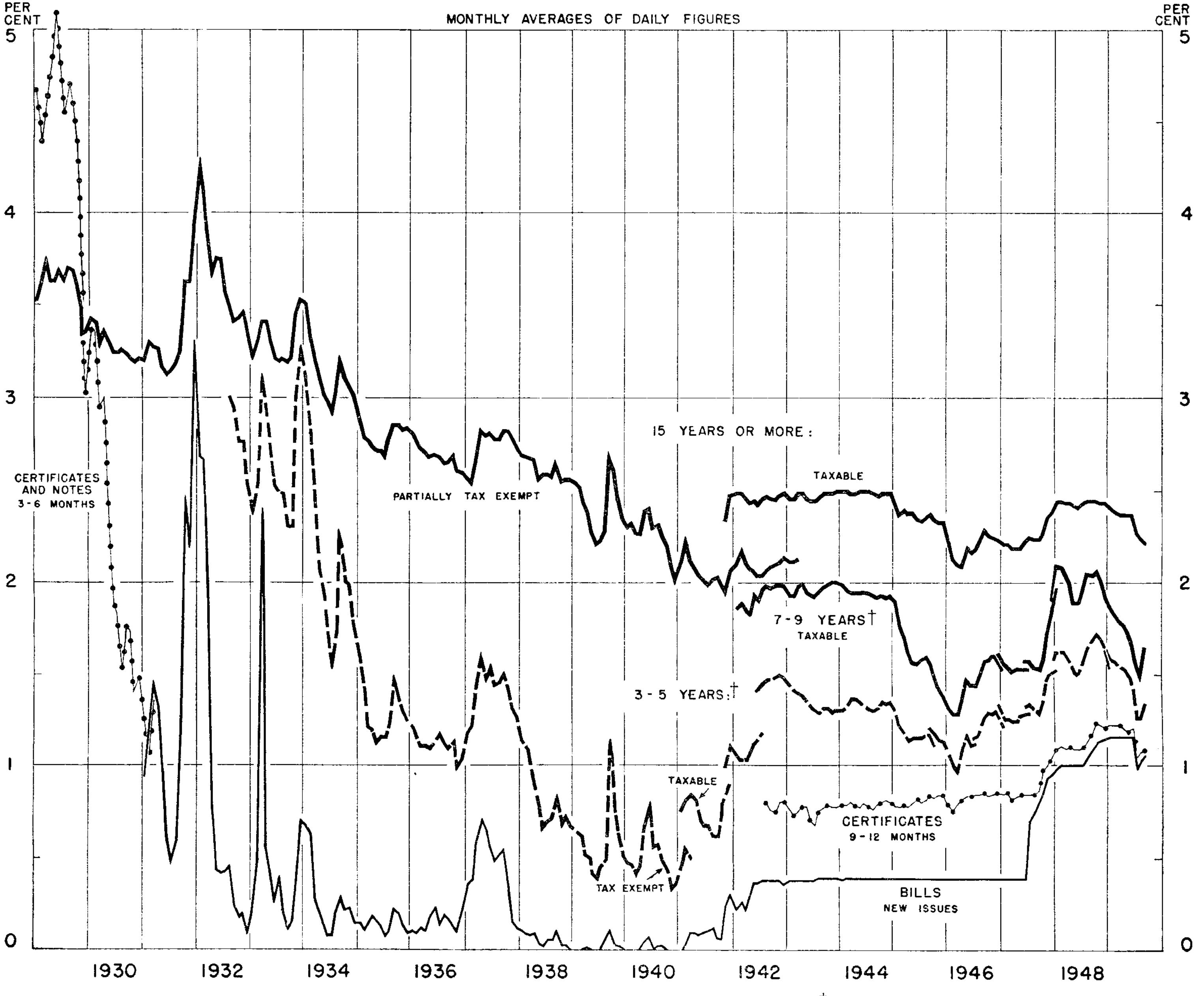

† BREAKS IN LINES REPRESENT CHANGES IN ISSUES INCLUDED.

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as market transactions in Government securities, thus became important money-market factors and had to be taken into account in formulating Federal Reserve policies.

Term structure of interest rates.—During the 1935–40 period, as shown on the next chart, interest rates gradually declined. By the latter part of the period, rates on short-term Treasury bills were close to zero; yields on high-grade long-term bonds, Government and corporate, were at record low levels. The low interest rates then prevailing reflected the effect of a huge supply of loanable funds in relation to the demand for such funds. The supply had been greatly expanded by the heavy gold inflow which gave unprecedentedly large excess reserves to banks; it also included a substantial volume of savings held by investment institutions seeking investments of relatively low risk. Demand for loans by borrowers, other than the United States Government, was small because of depressed conditions in the economy, as well as because of the large amount of liquid funds already held by nonfinancial businesses and by individuals.

The particular term structure or pattern of rates prevailing prior to the war reflected in large part the strong preference of lenders, and particularly of banks, for liquidity, together with a reduced supply of short-term assets which could be easily turned into cash. Such assets were in very large demand and commanded a substantial rate advantage over long-term securities. This desire for liquidity was a product of the rapid increase in available funds as well as of the experience of banks and other lenders in the early thirties when bond prices declined sharply.

Orderly market operations.—It was during this 1935–40 period that the Federal Reserve System accepted the responsibility for maintaining orderly conditions in the market for United States securities. In particular, the System gradually found it necessary to give more consideration to the bond market rather than to confine its operations largely to the short-term money market. When a sudden decline developed in the bond market in March and April 1937, it became quickly apparent that large-scale, and particularly disorderly, liquidation of bonds by banks could cause repercussions not simply in the Government bond market but also in capital markets in general, and possibly in the business situation. The Board of Governors in its 1937 annual report, after describing developments in the bond market in March and April 1937, made the following statement:

> Intervention by the Federal Reserve System in the bond market in March and April, therefore, helped to stabilize that market. In recent years the bond market has become a much more important segment of the open money market, and banks, particularly money-market banks, to an increasing extent use their bond portfolios as a means of adjusting their cash position to meet demands made upon them. At times when the demands increase they tend to reduce their bond portfolios and at times when surplus funds are large they are likely to expand them. Since prices of long-term bonds are subject to wider fluctuations than those of short-term obligations, the increased importance of bonds as a medium of investment for idle bank funds makes the maintenance of stable conditions in the bond market an important concern of banking administration.

A second comparable occasion arose at the outset of the war and the Board in its 1939 annual report explained its position as follows:

> In undertaking large-scale open-market operations in September 1939, the System was guided principally by the following considerations:
>
> (1) By helping to maintain orderly conditions in the market for United States Government securities the System can exert a steadying influence on the entire

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capital market, which is an essential part of the country's economic machinery, and disorganization in which would be a serious obstacle to the progress of economic recovery. The market for United States Government securities is the only part of the capital market in which the System is authorized by law to operate, and Government securities occupy a vital place in that market.

(2) The System also has a measure of responsibility for safeguarding the large United States Government portfolio of the member banks from unnecessarily wide and violent fluctuations in price. The System cannot and does not guarantee any current prices of Government obligations, nor does it undertake to preserve for member banks such profits as they may have on their Government securities, or to protect them against losses in this account. The Government security market, however, has become in recent years the principal part of the money market, and member banks are in the habit of adjusting their cash positions through sales and purchases of United States Government securities. This practice has arisen partly because of a shrinkage in the availability of other liquid assets, such as street loans and bankers' acceptances, which in earlier years were in much larger volume and were the medium through which banks were likely to adjust their positions. In the enhanced importance of the Government portfolio to member banks, the System sees an additional reason for exerting its influence against undue disturbances in Government security prices.

Bank examination policies.—During this same period official policies with regard to bank examinations were also revised in recognition of the growing importance of bonds in bank portfolios. The policy of not requiring deduction from capital of paper losses on highest grade bonds encouraged the banks to appraise their investment portfolios on a basis of longer range or intrinsic worth rather than by the precarious yardstick of current market quotations. Where declines in market prices of bonds reflect only changes in the level of long-term interest rates and not impairment of the credit position of the issuer, the position of investors holding the bonds is not materially affected unless they wish to sell them. For banks to sell bonds should be unnecessary when they have adequate secondary reserves in the form of short-term assets and when the Federal Reserve can make advances to meet any temporary needs.

Financing the war

During the period of financing the earlier defense program and more particularly in that of heavy wartime expenditures, Treasury and Federal Reserve operations and policies were closely related. Treasury and Federal Reserve officials had frequent conferences and in other ways interchanged views with respect to plans for financing the war, organizing machinery for marketing United States Government securities, and developing and putting into effect credit policies that would meet the Nation's war requirements while minimizing the inflationary effects.

At the beginning of the defense program banks had abundant excess reserves and the problem was in part one of preventing undue expansion of private credit under the stimulus of growing demands. With this situation in mind, various groups of Federal Reserve officials (the Board of Governors, the 12 presidents of the Federal Reserve banks, and the Federal Advisory Council) issued a joint report to Congress in December 1940, presenting a program of measures designed to provide the means for more effective restriction of possible inflationary developments.

As a part of the Government's program to combat inflation and for the purpose of reducing the large volume of excess reserves and thus establishing better contact between the Federal Reserve banks and the money market, the Board in the autumn of 1941, after con-

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sultation with the Secretary of the Treasury, increased reserve requirements of member banks to the limit of its statutory power. At the time the Secretary of the Treasury and the Chairman of the Board issued the following statement:

The Treasury and the Board of Governors will continue to watch the economic situation and to cooperate with other agencies of the Government in their efforts, through priorities, allocations, price regulation, and otherwise, to fight inflation. Recommendations on the question of what additional powers, if any, over bank reserves the Board should have during the present emergency and what form these powers should take will be made whenever the Treasury and the Board, after further consultation, determine that such action is necessary to help in combating inflationary developments.

When the United States entered the war in December 1941, the Board issued the following statement with respect to war finance:

The financial and banking mechanism of the country is today in a stronger position to meet any emergency than ever before.

The existing supply of funds and of bank reserves is fully adequate to meet all present and prospective needs of the Government and of private activity. The Federal Reserve System has powers to add to these resources to whatever extent may be required in the future.

The System is prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements.

Continuing the policy which was announced following the outbreak of war in Europe, Federal Reserve banks stand ready to advance funds on United States Government securities at par to all banks.

Objectives of war finance.—During the war period the Federal Reserve System and the Treasury endeavored to coordinate their respective policies and actions toward common objectives. The major objective, as stated in the Board's annual report for 1942 and in other connections, was to derive the largest possible amount of war funds from current income and from savings and to depend as little as possible on the creation of bank credit. This objective was fully shared by the Treasury. It was recognized, however, that all Government expenditures could not be raised by taxation and borrowing from nonbank investors and that some borrowing from banks would be necessary to supply funds for an expanding war economy with its abnormal demands for money. Another important objective of the Federal Reserve as well as the Treasury in connection with war finance was the maintenance of the structure of interest rates at approximately the levels existing at the beginning of the war.

In furtherance of these aims, the Federal Reserve undertook to supply banks with additional reserve funds after those available at the beginning had been utilized. The large-scale purchases of Government securities by the Federal Reserve needed to keep short-term interest rates from rising fully supplied banks with all the reserves they needed to do their share in financing the war.

Discussions between the Treasury and the Federal Reserve during the war and postwar periods related particularly to the specific means of carrying out their common broad objectives in a manner that would augment to the smallest possible extent inflationary pressures, both immediately and in the future. It was recognized that the policies being followed were necessary in view of the exigencies of war finance and that inevitable inflationary developments would have to be restrained largely by use of other measures of control such as rationing

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and price fixing. It was acknowledged that, although the war might be financed at even lower rates of interest through the Federal Reserve and the banks, such policies would make more difficult the control of inflation through other measures and would also intensify postwar difficulties. Thus, a difficult combination of measures was needed—ready availability of additional reserves required for war finance but at the same time all feasible attempts to limit bank participation, which would unduly inflate the supply of money.

Any differences in point of view between the two agencies reflected their respective areas of operations and the policies adopted were determined after consideration of the various views. The Treasury had the direct responsibility for marketing an unprecedented volume of new issues, while it was the responsibility of the Federal Reserve to safeguard the credit structure as much as possible from current and prospective inflationary effects of these issues, particularly issues that were absorbed into the banking mechanism. The chief concern of the Federal Reserve was to place greater limitations on purchases by banks, actual or potential, of long-term, higher-interest bearing securities. The Treasury was conscious of this problem and devised special securities, noneligible for bank holding, tailored to tap specialized sources of savings funds. It also increased greatly the volume of short-term issues outstanding. Discussions between the agencies when differences of emphasis emerged related largely to the level and structure of short-term interest rates and the amounts and types of longer-term issues that were available for purchase by banks.

The results of war-financing policies are illustrated in the chart previously presented showing yields on United States Government securities and that on the distribution of the public debt by types of issues which follows this page. The interest-rate structure showed little change until 1945 when longer-term rates declined. All types of Government securities showed substantial increases. Commercial banks added large amounts to their holdings of bonds, as well as to holdings of notes and certificates, but after 1942 reduced their buying of bills. Bills and other short-term securities were purchased in substantial amounts by the Federal Reserve throughout the war.

Level and structure of interest rate.[2]—The wide spread between short- and long-term interest rates, inherited from the prewar period of easy money, created some difficult problems under conditions of war finance in which funds had to be raised in unprecedented volume. Both the Treasury and the Federal Reserve were in full agreement that, for purposes of war financing, it would be desirable to finance the war at relatively stable interest rates. This conclusion was reached on the basis of the experience gained in financing World War I and was designed to eliminate the incentive to defer subscriptions in expectation of progressively rising interest rates. The decision to maintain a stable structure of interest rates was made to serve the following purposes:

(1) To encourage prompt buying of securities by investors, who might otherwise have awaited higher rates;

(2) To assure a strong and steady market for outstanding securities;

(3) To keep down the interest cost on the war debt; and

[2] This part of the discussion relates in particular to question 3 in this group.

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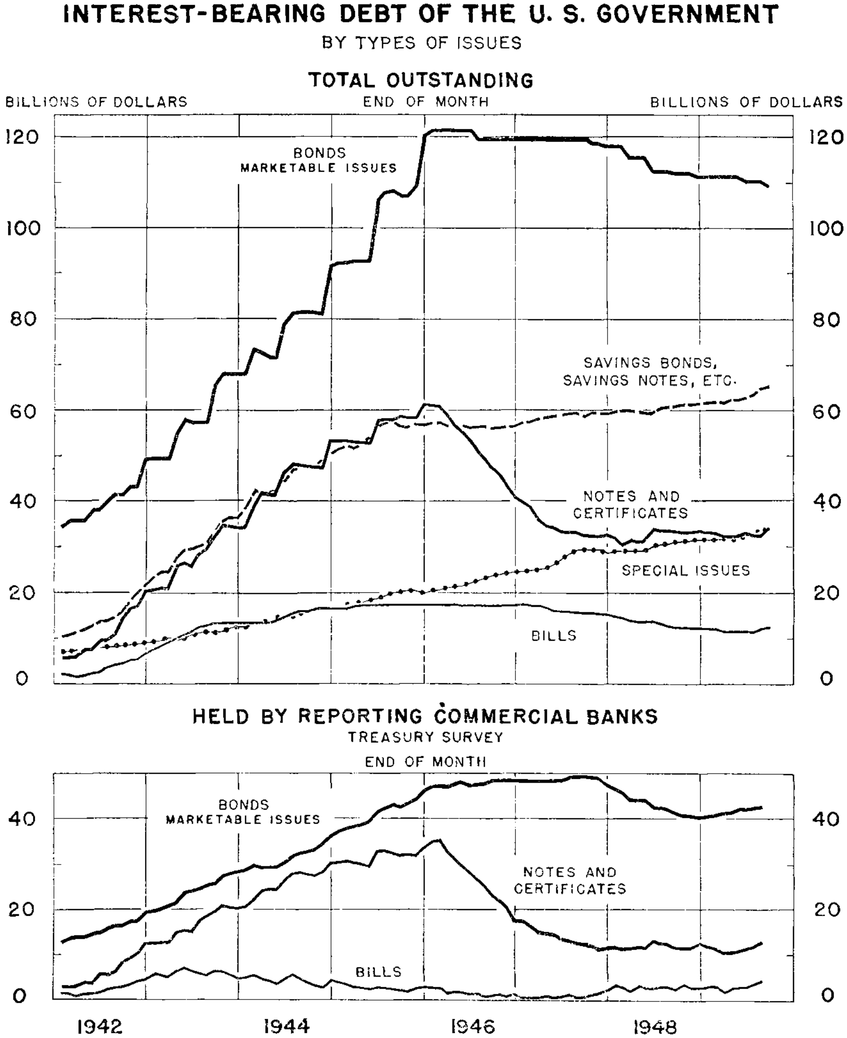

(4) To limit the growth in bank and other investors' earnings from their public debt holdings.

It became the responsibility of the Federal Reserve authorities consequently to see to it that sufficient reserves were made available to maintain a stable interest rate level.

Both the Treasury and Federal Reserve were also in full agreement that, if war financing was to be rapidly launched with a minimum of difficulties, it would not be desirable to make any substantial adjustment in the pattern of short- and long-term rates that prevailed at the time. Maintenance of a fixed structure of rates, however, gave a strong incentive to investors "to play the pattern of rates," i. e., to purchase longer-term securities not to hold to maturity but for resale at higher prices as maturity approached. With the low level of short-term rates stabilized by action of the Federal Reserve, there

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was no possibility that corrective market forces would eliminate the incentives that encouraged the practice.

These related decisions were shared by the Treasury and the Federal Reserve. As events developed and it became evident that the financing of the war was involving ultimately much larger amounts than were generally expected at the time these basic decisions had to be made the task of stabilizing an abnormal rate pattern created serious problems for the Federal Reserve. These problems led to a variety of suggestions for modifications in the war-finance program. They became much more serious under conditions of reconversion after the war. The System suggestions in general fell under three heads: moderate adjustments in short-term rates to narrow the spread, further measures to limit purchases of securities by banks particularly the longer-term issues, and more offerings to nonbank investors of long-term bonds with restricted marketability. Some of these suggestions were adopted or led to modifications or changes in programs.

At the time, and even now from the vantage point of retrospect, one cannot be categorical about these suggestions or about their results. The money market is a complex structure and the needs of war finance were without precedent. Looking backward, it still seems that the decision not to let interest rates rise during the war was right in that the war was financed at an exceptionally low interest cost, the Treasury had no difficulty in obtaining all the funds it needed, and there was no lack of confidence in Government securities. The most important lesson of the war-financing experience is that it was desirable to have a stabilized level of rates during the war, but not necessarily the particular highly abnormal structure of rates which happened to exist at the beginning of the war.

In looking back on these problems, which antedate my coming to the Board, as well as in discussing those with which I have had to deal, I have sought to review the entire period covered by the questionnaire, not as the advocate, but in a more judicial spirit, mindful of the end result which was a truly splendid achievement in financing the most devastating and costly war of all time and in restoring the country to full peacetime production and employment.

Problems of postwar inflation

In the transition period from a war to a peacetime economy the inflationary problem became more acute, notwithstanding the termination of heavy Government deficits. The development of inflation was made possible primarily by the large volume of liquid assets built up during the period of war finance, accompanying shortages of goods and deferred demands, but it was augmented by postwar expansion of credit to private borrowers. Liquidation of Government securities was an important source of funds for current spending and for credit expansion, and the Federal Reserve found it necessary to purchase securities in order to maintain a stable and orderly market for Government securities. These purchases supplied additional bank reserves. Under the circumstances action for counteracting inflationary developments had to be limited to relatively moderate measures.

Federal Reserve officials were thoroughly aware of the dilemma presented by the conflicting problems of debt management and monetary policy in the postwar period and endeavored by various means to restrict credit expansion while at the same time stablizing the market

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for Government securities. The Treasury also endeavored through fiscal and debt retirement operations and the use of its deposit balance to exert an anti-inflationary influence. Proposals were made by the Federal Reserve for legislation to provide additional powers needed to deal more effectively with the situation, but none of these was adopted until the summer of 1948.

Following is a summary of developments and of measures adopted or considered by the Treasury and the System with respect to debt management and monetary policy in the postwar period.

Playing the pattern of rates.—The practice of playing the pattern of rates increased considerably in 1945 and became most prevalent early in 1946. It resulted in such a rise in bond prices that market yields on long-term restricted bonds declined to a little over 2 percent, while those on medium-term bank eligible bonds declined below 1½ percent, as shown in the chart previously presented. The short-term securities sold were largely purchased by the Federal Reserve, and the bank reserves thus created were pyramided into a larger volume of bank credit expansion and consequently a further rapid growth of bank deposits.

One remedy for this situation would have been to permit short-term rates to rise to a point at which such shifts were not sufficiently profitable. The System, however, recognized the disadvantage to the Treasury, as well as the possible disturbance in the Government securities market, of any marked advance in short-term rates. Attempts were made to solve the problem by other means, while moderate adjustments in some rates most out of line were recommended by the Federal Reserve.

Preferential discount rate.—In 1945, the System came to the conclusion that it should discontinue a preferential discount rate of one-half of 1 percent on 15-day advances to member banks secured by short-term Government securities established early in the war to encourage banks to purchase and hold such Government securities. Banks were using this facility at times to hold Government securities when faced with a loss of reserves, and this use served to create additional reserves. The Treasury opposed the proposed elimination of this rate, but the change was finally made in April 1946.

Elimination of bill-buying rate.—Federal Reserve authorities in 1945 and 1946 considered the discontinuance of the bill-buying rate of three-eights of 1 percent and the repurchase option established early in the war. It was proposed that the rate on bills be permitted to approach the ⅞-percent rate on 1-year certificates, with support of the latter rate continued at that level. The purpose of these steps was to reduce the abnormal spread in the pattern of rates and to encourage banks to hold more bills. In 1947, the Treasury concurred in the discontinuance of the buying rate on bills and the repurchase option as a part of a program in which an increase was permitted also in the rate on certificates. This action is discussed below.

Special reserve requirement.—In order to place limitations on bank-credit expansion on the basis of reserves created by purchases of Government securities by the Federal Reserve and at the same time avoid a substantial rise in interest rates, the Board of Governors proposed various special measures of legislation for consideration by Congress. These proposals were first presented in the Board's annual report for 1945 and more definitely recommended in modified form on various

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subsequent occasions. The principal proposal was for the System to be granted authority to require that banks hold, in addition to other required reserves, special reserves in the form of Treasury bills or Treasury certificates of indebtedness, balances with Federal Reserve banks, or other cash assets.

This proposal was designed to give the Federal Reserve means of further restricting bank-credit expansion, without raising interest rates on Treasury obligations, but it was not enacted by Congress. In August 1948, Congress gave the Board emergency authority to raise reserve requirements for member banks by limited amounts. This authority, which is discussed in a later section, was used in part and served some of the purposes aimed at by the other proposals.

Treasury debt retirement.—Use by the Treasury of surplus cash to retire bank-held securities became the dominant anti-inflationary factor of the postwar period. This action served to diminish the practice by banks of shifting from short-term to long-term securities, which during 1945 and 1946 provided the basis for expanding bank reserves. In 1946, the Treasury offered new issues in exchange for only a portion of maturing securities, and the remainder were redeemed for cash, drawing upon a large Treasury cash balance in excess of needs built up in the Victory-loan drive at the end of 1945. This policy brought about some decline in the volume of bank credit to the extent that commercial banks held the redeemed securities and of bank reserves in the case of securities held by the Reserve banks. In this way, the liquidity position and also the reserves of banks were reduced. As a consequence, banks were less willing to dispose of additional amounts of short-term securities in order to purchase longer-term issues.

Beginning in 1947, the Treasury confined its retirements largely to Federal Reserve holdings of maturing certificates and to Treasury bills, of which the Federal Reserve held the major portion. Substantial retirements of maturing securities were made from the proceeds of a budgetary surplus and also by use of funds obtained through sales of savings bonds to the public. This policy, which resulted in a direct drain on bank reserves and on bank-liquidity positions, was continued into early 1949 and was by far the most important and effective measure of restriction on inflationary credit expansion.

Increase in bank loans.—Another development which brought to an end bank purchases of long-term securities, but not their selling of short-term securities, was the growing demand for bank loans. Loans to businesses, consumers, and property owners increased sharply during 1946 and 1947. In order to meet these demands, banks sold securities to the Federal Reserve. These sales created reserves which supplied the basis for multiple credit expansion.

Rise in short-term rates.[3]—In the middle of 1947, the Federal Reserve and the Treasury agreed upon a policy of permitting rates on short-term securities to rise. This policy and its purposes were described in the Board's annual report for 1947 as follows:

Beginning in July, the Federal Reserve System and the Treasury adopted measures to permit some rise in interest rates on short-term Government securities in order to increase their attractiveness to banks and other investors and to place an additional restraint on further monetary expansion. The System

[3] The discussion in this section relates particularly to question 4 in this group.

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discontinued its buying rate on Treasury bills, which had been fixed at ⅜ percent since 1942. The rate on bills rose during the remainder of the year to nearly 1 percent, as is shown in the chart. The length of term to maturity of newly offered Treasury certificates was shortened in August and September; and, subsequently, higher issuing rates were placed on new issues. These rates rose from ⅞ percent to 1⅛ percent by the end of the year.[4]

The policy, which continued until the rate on certificates had reached 1¼ percent in October 1948, was effective in reducing the shifting of short-term securities to the Federal Reserve and in encouraging banks to increase their holdings of such securities. There developed a tendency on the part of banks to reduce holdings of long-term securities and to buy short-term securities, as well as to expand their loans. This tendency reflected in large part the gradual retirement of maturing bonds and their refunding into short-term securities. It showed a willingness on the part of banks, for liquidity reasons, to hold short-term securities at moderately lower rates than bond yields, whereas they would not do so at very low short-term rates. The profits of playing the pattern of rates were substantially reduced. Another factor in this change probably was a feeling that the rise in short-term rates might lead to a reduction in premiums on bonds.

In any event, during 1947 and part of 1948 banks in general reduced their holdings of Treasury bonds and increased somewhat their holdings of bills. The higher short-term rates, therefore, had the desired effect of encouraging banks, as well as others, to hold short-term securities. As a consequence, the Reserve System was enabled to reduce its holdings and thereby absorb bank reserves. To some extent the reserves absorbed were supplied by System purchases in supporting the bond market, as explained below.

While the Treasury and the Federal Reserve were in general agreement on the policy of higher short-term rates, Federal Reserve authorities favored somewhat more frequent increases in rates. It was hoped that the rise in short-term rates would permit a somewhat more flexible policy in open-market operations. Since a rigid pegging of all rates prevents money-market forces from developing their own correctives, the change in policy was looked upon as a step toward reducing the ready availability of bank reserves provided by rigidly maintaining short-term rates at low levels.

Nonbank sales of securities and Federal Reserve support of bond prices.[5]—In the latter part of 1947 investment institutions and other nonbank holders of securities began to sell Treasury bonds in substantial amounts. This movement reflected primarily growing demands for investment funds on the part of the borrowers, particularly corporations, State and local governments, and property owners. Partly because of these demands and partly because of credit-restriction measures, money rates and bond yields generally rose during the last half of 1947. This movement began to be reflected in the Government bond market and caused a sharp decline in the prices of these bonds from the high premiums at which they had been selling. As a result the nature of the problem changed from one in which the Federal Reserve was buying short-term securities, while the market

[4] Thirty-fourth Annual Report of the Board of Governors of the Federal Reserve System, p. 5.
[5] The discussion in this section relates in particular to question 4 in this group.

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bought bonds, to one in which the Federal Reserve was called upon to purchase large amounts of bonds.

A considerable degree of uncertainty developed as to the maintenance of support buying by the Federal Reserve or as to the prices at which support would be supplied. A broad wave of bond selling ensued. The System maintained its purchases, but late in December 1947 support prices were lowered to a level which would keep all bonds at par or slightly above. Widespread selling of bonds by nonbank investors slackened somewhat in the spring of 1948, but was resumed in the summer. Finally, in November 1948, selling definitely slackened. Subsequently the Federal Reserve was able to reduce its holdings, and did so after consultation with the Treasury.

During the period of support operations questions arose as to the advisability of the Federal Reserve continuing to supply inflationary funds through purchasing at par or higher prices Government bonds being sold by investors to shift funds to other uses. It was suggested that an effective means of restraining inflation would be not to provide funds for these purposes so readily and to permit higher long-term interest rates to operate as a restraining influence. The large-scale purchase of bonds by the Federal Reserve accentuated inflationary developments, and presumably a contrary policy would have exerted a strong anti-inflationary influence, since increasing long-term interest rates has generally been a more effective deterrent on business commitments and plans than increasing short-term rates.

The Federal Reserve, however, was in entire accord with the Treasury that maintenance of a stable and orderly market for Government bonds was an overriding objective under conditions prevailing at that time. It was agreed that the longest-term bond should not be permitted to decline below par. Considerations entering into this decision included the unprecedented volume of Government bonds outstanding, the large refunding problem of the Treasury, the possibility that fear of declining bond prices would lead to much more liquidation, and concern that a decline in bond prices might cause a deterioration in the position of many financial institutions holding large amounts of bonds. As I stated before the Senate Banking and Currency Committee on May 11, 1949:

> In retrospect, I am certain that our action in support of the Government securities market was the right one. That program was a gigantic operation. In the 2 years 1947 and 1948, the System's total transactions in Government securities amounted to almost $80,000,000,000. Despite this huge volume of activity, the net change in our total portfolio was relatively small. I am convinced that we could not have abandoned our support position during this period without damaging repercussions on our entire financial mechanism as well as seriously adverse effects on the economy generally.

It needs to be recognized in the long run, however, that interest rates perform an economic function and should reflect the relation between the supply of savings and the needs for capital formation. To keep down the rate of interest by making credit freely available at a time when capital demands exceed current savings has an inflationary result. Conversely, to increase rates of interest and thereby discourage borrowing at a time when business activity is low, is conducive to further contraction. Monetary policies should be flexibly adapted to the changing needs of the economy. However, in view of the large outstanding public debt and its widespread distribution, the Federal Reserve faces the dilemma of endeavoring to follow flexible

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monetary policies without detracting from the willingness of investors to be firm holders of Government securities.

Increase in reserve requirements.—While the System could not stop purchase of Government securities and still maintain a stable bond market, it had some power to limit the effect of such sales upon bank credit expansion. As pointed out, higher short-term interest rates operated toward this end by encouraging banks and others to buy short-term securities from the Federal Reserve. Increases in bank reserve requirements also provided a means of immobilizing the additional reserves created by Federal Reserve purchases of securities from nonbank investors, so that they would not give the basis for a further multiple credit expansion.

During the first half of 1948, the Board exercised virtually all the remaining authority it had to increase reserve requirements. The authority it had not exercised was limited to central reserve city banks. Requirements against demand deposits of these banks were raised by two points in February and again in June, and these increases added about a billion dollars to required reserves.

In August 1948, Congress granted the Board emergency powers to increase reserve requirements for all member banks, and increases made under this authority in September absorbed about $2,000,000,000 of reserve funds. These increases in reserve requirements just about offset additional reserves supplied during the previous 10 months by net purchases of securities from nonbank investors. They served to reduce the liquidity positions of banks and thereby to discourage further extensions of credit.

Abatement of inflationary pressures

In view of the changed economic situation that became apparent early in 1949, the Board took action in May and June to reduce reserve requirements of member banks. The emergency power to raise reserve requirements expired June 30, 1949. On June 28, the Federal Open Market Committee issued the following statement:

> The Federal Open Market Committee, after consultation with the Treasury, announced today that, with a view to increasing the supply of funds available in the market to meet the needs of commerce, business, and agriculture, it will be the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve banks with primary regard to the general business and credit situation. The policy of maintaining orderly conditions in the Government security market and the confidence of investors in the Government bonds will be continued. Under present conditions the maintenance of a relatively fixed pattern of rates has the undesirable effect of absorbing reserves from the market at a time when the availability of credit should be increased.

In August 1949, after further consultation with the Treasury, additional reductions in reserve requirements were made on the basis of permanent statutory authority to release about 1.8 billion dollars of reserves. This series of reductions in reserve requirements resulted in a substantial demand by banks for Government securities. Bond prices rose sharply, and yields on short-term securities declined. For the purpose of maintaining orderly conditions in the money market, the Federal Reserve met the demand for short-term securities by selling a part of the System portfolio, and thus moderated the decline in money rates.

At the same time, the System discontinued the practice of freely selling Government bonds. With the adoption of this policy, pressure

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of market forces brought about a decline in yields on medium- and long-term Government securities. This had the effect of encouraging investors to seek corporate and municipal securities and mortgage loans as outlets for the funds they had available for investment.

This greater flexibility in open-market policy places the System in a better position to carry out its functions in adjusting to changed economic conditions.

5. In what way might Treasury policies with respect to debt management seriously interfere with Federal Reserve policies directed toward the latter's broad objective?

(NOTE.—The following also provides an answer to question 6 (*a*), which reads: "What changes in the objectives and policies relating to the management of the Federal debt would contribute to the effectiveness of Federal Reserve policies in maintaining general economic stability?")

As explained in the answer to the preceding questions, because of the great importance of the public debt in the present financial structure of the country, Treasury policies with respect to new borrowing, retirement, and refunding of the debt unavoidably affect credit and money-market developments and influence Federal Reserve operations. Likewise, Federal Reserve policies can have an important influence upon management of the debt by the Treasury. For these reasons, the Treasury and the Federal Reserve must be constantly mindful of each other's needs in determining their policies.

The importance of the problem of debt management is indicated not merely by the size of the present Federal debt, in excess of 250 billion dollars, but by its proportion to the total of all debt, the impact of its management on all interest rates, the cost of servicing the debt, and proper provision for its retirement. The total Federal Government debt is now almost exactly the same as the gross national product valued at the current postwar price level, whereas in 1939, for example, it was little over one-half of the gross national product. The Federal debt is now over half of all public and private debt in this country, compared with less than one-fourth of the total in 1939 and less than a tenth in 1929.

While these comparisons are not intended to suggest that there are certain normal relationships that should be maintained, the broad changes that have occurred do indicate that the public debt has become a far more important element in the economy than formerly. They also suggest that changes in the holdings of the debt might have far-reaching effects on the economy. It seems essential that debt management be directed not merely to the financial considerations of Government itself, as important as they may be, but to the effect of such management on our entire economy.

The present distribution of the Federal Government debt by types of issues and by broad groups of holders is shown on the attached table. The bulk of the debt is in marketable issues held by banks, other investment institutions, business corporations, and individuals. Ninety billion dollars of Government securities are due or callable within about 3 years, and over two-thirds of these are held by the banking system, including the Federal Reserve banks.

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Estimated ownership of U. S. Government securities[1] *Aug. 31, 1949*

[Par values, in billions of dollars]

Type of security	Total all investors	Investor classes					
		Federal agencies and trust funds	Federal Reserve banks	Commercial banks	Mutual savings banks	Insurance companies	All other investors
Marketable securities:							
Treasury bills	12.1	0.1	3.5	4.5	(2)	(2)	4.1
Certificates of indebtedness and Treasury notes	32.8	.1	6.3	14.4	0.2	0.8	11.1
Bonds:							
Bank-eligible, total [3]	61.0	.7	2.9	44.6	1.8	3.6	7.5
Due or callable:							
Within 5 years	46.9	.3	2.7	34.2	1.5	2.4	5.8
5 to 10 years	9.8	.3	.1	6.9	.2	.9	1.3
After 10 years	4.3	.1	(2)	3.4	.1	.2	.4
Bank-restricted	49.6	4.6	4.9	1.0	8.9	15.0	15.2
Total marketable securities	155.6	5.4	17.5	64.4	11.0	19.4	37.9
Nonmarketable securities:							
Savings bonds	56.5	(2)	----------	1.5	.5	.7	53.8
Savings notes	6.8	(2)	----------	.1	(2)	.1	6.6
Special issues to Government agencies and trust funds	33.4	33.4	----------	----------	----------	----------	----------
Other, including noninterest-bearing securities	3.7	.1	----------	.6	.1	.3	2.5
Total nonmarketable securities	100.3	33.5	----------	2.2	.6	1.2	62.8
Total, all securities	255.9	38.8	17.5	66.7	11.6	20.6	[4] 100.7

[1] Total gross public debt and guaranteed securities.
[2] Less than $50,000,000.
[3] Includes Treasury bonds and minor amounts of other bonds.
[4] Consists of 69.1 billion dollars held by individuals, 8.3 billion held by State and local governments, and 23.3 billion held by "other corporations and associations."

For the Treasury the immediate problem of debt management is concerned primarily with refunding maturing issues. The nature of these refundings has an important bearing upon the problems that the Federal Reserve may need to face to assure an orderly market and at the same time to be in a position to follow flexible monetary policies. There is an annual turn-over of some $45,000,000,000 a year in short-term securities and in addition bond issues that become callable or mature amount to from 11 to 17 billion dollars in each of the next three calendar years. The types of securities offered to refund these maturities will have a bearing upon the demands for bank credit and thus upon the Federal Reserve System.

Manifestly, policies with respect to interest terms, maturities, and types of securities to be offered for the purpose of obtaining new money or for refunding or retiring maturing issues all have a bearing on current as well as possible future problems and policies of the Federal Reserve. Debt management policies and Federal Reserve policies must therefore be harmonized basically with a view to maintaining economic stability at high levels.

6. What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury objectives and policies in the field of money, credit, and debt management?

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The close relationship of monetary policy and debt management will continue to require constant cooperation and coordination between the Treasury and the Federal Reserve.

As I have stated in answer to question II–6 (b), close cooperation now exists between the Treasury and the Federal Reserve in all matters of mutual concern. Cooperation and coordination between responsible heads of governmental agencies depend upon the individuals concerned and their grasp of mutual problems and responsibilities. The present method of consultation between policymaking and operating officials of the two agencies is on a voluntary basis. I can conceive of no formalized action that would add to the satisfactory relationships that prevail.

(For answer to question 6 (a), see II–5.)

6 (*b*) What would be the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board? Would you favor such a provision?

For many years prior to the enactment of the Banking Act of 1935 the Secretary of the Treasury was an ex-officio member of the Federal Reserve Board. Experience demonstrated, however, that this arrangement had serious disadvantages. Being fully occupied with the extensive duties of his own Department for which he was primarily responsible, the Secretary was unable to devote adequate attention to the problems of the Board or to attend its meetings with regularity. Today the burden of official responsibilities borne by the Secretary is even greater.

In the course of hearings on the Banking Act of 1935, both Senator Glass and Senator McAdoo, each of whom had previously occupied the office of Secretary of the Treasury at a time when the Secretary was also ex-officio Chairman of the Reserve Board, expressed the opinion that the Secretary should not be a member of the Board. During the same hearings, Secretary of the Treasury Morgenthau, who was at the time ex-officio Chairman of the Board, indicated that he believed the various controls of credit should be centered in a Government agency which should be as independent as possible in its determinations of credit policies.

The closest working arrangement now exists between the Treasury and the Federal Reserve, with constant consultation in all matters of mutual concern and a full appreciation of the responsibilities placed upon both. There is therefore no need for restoring the ex-officio status of the Secretary on the Reserve Board.

III. International Payments, Gold, Silver

1. What effect do Federal Reserve policies have on the international position of the country? To what extent is the effectiveness of Federal Reserve policy influenced by the international financial position and policies of this country? What role does the Federal Reserve play in determining these policies? In what respects, if any, should this role be changed?

During the period since the passage of the Federal Reserve Act, the international financial position of this country has undergone profound changes incident to two world wars and the world-wide

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depression in the early thirties. The country, transformed from a debtor to a creditor Nation, has not been adequately prepared to cope with the resultant new problems. The changed international situation brought to the United States a heavy inflow of gold, which greatly expanded the reserves and lending power of the banking system; it also presented this country with strong demands from abroad for financial and other economic assistance through investment, extension of credits, grants, and other means. These various developments deeply affected the domestic economy and the value of the currencies of other countries relative to the dollar.

Traditional functions of central (or reserve) banking organizations include the two tasks of helping to maintain domestic economic activity at the highest sustainable levels and also of aiding in keeping international financial payments and receipts currently in balance. Broadly speaking, free-enterprise countries look to their central banking institutions for performance of functions that relate to current movements of foreign exchange and of gold. In most of these countries, the international exchange of goods and services is greater relative to aggregate internal economic activity than it is in the case of the United States. In most of these countries the central bank participates directly in the management of foreign exchange operations.

In the United States the Federal Reserve System has not customarily participated directly in foreign exchange operations, except in the sense that imports and exports of gold directly affect the availability of dollar exchange in the world market. The strength of the dollar has been of such a nature and our gold reserves have been so large that any direct intervention in foreign exchange markets has not been necessary. The Federal Reserve System, however, also provides services as correspondent for foreign central banks and monetary authorities. This function includes foreign exchange operations for foreign central banks, and also the making of advances to them, as well as the holding of dollar balances of foreign correspondents.

In the experience of the Federal Reserve System, from its inception to date, movements of gold have constituted a factor of the first importance in determining the magnitude of its operations in the domestic markets, since gold imports and exports have a direct effect upon the reserves of member banks and, therefore, upon the demand for credit at Federal Reserve banks. Throughout most of the history of the Federal Reserve System, the international financial position of the country has been strong and the Federal Reserve System has not had to fear excessive gold withdrawals. Its problem rather has frequently been to prevent the gold that has flowed to this country from inflating the economy of the United States. The Federal Reserve System must always take account of the fact, however, that its policies directed toward the supply, availability, and cost of money within the United States directly affect the balance of international payments of this country. Because of the important position of this country in the world economy, there are likely to be accentuated world-wide effects from domestic developments. These effects are sometimes amplified by the psychological repercussions which fluctuations in the United States may have in foreign countries.

In turn, the maintenance of international stability, economic and political, has become of critical importance to the internal stability and security of the United States. In a longer view, any contribution

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which Federal Reserve policies may make to this country's economic well-being may well be lost unless economic and political stability is achieved in the rest of the world. Even though foreign trade forms in absolute volume a small percentage of our total trade, the fluctuations both of prices abroad and of export and import volume have wide effects on our whole economy. A steady expansion of mutually beneficial trade between the United States and other countries can take place only if prices remain tolerably stable throughout the trading area, if exchange rates are appropriate and also reasonably stable, and if the balances of international payments are consistent with the resources of the main debtor and creditor countries. To establish and maintain such conditions is beyond the power of any single country acting alone. Similarly, the achievement of enduring peace requires economic progress throughout the world. Progress toward economic prosperity and political stability depends in great measure on the wisdom of governmental economic and financial policies in each country.

Domestic monetary and credit policies and the international financial position and policies of the United States are thus inextricably linked together. In addition to the tasks in foreign financial operations of the United States which it now performs, the Federal Reserve System is equipped to do more in this field. The System has a direct interest in United States foreign financial policy not only because of its immediate relation to the domestic monetary situation but also because of the general interest of the United States in the achievement and maintenance of monetary and financial stability abroad.

The role of the Federal Reserve with respect to international financial policies is at present most directly performed through membership on the National Advisory Council on International Monetary and Financial Problems. The Chairman of the Board of Governors is by law a member of this Council, and members of the Board's staff participate in the Council's well-organized staff work. This Advisory Council is responsible for coordinating the policies and operations of all United States Government agencies which Congress authorizes to engage in foreign financial, exchange, or monetary transactions.

Apart from the work of the Federal Reserve in connection with the National Advisory Council, the System is frequently called upon for advice and counsel to Congress and to Government agencies dealing with international monetary problems. The System also functions operationally in the foreign field, as mentioned in question I–1, by holding balances and acting as correspondent for foreign central banks and governments, making advances to foreign central banks, and passing judgment on applications by member banks and certain banking corporations to establish foreign branches and regulating their activities in foreign countries.

In postwar years, the United States has had a vital interest in the achievement of internal stability in many foreign countries, and in their making the best possible use of their own resources and of the aid they are receiving from the United States. In the cases of Germany and Japan, where the United States has had a direct responsibility as an occupying power, the occupying agencies have on occasion consulted the Federal Reserve with respect to monetary policies to be followed. There have also been frequent occasions when foreign countries have sought the technical advice and assistance of the Federal

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Reserve or when a United States Government agency (such as the Economic Cooperation Administration), having responsibilities that directly concern a foreign country's monetary and financial policies, has requested special help from the System. By providing technical missions to help foreign countries in the development of appropriate policies, the Federal Reserve System has contributed to achieving more fully the basic objectives of United States policies.

The principal problems which arise for consideration in the National Advisory Council are those which are intimately connected with the restoration of stability in the world economy through providing an adequate supply of dollars. These problems are therefore closely interrelated with Federal Reserve policies in the domestic field. During recent years, the most important problems coming to the Council's attention have related to giving aid to foreign countries in the form of loans and grants. There have also been important problems of exchange rates and exchange controls in other countries. Also related to these problems has been the question of United States policies with respect to the purchase and sale of gold. The National Advisory Council has proved to be an efficient and desirable medium for bringing together representatives of the Federal Reserve System and representatives of other Government agencies whose responsibilities bear on foreign financial policies.

Although, in recent abnormal circumstances of international imbalance, the Reserve System's operating functions in the foreign field have been of limited scope, its representatives have generally been able to play an important part in the Council's activities because of their familiarity with the kinds of analysis that are involved. Strengthening of the Reserve System's operating collaboration in the field of international finance may be expected as further progress is made toward the reestablishment of more normal international financial relationships and mechanisms.

> 2. Under what conditions and for what purposes should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effect would an increase in the price of gold have on the effectiveness of Federal Reserve policy and on the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

An increase in the price that the United States pays for gold would have two major monetary results aside from dangerous psychological repercussions: (1) The amount of the increase with respect to any gold purchased would provide monetary aid from the American economy as a whole to producers of gold (largely foreign) and to foreign countries selling gold from accumulated stocks. (2) A corresponding addition (again with respect to gold purchases) would be made to bank reserves, which would provide the basis for a manifold expansion of credit that might be highly inflationary.

As to the first result, an increase in the price of gold would provide additional dollars to foreign countries without reference to the needs of the recipients. The extending of grants or credits, in such amounts as are in conformity with the real needs of the countries receiving them and are in the interest of the United States, is far better than increasing the price of gold as a means of providing any

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additional dollars needed. The United States is thus able to select the countries and the periods of time for which such aid would be given.

Concerning the second result, this country has no shortage of money. In fact, there is an abundance of gold reserves, on the basis of which additional money could be readily created by monetary and fiscal action. Increasing the price of gold is a deceptively easy, as well as potentially dangerous, way for the Treasury to provide more dollars for foreign aid (by buying foreign gold) or for domestic purposes (by buying domestic gold or by revaluing its existing stock) without having to raise taxes or to borrow. Such an arbitrary creation of more dollars is as inflationary as would be the arbitarary creation of an equal amount of "greenbacks" and more inflationary than Treasury borrowing of a corresponding amount from the banking system. This country should not resort to such potentially harmful means of raising funds.

Any change in the dollar price of gold, either up or down, would have the following important effects: (1) Unless accompanied by a proportionate change in the price of gold in terms of all other currencies, it would dislocate the entire pattern of foreign-exchange rates; (2) it would change the dollar value of existing gold reserves, both at home and abroad; (3) it would alter the profitability, and thus the level of production, of the gold-mining industry; (4) it would change the dollar value of this country's gold stock and all future additions to it, and thus be a basis for monetary expansion or contraction; and (5) it would constitute a major change in United States monetary policy, with unforseeable psychological effects. In what follows each of these effects is discussed.

1. Unilateral changes in a country's price of gold have in the past been a means of altering exchange rates, and thus have served to adjust disparities between commodity price levels in that country and in the outside world. For example, if commodity prices and costs in a given country are too high in relation to those in the outside world, it might help to restore equilibrium by raising the price of gold in that country's currency, i. e., by depreciating its currency in terms of gold and also of such foreign currencies as remain unchanged in terms of gold. Conversely, if prices in the outside world were higher than in the given country, the country might reduce its price of gold in order to help bring about a better relationship.

During the spring and summer of 1949 price levels in many foreign countries were too high in relation to prices in the United States. To attempt to correct the disparity by a change in our price of gold (assuming that other countries made no change) would have called for a reduction in the gold price from $35 to some lower figure, that is, by an upward valuation of the dollar in terms of gold and of other currencies. This, however, would have caused serious dislocations in many foreign countries and would have had severe psychological consequences domestically. The needed adjustments were brought about in September by devaluations (in terms both of dollars and of gold) of a number of foreign currencies.

2. A change in the dollar price of gold would alter the dollar value of all existing gold reserves in direct proportion to the change in price. Thus a 50 percent increase in the price of gold would result in

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a 50 percent increase in the dollar value of gold reserves, both in the United States and throughout the world.

In the case of the United States, it is clear that a rise in the price of gold is not needed to augment the value of domestic gold reserves, since these are more than adequate for present and foreeable monetary needs. Under present legislation, the Federal Reserve System is required to maintain a reserve of 25 percent against Federal Reserve notes and deposits, but the present ratio is actually about 55 percent. Even if the latter ratio were to fall to the legal minimum, an increase in the gold price would not be an appropriate means of correction.

In the case of foreign countries, the situation varies. Many countries, because of postwar dislocations, are seriously handicapped at the present time by a domestic shortage of gold and dollar reserves. But a rise in the price of gold would help most those countries which already have large reserves. Every country which holds gold would automatically receive an increase in the number of dollars available to it, so that the largest increases would go to the largest holders, which are the Soviet Union and Switzerland as well as the United Kingdom. Under present and prospective circumstances, if the United States wished to make more dollars available for foreign reserves, it would be preferable to do so by extending stabilization credits to those countries whose reserves we wish to increase. Making dollars available to selected countries by means of credits would cost the United States less, in real terms, than trying to help these countries by making dollars available indiscriminately in exchange for gold.

3. A change in the dollar price of gold would alter the profitability of gold mining, and thus the level of gold production. Following the increase in the dollar price of gold in 1933–34 (from $20.67 to $35 per ounce), gold production, both in physical volume and even more in dollar value, was greatly stimulated all over the world. Because of the world-wide rise in costs of labor and materials which occurred as a result of World War II, the profitability of gold mining has sharply fallen, and production has contracted considerably from the peak level of 1940. Accordingly, proposals have been freely forthcoming from world gold-producing interests to raise the dollar price of gold. The dollar price of gold, however, is still higher relative to the general level of commodity prices than it was in the 1920's, and gold production remains above the level of that period.

An increase in the price of gold would no doubt stimulate gold production. As for the United States, however, there is clearly no need for an increase in domestic gold production, since gold reserves in this country are far in excess of minimum requirements. An increase in the dollar price of gold obviously cannot be justified on the sole ground that it would increase the profits of gold mining.

In the case of foreign countries, those producing gold—which would be the immediate beneficiaries of a rise in the gold price—are not the ones whose need for assistance is greatest. While they might use the augmented value of their gold to pay for imports from western Europe and thus enable western Europe to do more toward balancing her trade with the United States, it would be much more to the advantage of the United States to accomplish this end by extending grants or loans.

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4. As to the effects that an increase in the price of gold might have on our domestic monetary system, it is important to emphasize that this country's existing gold holdings, valued at the present price of gold, would support a far greater volume of money than needed for any likely future contingency.

The immediate monetary effect of an increase in the price of gold would be a "profit" from the revaluation of our existing gold stock. Expenditure of this "profit," which presumably would be within the discretion of the Treasury, would increase commercial bank reserves, and thereby foster a multiple expansion of bank credit, subject to the reserve requirements of banks in effect at the time. Increased bank reserves and resulting multiple expansion of bank credit would also be fostered by accelerated inflow of gold from foreign sources and domestic output. These developments would expose the economy to great inflationary dangers.

The Federal Reserve has no means adequate to cope with such a danger. In the absence of greatly expanded authority to absorb or immobilize the inflationary reserves thus created, the Federal Reserve would be incapable of performing its function of adjusting the credit supply to the needs of a stable economy.

Increasing the price of gold would be an awkward and dangerous instrument for this country to use, particularly in view of the fact that other more effective and far less risky means are available or could readily be found to accomplish anything constructive that would be accomplished by changing the price of gold.

5. Lastly, it should be emphasized that any change in the price of gold would constitute a major change in the foreign economic policy of the United States. Since January 1934 the price of gold in terms of the dollar has remained unchanged at $35 per ounce. Thus, for over 15 years there has been a fixed relationship between gold and the dollar—one of the few elements of stability in an international economic situation that is only slowly recovering from the ravages and disruptions of extended world war. Changing the dollar price of gold would inevitably weaken the high confidence that this country's currency universally enjoys.

> 3. What would be the principal advantages and disadvantages of restoring circulation of gold coin in this country? Do you believe this should be done?

The advantages which might be gained by restoring the circulation of gold coin in this country are negligible and serious disadvantages would be incurred. None of the important domestic or international monetary problems now facing us would be appreciably helped toward solution.

Confidence in money, in our day, is based upon its internal purchasing power and the ability of a country to meet its external obligations, not upon internal convertibility of the money into gold. The currency of the United States is the most generally acceptable currency in the world today. Confidence in it is assured by the productive power of the United States economy. Gold is readily available and existing reserves are more than adequate to meet any conceivable international drain of funds. Since the chief argument for institut-

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ing a gold-coin circulation would be the strengthening of confidence in the currency, it is clear that on these grounds no need for taking such a step exists today.

The argument that a return of gold-coin circulation would bring about a desirable and automatic regulation of the domestic money supply and would assure the country a "sound" monetary system—in the sense that such a system would be "sounder" than the present one—is not valid. On the contrary, the adoption of a gold-coin standard might actually hinder the maintenance of a stable and prosperous economy, since there is no automatic relation between the demand for gold coin and the economy's need for money. The demand for gold for individual use, as contrasted with its use to balance international payments, reflects various speculative and capricious influences which should not affect monetary policy, and fails to indicate other conditions which ought to guide monetary policy. Thus a strong public demand for gold coin might arise in time of depression, as occurred in 1931–33, imposing a restrictive monetary policy at the very time when the opposite policy is necessary. In time of rising prices, when shifts from money to commodities are likely, demand for gold might be small, so that the necessary restrictive action would not automatically occur. If during wartime, moreover, heavy demands for gold should appear, free sales of gold would reduce our gold stock, stimulate speculation against the currency, and hinder the financing of the war. Furthermore, depletion of gold reserves resulting from private hoarding could conceivably impair our ability to meet extraordinary wartime expenditures abroad.

An overriding reason against making gold coin freely available is that no government should make promises to its citizens and to the world which it would not be able to keep if the demand should arise. Monetary systems for over a century, in response to the growth in real income, have expanded more rapidly than would be permitted by accretions of gold. In the United States today our gold stock, although large, is only 15 percent of our currency in circulation and bank deposits, and less than 7 percent of the economy's total holdings of liquid assets. The retention of a gold base is desirable in order to maintain international convertibility, and a gold-standard system has therefore evolved in which the various forms of money and near money in the country are ultimately convertible to gold, where that is necessary to meet the country's international obligations. Return to a gold-coin standard, however, would clearly expose the economy to the risk of drastic and undesirable deflation at times of high speculative demand for gold for hoarding, or else the Government would have to withdraw its promise of gold convertibility. Conjecture as to the possibility of such a withdrawal would stimulate a speculative demand for gold and might precipitate the event feared. The long-run effect would be to weaken rather than to strengthen confidence in the dollar.

In regard to the international effects, it is often contended that if gold were made freely available by the United States, whether in the form of coin or otherwise, one effect would be to eliminate the premium at which gold is quoted, in relation to the United States dollar, in black or free markets abroad. However, the present premium of gold over the dollar in foreign markets is a matter of very limited importance.

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It reflects chiefly the special suitability of gold for hoarding, its great familiarity, and its anonymous nature. It cannot even remotely affect the stability of the United States dollar.

4. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

In considering the role of silver in our currency system the pertinent facts may be summarized as follows:

Of the total paper money and coin in circulation amounting to 27.5 billion dollars at the end of June 1949, there were 2.1 billion dollars of silver certificates and 1.1 billion dollars of silver dollars and subsidiary coin containing silver. The Treasury purchases newly mined domestic silver at a price fixed by law in 1946 of 90.5 cents per ounce. The Treasury may also purchase other silver at whatever price it deems appropriate. Because of the fact that the New York free-market price of silver is currently around 73 cents an ounce, all domestic production is sold to the Treasury.

The silver thus acquired by the Treasury may be monetized at any time, either through coinage or through issuance of silver certificates at the statutory price of $1.29 per ounce. The silver received by mints and assay offices in 1948 totaled about 37,000,000 ounces, costing the Treasury about 33 million dollars. Since the end of 1934 silver acquired by the Treasury has cost 1.4 billion dollars and silver certificates and coin issued have aggregated 1.7 billion dollars.

To the extent that silver purchases increase the country's money supply, there is a resulting increase in bank reserves and thus in the base for credit expansion. These arbitrary additions to bank reserves have no relation to the need for reserves and, so long as the supply of gold and Federal Reserve credit continues ample, are unnecessary. So long as additions to reserves through silver monetization remain relatively small, their monetary effects can be offset whenever desirable.

In regard to the international monetary aspects of silver, these are of secondary significance in the present-day world, since no important country is on a silver standard, although several countries use silver for coinage and a few (chiefly Mexico and the Netherlands) maintain part of their currency reserves in silver. The vital problem of the stabilization of foreign currencies today involves their relation to gold and the dollar, and the carrying out of necessary internal adjustments, rather than their relation to silver which has practically no status today as a means of settlement of international balances.

Accordingly, in the light of the aims and present operation of our monetary system, no extension of the role of silver in the monetary system would be desirable.

IV. Instruments of Federal Reserve Policy

Introduction

Purposes and functions of the Federal Reserve System, as indicated in the answers to the questions in section I, are primarily concerned with regulating the supply, availability, and cost of money with a view to the basic objective of promoting economic stability at high levels of employment and production. This broad objective coincides with the guiding principles set forth in the Employment Act of 1946

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as the continuing policy and responsibility of the entire Federal Government. The instruments which the different branches of Government may use in furthering this objective vary in accordance with the functions of the respective agencies. In a private-enterprise society such as ours, Government action to promote stability should be as much as possible of a type that will operate in a general manner, while specific decisions as to what shall be produced and bought should be left largely to the free choice of individuals in the market.

The Committee for Economic Development, in its statement Monetary and Fiscal Policy for Greater Economic Stability, set out the principles of Government action best suited to our system as follows:

> The appropriate powers of government in a free society are powers that can be democratically exercised without arbitrary discrimination among and coercion of individuals. This consideration does not debar the people from establishing through their government the general framework, equally applicable to all, within which the members of the society shall operate. The government must, for example, establish the terms on which individuals must contribute to the support of the government through taxation; it must establish the general conditions under which money can be created. If certain basic rules of nondiscrimination are observed, the power to levy a tax or to limit the creation of money can be used without coercion of individuals. But the exercise of these powers does have a great effect upon the stability of the economy. The important distinction is between power to coerce individuals and power to affect the general behavior of the economy.

Monetary policies of government are particularly adapted to this objective. They are designed to help stabilize the economy and at the same time leave specific decisions of lending and borrowing to individual bankers, businessmen, and others. Instruments which the Federal Reserve may use to influence the credit situation and the money supply fall into two major groups—general instruments which affect the total volume, availability, and cost of bank reserves, and selective instruments which supplement general instruments in particular sectors without directly influencing other areas of the market.

General instruments include those which affect primarily the volume of member bank reserves, such as open market operations and discounts; those whose major influence is upon the availability of reserves, such as changes in reserve requirements and policies and regulations regarding the eligibility or acceptability of bank assets as a means of obtaining access to Federal Reserve credit; and those which affect primarily the cost of bank reserves, such as discount rates and buying and selling rates on Government securities and on acceptances.

The principal selective instrument which the Federal Reserve is empowered to use at this time is the authority to establish and change margin requirements on listed securities. For limited periods in the past the System has been authorized to regulate consumer installment credit.

Appraisal of the effectiveness or the adequacy of instruments of Federal Reserve policy must take into consideration the surrounding circumstances in each case, and the interrelation of different instruments. Each instrument is important to the extent that it helps to round out the entire framework designed to achieve the objectives of Federal Reserve policy. Thus, authority to change reserve requirements is needed and justifiable only because without it the System would be severely handicapped in efforts to maintain an effective influence over the money supply.

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It is also necessary in appraising the adequacy of instruments used by the Federal Reserve to give proper weight to all of the accompanying economic conditions and factors. Monetary policy alone cannot assure economic stability. Fiscal and other policies of Government or business may at times make positive action in the monetary field unnecessary or prevent such action from being effective. The instruments used by the Federal Reserve should not, strictly speaking, be referred to as "controls"; they generally do not control in a direct manner, but only influence the course of economic developments. Under some conditions, mild measures may be sufficient to exert considerable influence, while under other conditions more vigorous measures may be essential to affect economic forces. Changes occur, moreover, which reduce the effectiveness of instruments as compared with what they had been or call for the application of new instruments.

> 1. What changes, if any, should be made in the law governing the reserve requirements of member banks? In the authority of the Federal Reserve to alter member bank reserve requirements? Under what condition and for what purposes should the Federal Reserve use this power? What power, if any, should the Federal Reserve have relative to the reserve requirements of nonmember banks?

Banks as a group need to hold reserves to promote monetary and general economic stability. From the standpoint of the individual bank, its required reserves are assets that cannot be loaned or invested to earn an income and, accordingly, represent a contribution which that bank makes to effective national monetary policy. It is important that the basis used for allocating among different banks the total burden of holding required reserves be as fair and equitable as it can be made.

The existing statutory basis for member bank reserve requirements tends to be inequitable in important respects as among banks. The present system of classifying banks for reserve purposes on the basis of geographic location dates back to the establishment of the national banking system over 85 years ago. A member bank's designation for reserve-requirement purposes depends on whether it is located in a central Reserve city or in a Reserve city, or whether it is outside of these cities—a so-called country bank. A member bank located in a central Reserve or Reserve city must hold reserves at the higher percentages designated for such a center, irrespective of whether it is doing the correspondent banking type of business (holding of interbank balances and nonmember bank reserves, which is associated with the designation of a Reserve city and initially was the justification for the higher requirements for banks in Reserve cities). On the other hand, another member bank holding an important volume of deposits of banks, but located outside the Reserve city areas, need maintain only the reserve percentages required of country member banks. Some inequities of this kind have been relieved by the Board's discretionary authority relating to outlying areas of Reserve cities, but many cases of inequity cannot be solved in this way and a basic problem of equity of treatment as among member banks still remains.

In order that the necessary burden on banks of holding reserves in the public interest may be as fairly distributed as possible, consideration should be given to a fundamental revision in the basis for estab-

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lishing bank-reserve requirements. Differences in reserve requirements should be based more largely on the nature of deposits than on the location of banks. Higher requirements might be set against interbank deposits than against other types of demand deposits and lower requirements, as at present, against time deposits, strictly defined.

A second problem of fairness in connection with member bank reserve requirements arises in connection with the treatment of vault cash. At present, member banks may count as legal reserves only funds on deposit at the Federal Reserve banks. Some banks, because of location or the particular needs of their customers, need to hold substantially larger amounts of vault cash than others. From the standpoint of its contribution to the effectiveness of monetary controls, however, the vault cash which banks need for operating purposes is the equivalent of deposits at the Reserve banks; both are in effect liabilities of the Federal Reserve banks. When banks obtain currency they must draw on their reserve balances or obtain equivalent reserve funds, and they can obtain reserve deposits in exchange for currency. If a basic revision in bank reserve requirements is made, provision should be made to permit banks to count vault cash as reserves.

Banks should probably also be permitted to count as part of their reserves that part of their interbank balances which the correspondent bank in turn must hold as reserves with the Federal Reserve. Under a revised system of requirements, such balances might require more reserves than other types of deposits.

The staff of the Federal Reserve has studied for some time the matter of a fundamental change in the basis for reserve requirements. A preliminary report by a staff group was made to the Joint Committee on the Economic Report, at its request, on May 27, 1948. The staff is still studying this question, and when Congress may wish to consider specific proposals we shall be glad to make available the results of this work.

The authority to change reserve requirements is an important instrument for generally contracting or expanding the liquidity position of the banking system and for making other credit instruments effective. It may be needed particularly to absorb excessive reserve funds of banks obtained from large gold inflows or return of currency from circulation, and perhaps also from Federal Reserve purchases of Government securities in maintaining orderly markets. Although the Federal Reserve now holds about $17,000,000,000 of Government securities which might be sold to absorb reserves arising from inflows of gold or currency, these inflows could over a period of years be so large as to deplete the System's resources to below a reasonable operating level. Moreover, it would be disruptive for the System to endeavor to sell Government securities at a time when other holders would be selling on balance.

The Federal Reserve should have authority broad enough to meet its responsibilities under different situations. The Federal Reserve cannot function properly if it must go to Congress for adequate authority after an emergency has arisen. Monetary and credit actions work best when they can be applied in time to prevent a crisis from arising.

Reserve requirements are imposed on banks in the national interest and in the interest of the entire banking system. They are part of

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the necessary mechanism by which the supply of money and credit may be influenced to promote economic stability. To the extent that banks do not bear their fair share in what is a national responsibility, the effectiveness of monetary policy is weakened, to the detriment of all banks. It is clearly unfair and inequitable to ask member banks alone to bear the burden. This aspect of the question is discussed in the answer to question V-1.

2. Should the Federal Reserve have the permanent power to regulate consumer credit? If so, for what purposes and under what conditions should this power be used? What is the relationship between this instrument and the other Federal Reserve instruments of control?

The Board has heretofore proposed that the authority to regulate consumer credit—or rather, consumer installment credit—be made permanent. It is unquestionably a useful tool, supplementary to reserve requirements and other available instruments, to influence credit conditions in the interest of economic stability. The arguments for the proposal have been so extensively presented in the Board's annual reports and elsewhere that I shall not undertake to review them here, but I shall, of course, be glad to discuss this subject before the committee if you should so desire.

3. What, if any, changes should be made in the power of the Federal Reserve to regulate margin requirements on security loans?

A few minor changes in the margin provision of the Securities Exchange Act of 1934 might be desirable. These provisions have worked reasonably well as they stand.

The statutory objectives for which the power is to be used are in line with those set forth in the Employment Act of 1946, and, taking the Securities Exchange Act as a whole, are set forth with sufficient precision to serve the desired purpose.

A possible change, in a liberalizing direction, would be one clarifying and extending the Board's power to make rules to permit brokers to extend credit on unregistered (i. e., unlisted) securities, when this would serve the public interest and not be inconsistent with the purposes of the act.

There is a possibility that need for a provision permitting regulation of bank loans for the purchase or carrying of unregistered securities might develop at some time in the future, but up to the present there has been no evidence of the necessity for such authority.

4. Should selective control be applied to any other type or types of credit? If so, what principles should determine the types of credit to be brought under selective control?

As of the present time, we do not advocate that selective control be applied to other types of credit.

Persuasive argument can be made for selective regulation of real-estate credit, since it can exert an unstabilizing influence on the course of business in much the same way as consumer credit does. However, the administrative difficulties of regulation in the real-estate field are formidable. It is possible that similar objectives can be achieved by

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closer coordination between Federal Reserve monetary policies and the policies of Government agencies which make, guarantee, or encourage real-estate loans. Reference here is to a domestic advisory council, referred to elsewhere. Since real-estate credit activities of Government agencies exert a strong influence on monetary and credit conditions, further exploration of this problem is very desirable. With abatement of abnormal demand for housing, it should be possible to bring about more coordination of policies in the interest of better stabilization in this area.

5. In what respects does the Federal Reserve lack the legal power needed to accomplish its objectives? What legislative changes would you recommend to correct any such deficiencies?

By far the most important deficiency in the System's legal powers is found in the field of bank reserves. The desirability of correcting these deficiencies and rationalizing the basis for determining reserve requirements is discussed more fully in the answers to questions IV–1 and V–1.

Although of somewhat less significance, there are a number of deficiencies in other areas that deserve mention. Some of these are discussed in the answers to other questions as follows:

Consumer credit, discussed in the answer to question IV–2;

Capital requirements for admission to the Federal Reserve System, discussed in the answer to question V–2; and

Financing of small businesses, discussed in the answer to question VI–5.

In an effort to prevent abuses which had developed in connection with the operation of bank holding companies, the Banking Act of 1933 authorized the Board to impose certain restrictions on such holding companies as a condition to their right to vote stock controlled by them in member banks. Subsequent experience, however, has demonstrated that the 1933 legislation is inadequate for effective regulation of bank holding companies.

Almost every one of the Board's annual reports since 1943 has recommended legislation to improve the situation, and S. 829, a measure for that purpose in the Eightieth Congress, was favorably reported by unanimous action of the Senate Banking and Currency Committee. Currently, S. 2318 and H. R. 5744 have been introduced in the Eighty-first Congress on the subject.

Except between 1935 and 1942, the Federal Reserve banks throughout their 35-year history have always had authority to purchase Government obligations directly from the Treasury. Since 1942, however, the authority for such direct purchases has been limited to an aggregate maximum of $5,000,000,000 at any one time, and the authority has been in temporary form. The time limit has been extended from time to time, but under present law the authority will expire on June 30, 1950.

The provision for the Reserve banks to make such direct purchases provides a flexible method of easing the money market in occasional brief periods of heavy drain, as, for example, around tax-payment dates. It affords the Treasury a source from which it may obtain funds to meet temporary contingencies, making it possible for the

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Treasury to operate with a smaller cash balance than might otherwise be necessary. This mechanism has been used from time to time for short periods. It should be extended beyond the present deadline of June 30, 1950, and preferably made permanent.

In addition to the matters mentioned above, there are certain features of the law which, although not of vital importance, may deserve reference here. These are requirements which are impracticable or unnecessary and impair to some extent the efficient functioning of the Federal Reserve System. Some examples of such requirements may be mentioned:

The requirement of section 16 of the Federal Reserve Act for the segregation of collateral against Federal Reserve notes in the form of eligible paper, gold certificates, or Government obligations is cumbersome and yet adds nothing to the quality of such notes since they are a prior lien on all the assets of the Federal Reserve banks and are obligations of the United States. There could be written into the law a formula which would accomplish the same purpose without the procedural requirements of this provision.

The provision of section 16 prohibiting any Federal Reserve bank from paying out Federal Reserve notes issued by another Federal Reserve bank, except under penalty of a 10-percent tax, serves no useful purpose and the cost of sorting and returning such notes results in at least $350,000 a year of unnecessary expense to the Federal Reserve banks.

The requirement of section 14 (d) of the Federal Reserve Act that each Federal Reserve bank must establish discount rates every 14 days has entailed unnecessary inconvenience and might well be modified so that at least in the ordinary cases such rates could be established less frequently, say, once during each month.

The provision of section 10 (b) which requires an interest rate higher by at least one-half percent per annum than the highest discount rate of the Federal Reserve Bank for advances to member banks secured by any satisfactory collateral other than eligible paper should be eliminated.

V. Organization and Structure of the Federal Reserve System

1. In what respects, if at all, is the effectiveness of Federal Reserve policy reduced by the presence of nonmember banks?

The effectiveness of Federal Reserve policies is reduced by the fact that nonmember commercial banks, some 7,250 in number, are not subject to the same reserve requirements as the 6,900 member banks, and that they do not have the same direct access as member banks to the credit facilities of the Reserve banks. This is true even though the lending power of nonmember banks is indirectly affected by changes in the total volume of reserves available to the banking system and they share indirectly in the benefits growing out of the existence of the Federal Reserve System. The table below shows the composition of the commercial banking system by class of banks as of June 30, 1949.

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Number and deposits of all commercial banks in United States, by class of bank, June 30, 1949

	Number of banks		Total deposits	
	Number	Percentage of total	Millions of dollars	Percentage of total
Member banks:				
National	4,987	35.3	78,219	56.8
State	1,913	13.5	38,745	28.2
Total	6,900	48.8	116,964	85.0
Insured nonmember	6,517	46.0	18,410	13.4
Noninsured	733	5.2	2,146	1.6
All commercial	14,150	100.0	137,520	100.0

I wish at the outset to indicate my general position on the problem raised by this question, mainly with respect to the implications of a divided banking structure.

There is no simple answer to the problem presented by a divided banking structure. It must be considered from many angles, historic and institutional as well as political and economic. If it is the purpose of this inquiry to point out a constructive course of future action, little would be gained by a simple reiteration at this point of the many problems presented to those charged with the administration of national policies by the existence of thousands of nonmember banks. The dangers inherent in a divided banking system such as ours have been repeatedly considered by the Congress, and on various occasions legislation has been enacted looking toward eventual integration of our thousands of individual banks into a more logical banking structure. In each instance, however, forces have arisen of sufficient strength to nullify the action or to prevent such integration before the deadline date.

It seems fairly clear to me that these forces are no less powerful today than they have been in the past and that, in the absence of a major banking catastrophe, it would be futile to premise a course of constructive action upon the promotion of legislation requiring all commercial banks, or even all of those that enjoy the benefits of Federal deposit insurance, to undertake all of the responsibilities that are carried by members of the Federal Reserve System. If we are to be realistic as well as conscientious, I would prefer rather to have us bend our efforts toward measures sufficient to buttress the most glaring weaknesses in our present structure. This, it seems to me, is the path of wisdom if we are to avoid the widespread calamities that might yield us in the end a more logical and integrated structure of banking but only after and at the expense of another banking collapse.

I want to make my own position clear. I have always supported the dual banking system. I welcome it as a source of flexibility and decentralization in our banking supervisory structure. Our thousands of individual unit banks established in our separate communities, chartered and supervised in some cases by Federal and in other cases by State authorities, have made a distinct contribution to our free enterprise society, a contribution that finds little parallel in the more centralized banking systems of other countries. They are in intimate contact with their local customers. They are sensitive to local needs.

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They have helped build and maintain the vitality of small and medium-sized business in this country and they have contributed to the spirit of competition and initiative that is characteristically American.

The term "dual banking" should not be confused with "the divided banking system"; i. e., the division of banks into members of the Federal Reserve System and nonmembers. The Federal Reserve System was created originally to preserve our unit banking system and our dual banking system and to protect it from its one fatal weakness; namely, the recurrence at relatively frequent intervals of devastating money panics. It was established with full recognition of the desirability of continuing dual banking and membership in the System has not destroyed it. The Federal Reserve System itself is vulnerable, however, to the extent that it lacks direct contact with half of the banks of the country; mainly, the smaller banks. We need direct contact with these banks and there are times, particularly times of strain, when they vitally need contact with us. That contact, of course, would be provided if they all took out membership in the System, but it seems to me that universal membership is not a feasible solution of the problem. I want naturally a membership that is as large as possible and I would recommend changes in the Federal Reserve Act to make it easier for nonmember banks to join the System. I am not in favor of compulsory membership in the Federal Reserve System. I think it is important that our membership remain on a voluntary basis.

While I personally favor the preservation of dual banking and voluntary membership as the basis of our Federal structure of reserve banking, I do not wish to minimize the fact that this lack of integration presents a very serious problem.

What does it mean to have a commercial banking structure that consists of over 14,000 individual banks, of which fewer than 5,000 hold national charters while the remaining operate under the differing charter provisions of the 48 separate States? Does the existence among all these banks of a small number of large correspondent banks, as well as a few branch and group banking systems, provide sufficient interconnection to assure an adequate flow of loanable funds from regions where financial resources are ample to regions in need of outside financial assistance? What are the limitations imposed on national monetary policies by the fact that less than 2,000 of the 9,000 State-chartered institutions have chosen to take out membership in the Federal Reserve System? To what extent are these limitations offset by the fact that most of the larger banks, including most of the correspondent bank and branch banking systems, are members of the Federal Reserve System so that it includes 85 percent of the total deposits of the commercial banking system? Does the fact that the Federal deposit insurance system covers all but a handful of our banks provide indirectly that hard central minimum core of essential unity which first the national banking system and later the Federal Reserve System failed to achieve?

There are many, particularly among the commercial bankers, who feel that the division in our banking structure, and even in the authority of the Federal Government to supervise banks, is no longer a danger. They believe, in fact, that this division has become an asset in that it diffuses governmental power and responsibility and, conse-

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quently, safeguards the banks from capricious and arbitrary acts on the part of the public authorities. This consideration, however, runs both ways. If the minimum unification essential to survival has not, in fact, been achieved, the present division of powers between the various authorities may very well turn into competition in laxity in periods of prosperity as well as into impotence in times of stress. Something of this sort happened in the early 1930's when the problem of bank failures was acute. Difficulty again threatened in 1947 and 1948 when the efforts of the Federal Reserve System to temper the postwar inflation, through increases in reserve requirements, brought into sharp focus the competitive situation between member and nonmember banks. As the Federal Reserve System raised the reserve requirements of member banks, these member banks became increasingly aware of the competitive advantages with respect to reserve requirements held by nonmember banks, and correspondingly restive. Had the conditions of 1948 persisted much longer the ability of the System to meet its responsibilities might have been seriously impaired by withdrawals among its members.

The acute phase of the postwar inflation, fortunately, seems now to be in the past, and the particular circumstances that complicated central banking administration in that period have abated. We must, however, take counsel to forestall a comparable episode from arising in the future. We cannot rest content with a situation in which those charged by Congress with the administration of the Federal Reserve System may be prevented from discharging their responsibilities because of the competitive situation created by the inadequate reserve requirements of nonmember banks.

I feel that we may reach a constructive and practical solution of this problem if we concentrate on the two aspects of the situation where mandatory legislation is not only justified but essential to the Nation's welfare. One is that the legal reserve requirements which all banks must observe to retain their charters, whether they be State or Federal, be so drawn that the monetary strength of this country is not affected by a bank's voluntary decision to enter or withdraw from the Federal Reserve System. The other is that access to the Federal Reserve System—that is, to the ultimate source of financial liquidity in times of strain—be open to every commercial bank whether or not it is a member of the Federal Reserve System. These two changes are not separable. They must be linked together.

The legislation that would most directly accomplish these results would provide, first, that all commercial banks—that is, all banks carrying deposits subject to check—or at least all insured commercial banks, observe the same reserve requirements irrespective of whether they are member banks or nonmember banks. Such legislation would not affect the authority of the State supervisors over nonmember banks but it would remove once and for all the danger that the relative competitive advantages of membership, as compared with nonmembership, in the Federal Reserve System would affect the aggregate money supply of this country and inhibit the power of the Federal governmental authorities to deal effectively with problems of inflation.

If such legislation were enacted, it should provide for a revision of the reserve requirements now applicable to member banks, which contain many anomalies inherited from the past. The uniform reserve

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plan outlined to your Committee last year contains many features that merit consideration. It is discussed in the answer to question IV-1. This proposed uniform reserve plan would provide for a fairer distribution of reserves among member banks, and the requirements could be met by many nonmember banks with little change in their operations.

Should Congress be disposed to meet the problem presented by the continued existence of nonmember banks in this forthright fashion, I would recommend that direct access to the discount and loan facilities of the Federal Reserve banks be extended to all commercial banks without distinction as to whether or not they were members of the Federal Reserve System. Such a move would make generally available the most important present material advantage of membership in the Federal Reserve System. It might result in some losses in our membership, and, therefore, in the applicability of some of the supervisory safeguards that Congress has written into the Federal Reserve Act as a condition of membership, and perhaps in a decreased coverage of the par collection system. Much as I would deplore this weakening in System membership, I would prefer such a solution to a continuance of the present position. We would at least be sure that the aggregate volume of effective commercial bank reserves of the country would no longer be threatened by competition between member and nonmember banks. I would, of course, welcome the fact that all commercial banks would have direct access to the credit facilities of the Federal Reserve banks. It might well rescue many nonmember banks from trouble in times of strain.

A somewhat similar, but much less effective, suggestion has recently been advanced to deal with this same situation; namely, that Congress require all commercial banks to hold the same percentage of reserve against their deposits but that nonmember banks be permitted to count their balances held with correspondent banks as part of the assets available to meet the requirement to a much greater degree than would be permitted to member banks. This suggestion would not meet the basic logic of the situation since it would not provide assurance that the aggregate volume of effective bank reserves would be adequate to permit the central banking authorities to meet their responsibilities. It would go part of the way, however, toward minimizing the dangerous effects of a competitive situation, such as developed last year, in that the percentages of reserves which nonmember banks were required to carry would have changed parallel to changes in the percentages of the reserves which member banks were required to carry. If this improvement were all that could be achieved, it would not be safe to give direct access to the credit facilities of the Federal Reserve Banks to all nonmembers banks. It should be feasible, however, to provide direct access to the credit facilities of the Federal Reserve banks to all nonmember banks that chose of their own volition to carry their reserves in the Federal Reserve banks.

In considering any such legislation, Congress should review the other requirements now imposed on member banks.

My support of the dual banking system and my feeling that problems which need to be dealt with should be solved within this framework, even though it entails continued existence of a considerable number of nonmember banks, rests largely on my reading of the basic philosophy of the people of this country. We have here a most

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elaborate body of law, State and Federal, that deals with the financial structure. The American people have shown no reluctance to enact legislation to safeguard the soundness of banks, their safety, and their liquidity, although sometimes the need for such legislation was learned only through disaster. These purposes are common to the banking legislation of the 48 States and of the Federal Government, including the legislation creating the Federal Reserve System and the Federal Deposit Insurance Corporation. At the same time, the history of our banking legislation has shown definitely that the American people not only want banks and a central banking system that are simply sound, safe, and liquid, but they insist also on the preservation of banking institutions that are locally owned and locally managed. It is this insistence that explains the continued existence of our unit banking system, the preservation of our dual banking system, our separate regional Federal Reserve banks, and the unwillingness to unify our banking structure compulsorily under the Federal Reserve System. I, for one, am content as a realist to accept that insistence. Even more, I find myself in accord with it. Possibly, students of the problem in the past have been mistaken in seeking to safeguard our monetary structure by advocating universal membership in the Federal Reserve System, for that membership involves conformity with national standards with respect to a great many of a bank's activities. It is not solely confined to conformity with respect to reserves.

I suggest that instead of pushing for compulsory universal membership in the Federal Reserve System it would be better if we all were to concentrate on the elimination of competition in laxity with respect to reserve requirements. If we can gain that one objective, we can then direct access to the credit facilities of the Federal Reserve System and we will have dealt with the most serious threat to our ability to safeguard the monetary structure of this country.

The foregoing suggestions are based on the fact that Federal Reserve policies are accomplished in the main through expanding or contracting the amount of reserves available to banks. In the monetary system of the United States today, balances with the Federal Reserve banks and vault cash supply the basic reserves of the entire banking system; increases in the amount of these reserves make possible expansion in the supply of money while decreases are likely to necessitate contraction. The amount of these basic reserves that banks are required to hold against their deposits determines the volume of credit that can be extended by the banking system on the basis of any given total volume of such reserves. Under existing conditions the total volume of deposits in all commercial banks is approximately 7½ times the aggregate of reserve balances with Federal Reserve banks and vault cash held by commercial banks.

Member banks are required to hold balances with Federal Reserve banks as reserves against their deposits. Nonmember banks, on the other hand, may hold their reserves in the form of vault cash, balances due from other commercial banks, and, in some States, certain amounts of securities of the United States, States, and political subdivisions. Only the vault cash, which must be obtained indirectly from the Federal Reserve, will be reflected dollar for dollar in the demand for Reserve bank credit. Vault cash, however, constitutes only a very small portion of required reserves of nonmember banks; their reserves consist largely of balances due from other banks. Balances due from

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other banks, since the banks with which the funds are deposited can lend or invest them, do not restrict credit expansion except to the small extent that reserves are held against these deposits in the form of vault cash or of balances at the Federal Reserve banks. Balances deposited with correspondent banks are in large part available for lending by correspondent banks and thus may contribute to the process of multiple credit expansion on the basis of a given amount of basic reserves. Reserves consisting of securities are not effective as reserves in a monetary sense—i. e., as a means of regulating the total amount of credit that can be supplied by the banking system—because they are not immobilized assets but rather are assets which reflect credit expansion. A reserve requirement in the form of specified securities—e. g., United States Government securities—is, however, a limitation on the proportion of bank funds which can be invested in other loans and securities.

With reference to required reserves, it should be pointed out that member banks in practice hold as working balances certain amounts of vault cash and deposits with correspondents, in addition to their required reserves with Federal Reserve banks, whereas nonmember banks can count their minimum working balances as required reserves. Thus, the differences in percentages of deposits required to be held as reserves do not accurately reflect the actual differences in effective reserves that must be held by the member and nonmember banks.

Although member banks hold about 85 percent of total deposits of all commercial banks, it must be remembered that the effectiveness of reserve requirements lies not only in the aggregate volume of dollars required to be held as reserves; to a very considerable extent it lies in the direct impact of those requirements upon the loan and investment policies of the thousands of individual banks and the influence those policies exert upon the myriad users of bank credit. Accordingly, the fact that more than one-half of all commercial banks are not members of the Federal Reserve System and are not subject to Federal reserve requirements can seriously weaken the effectiveness of these requirements. Moreover, the geographical distribution of the nonmember banks is not uniform throughout the country but varies widely, ranging from approximately 15 percent of all commercial banks in the Federal Reserve District of New York to approximately 71 percent in the Federal Reserve District of Atlanta. As a result, the impact of Federal Reserve policies and the possibility of rendering assistance and support in time of need varies widely in different areas of the country.

Number of all commercial banks and percent which are nonmembers, by Federal reserve districts, June 30, 1949

Federal Reserve district	All commercial banks		Federal Reserve district	All commercial banks	
	Number	Percent which are nonmember banks		Number	Percent which are nonmember banks
Boston	498	33.1	St. Louis	1,473	66.4
New York	909	14.5	Minneapolis	1,281	62.8
Philadelphia	843	23.8	Kansas City	1,768	57.1
Cleveland	1,128	37.9	Dallas	1,019	39.1
Richmond	1,026	53.3	San Francisco	512	48.0
Atlanta	1,195	70.9			
Chicago	2,498	59.8	Total	14,150	51.2

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2. What changes, if any, should be made in the standards that banks must meet in order to qualify for membership in the Federal Reserve System? What would be the advantages of such changes?

The present statutory requirements with respect to the amount of capital necessary for admission of a State bank to membership in the System are arbitrary, unrealistic, and have little relationship to the capital needed by the banks. They should be substantially modified. For the same reason, specific provisions regarding the minimum amount of capital stock required for the admission to membership of a State bank operating an out-of-town branch or branches, or for the establishment of an out-of-town branch by a State bank, should be eliminated.

As a result of present capital requirements, sound banks which are otherwise entitled to membership, and most of which are insured banks, are prevented from becoming members of the Federal Reserve System or from establishing branches as member banks. A recent survey indicates that there are approximately 2,000 State banks which were not eligible for membership because of the present capital requirements.

Furthermore, present capital requirements have caused some State member banks to withdraw from membership in order to establish or continue out-of-town branches, which they can do as insured nonmember banks but cannot do as member banks. Since January 1, 1946, 11 State member banks have withdrawn from membership for this reason. In each case, after considering all of the factors prescribed by law, including the adequacy of capital structure, the Federal Deposit Insurance Corporation approved the bank's application for continuance of insurance as a nonmember bank and establishment or continuance of the branch. In each case, the bank's capital stock was less than the amount required for the operation of branches as a member bank.

As a general rule, banks which are eligible for Federal deposit insurance should not be barred from membership in the Federal Reserve System by arbitrary capital requirements. The following proposed changes are desirable in and of themselves and necessary in order to eliminate unwarranted discrimination against membership in the Federal Reserve System.

Instead of the present capital requirements, which relate only to the amount of capital stock and are based upon population, there should be only one specific capital requirement for admission to membership: a minimum of $50,000 paid-up capital stock, with the exception that a bank organized prior to the enactment of the proposed legislation might be admitted with paid-up capital of $25,000. The adequacy of a bank's capital structure should continue to be included among the factors to be considered by the Board of Governors in passing upon the application of a State bank for membership.

The Board has recommended such changes, and bills incorporating the recommendations have been introduced in the present Congress as S. 2494 and H. R. 5749.

Except for the suggested minimum capital stock, the discretionary authority proposed would be similar to that now prescribed for the Federal Deposit Insurance Corporation in passing upon applications

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for insurance and for the establishment of branches by insured nonmember banks.

Provisions of existing law

The existing law provides, in general, that no State bank shall be admitted to membership in the Federal Reserve System unless it possesses a paid-up unimpaired capital stock of at least $50,000 if in a place of not over 6,000 population; $100,000 if in a place of over 6,000 but not exceeding 50,000 population; $200,000 if in a place of over 50,000 population. Exceptions permit, in certain circumstances, the admission of State banks with a minimum capital stock of $25,000 if located in a place of not over 3,000 population, and with a minimum capital stock of $100,000 if located in an outlying district in a city with a population of over 50,000.

If a bank with an out-of-town branch established after February 25, 1927, wishes to become a member, or a State bank which is a member wishes to establish an out-of-town branch, it is required by law to have a capital stock of at least $500,000, except in a few States with relatively small population. A minimum of $250,000 is applicable in a State with a population of less than 1,000,000 and in which there is no city with a population exceeding 100,000; a minimum of $100,000 is applicable in a State with a population of less than 500,000 and in which there is no city with a population exceeding 50,000. In addition, the bank must have capital stock not less than the aggregate required for the establishment of national banks in the various places where the bank and its branches are located. In many cases, the capital requirements for the establishment of branches by State member banks (which are the same as for national banks) are much more stringent than those under the State law.

> 3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies? In the size, terms, and method of selection of the Board of Governors? In the Open Market Committee? In the boards of directors and officers of the Federal Reserve banks? What would be the advantages and disadvantages of the changes that you suggest?

Board of Governors

Before the recent debates on the executive salary bill (H. R. 1689), I would have answered the question with respect to changes in the size, terms, and methods of selection of the Board of Governors by recommending that no change be made, or at most that the membership of the Board be reduced from seven to five. However, these discussions reflected a widespread misunderstanding of the Reserve System's responsibilities for monetary and credit policies and of the need for salaries for members of the Board commensurate with their responsibilities. As I am in no way dependent upon my salary as a member of the Board, my comments on the question of salaries are actuated only by a desire to increase the effectiveness and prestige of the Federal Reserve System.

The executive salary bill as passed by the Congress increases the salaries of the Board from $15,000 to $16,000. The salaries of members of the Cabinet were increased from $15,000 to $22,500, under secretaries formerly receiving $10,000, $10,330, or $12,000 were in-

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creased to $17,500, and a number of other official salaries, ranging from $10,330 to $15,000, were increased to $16,000 and more. When the System was first organized, the salaries of the members of the Board were the same as those of members of the Cabinet, and they have been at that level for many years past. The fact that the Congress did not maintain in the executive salary bill the salary status of the members of the Board has disturbed me greatly, because it reflects either a misunderstanding as to the Board's responsibilities or a feeling that they are no longer as important as they have been in the past. Since the Board's responsibilities have increased over the years, particularly during and since the war and because of the great growth in the public debt, I am convinced that the action of the Congress is the result of a misunderstanding.

The availability of credit for the financing of business is the lifeblood of a dynamic society. When an agency is given the responsibility—as the Federal Reserve System has been—for increasing or decreasing the amount of credit available and the cost of such credit, its decisions and policies have a profound effect on all segments of the economy. Failure to meet that responsibility wisely in the public interest could do untold damage to business, industry, and agriculture. Sound national monetary conditions are essential to achievement of the objectives of the Employment Act of 1946. Primary responsibility in this field is vested in the Board of Governors. It would be difficult to exaggerate the importance of this responsibility, and hence the need for confiding it to men of wide experience who have great breadth of vision and understanding. In my opinion, this duty alone justifies a salary level for Board members that is substantially above the limitation set by the current legislation. In addition, the Board has other important duties. It has general and other major supervisory functions in connection with the operations of the 12 Federal Reserve banks and their 24 branches which perform central banking functions in the public interest and, therefore, are entirely different in their purposes and functions from the commercial banks which are private institutions. The Board also exercises special supervision over the relations of the Reserve banks with foreign banks and bankers. Its duties include the supervision and examination of banks. Additional responsibilities among others, include the issuance and retirement of Federal Reserve notes, which is the major portion of our currency, and the issuance of regulations relating to the many subjects to which the jurisdiction of the Board extends.

In the light of the above, I am satisfied that it is essential to the effective discharge of the Board's functions that the prestige of the position of a member of the Board and the salary for the position be such as to attract the best-qualified men available. Whether the Board consists of three, five, or seven members is not as important as to have the positions filled with men of the highest qualifications and competence who will be induced by the nature and standing of the position to accept and remain in office. There is no question in my mind that if the subordinate salary relationship established by H. R. 1689 is continued it will be most difficult, if not impossible, to attract to the Board men of the caliber I have indicated. After serving for a period of 18 months as Chairman, I feel that the salary relationship which existed in the past should be maintained; and, if the only way to restore that relationship is to reduce the number of members of the

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Board, I would strongly recommend that step. In this connection, it should be borne in mind that salaries and expenses of the Board and its staff are not paid from appropriated funds or governmental revenues or from assessments upon member banks but from earnings of the Federal Reserve banks in the normal course of their operations, particularly open-market operations.

If the Congress should reduce the present Board to five members and retain the present Open Market Committee, it would be my suggestion that the representative membership on the Committee be reduced to three or four instead of five as at present.

The present law requires that from the membership of the Board the President shall designate one member as Chairman and one member as Vice Chairman to serve as such for a term of 4 years. The purpose of this provision of the law was to afford a new President an opportunity to designate a Chairman and Vice Chairman of the Board. In practice, this provision has not worked out satisfactorily because it has not been possible to make appointments so that they would coincide with the term for which the President is elected. It would be preferable if the law were changed to provide that the President shall designate the Chairman and Vice Chairman for terms expiring on March 31, 1953, and March 31 of every 4 years thereafter.

Federal open-market committee

Differences of opinion have always existed as to the most desirable distribution of functions within the various parts of the Federal Reserve System and particularly as to where responsibility for the instruments of credit policy should be placed. One view expressed in answers to questions of the subcommittee is that authority with respect to more of these instruments should be lodged with the Federal open-market committee. It is my considered opinion that the present arrangement works very well. It has been my experience that the Board is constantly seeking and benefiting from the advice on System policies generally as provided not only through the open market committee but also through consultation with all of the presidents and the chairmen of the Federal Reserve banks and the Federal Advisory Council. A splendid spirit of cooperation and understanding on policy and procedure exists throughout the System, and my chief interest is to preserve and improve it.

If any change were to be made in this regard, I would prefer to consider an amendment to the law to place authority over open-market operations, and of all powers and authorities vested in the Board of Governors, in a reconstituted Board (which would be known as the Federal Reserve Board) consisting of three members appointed by the President with the advice and consent of the Senate, and the presidents of two of the Federal Reserve banks, making a Board of five full-time members. The terms of the three members appointed by the President would be 12 years, so arranged that one term would expire every 4 years. The present requirement that a member shall be ineligible after the completion of a full term should be eliminated, except that no one should be eligible for appointment for a term or the unexpired portion thereof if he would reach 70 years of age before the end of the term.

The two members chosen from the presidents of the Federal Reserve banks would each serve for a period of 1 year in accordance with a

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system of rotation among the 12 Federal Reserve bank presidents which would be written into the law. The two president members of the Board would be required to give their full time to the work of the Board. To be eligible for service as a member of the Board, a president of a Federal Reserve bank should have served as an officer of the bank for at least 2 years.

Such a proposal would terminate the existing arrangement under which authority over instruments of credit policy are divided between the Board of Governors and the Federal open-market committee. It would preserve the present advantages of having presidents serve on the open-market committee, and would be in harmony with the regional character of the Federal Reserve System, which contemplates that the coordination, supervision, and final determination of national credit and other major policies would be in the hands of a supervisory governmental body located in Washington. Because of the importance of the New York money market, provision should be made for participation of the president of the New York Federal Reserve Bank in the consideration of open-market policies and operations.

However, unless future experience should reveal a greater need than now exists for changing the duties or composition of the Federal-open-market committee, I would not recommend a change.

Directors of Federal Reserve banks

One of the major advantages of having a board of directors at each of the Federal Reserve banks is that it brings to bear on the problems of the System the wide range of training and experience possessed by the directors. This advantage can be most effectively utilized, however, if there be injected regularly into the membership of the board of directors fresh points of view. This can best be accomplished by a system of rotation of membership on the bank boards. Another advantage of such a system would be that a more frequent turn-over of directors would result in more of the outstanding businessmen in the various Federal Reserve districts having close contact with and understanding of monetary and credit policies. These problems are complex. They are not generally understood by the public. Men who serve as directors of the Federal Reserve banks or as members of the Federal Advisory Council gain a much better understanding of national monetary and credit problems and of policies designed to meet such problems, and they are thus able to inform other businessmen and bankers on these subjects. This results in a far wider understanding and acceptance of System policies.

In 1935 the Board adopted a policy under which class C directors of Federal Reserve banks (who are appointed by the Board) who had served six or more consecutive years (except in the case of the chairman of the board of directors) would not be reappointed. It was the hope of the Board that the same policy would be followed in the election by the member banks of class A and B directors of the Reserve banks but that course was followed only to a limited extent. Accordingly, in 1942, the Board announced that it had abandoned any fixed rule as to the length of service of class C directors but that it would adhere generally to a policy of rotation. Since it has not been possible to bring about a system-wide policy in this regard, it would be my recommendation that the law be changed to provide that directors of Federal Reserve banks (perhaps with the exception of the chairman

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of the board of directors) shall be ineligible for service as directors after the completion of two consecutive full terms of 3 years each.

Officers of Federal Reserve banks

The Banking Act of 1935 required that the chief executive officer of a Federal Reserve bank be a president, appointed by the directors with the approval of the Board of Governors for a term of 5 years, and all other executive officers and employees of the bank are directly responsible to him. Provision was also made for the appointment of a first vice president in the same manner and for the same term as the president and he serves as the chief executive officer in the absence or disability of the president.

For a variety of reasons relating to the freedom to assign responsibilites to officers and the selection of men to fill the second position on the executive staffs of the Federal Reserve banks, it would be preferable if the position of first vice president were eliminated. If that were done, the directors would be free to shift the more important duties and responsibilities among the vice presidents and make changes in the official line-up of officers without the difficulties sometimes encountered under the present arrangement.

Federal Advisory Council

There is no formal limitation on the length of time that a member of the Federal Advisory Council may serve. For the same reasons as are given above for the adoption of a system of rotating membership on the boards of directors of the Federal Reserve banks, I believe it would be desirable to provide for rotation in the membership of the Federal Advisory Council. The desirability of such rotation has been recognized in resolutions adopted by the chairmen of the Federal Reserve banks as well as by the Federal Advisory Council itself, but the directors of some of the Federal Reserve banks have not acted to put the suggestion into effect. Accordingly, I would favor a change in the law to provide that an individual shall not be eligible to serve as a member of the Council for more than three full consecutive calendar years.

Other changes

There are other changes of lesser importance in the organization of the System which I shall not undertake to detail in this reply but which would be desirable in the event a general revision of the Federal Reserve Act were undertaken.

VI. Relation of the Federal Reserve to Other Banking and Credit Agencies

1. What are the principal differences, if any, between the bank examination policies of the Federal Reserve System and those of the FDIC and the Comptroller of the Currency?

At the present time, the differences between the examination policies of the Federal Reserve, the FDIC, and the Comptroller of the Currency are not of material consequence. Such variations as formerly existed related mainly to the appraisal of assets held by the examined bank, and these appear to have been largely eliminated by an agreement on appraisal standards—more fully described in the answer to question VI-2—which was worked out among the three agencies in

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1938 and revised by them in 1949. The differences might be greater and of more significance in periods when inflationary and deflationary pressures are less evenly balanced and one or the other is tending to unstabilize the economy.

It is only natural that there should be some differences among the supervisory policies of the three agencies (as implemented by bank examinations and otherwise), in view of the fact that the responsibilities and principal functions of the respective agencies are not the same, but the differences in policies are on the whole less important than the similarities. General statements respecting their varying responsibilities, if made by any one of the three agencies, would perhaps be unacceptable to both the others. By reason of their institutional connection the examiners of the Federal Reserve System are particularly attentive, in appraising a bank's assets and the character of a bank's management, to taking into account the general business and credit conditions and the current monetary and credit policy of the Federal Reserve authorities.

> 2. To what extent and by what means have the policies of the Federal Reserve been coordinated with those of the FDIC and the Comptroller of the Currency where the functions of these agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination? To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks?
>
> 3. What would be the advantages and disadvantages of providing that a member of the Federal Reserve Board should be a member of the Board of Directors of the Federal Deposit Insurance Corporation? Would you recommend that this be done? Should the Comptroller of the Currency be a member of the Federal Reserve Board?

These questions relate in reality to a single problem—one of long standing and great complexity. It grows out of the fact that Federal supervision and regulation of banks are divided among three agencies set up by Congress for different purposes and at widely separated times in our banking history. The Comptroller of the Currency over 85 years ago was charged with the responsibility of chartering and examining national banks. As passed in 1913 and with later amendments, one of the purposes of the Federal Reserve Act stated in its preamble was "to establish a more effective supervision of banking in the United States," and the act places upon the Federal Reserve Board and the Federal Reserve banks, among other responsibilities, supervisory and examining functions with respect to all member banks. In the depression period of the early 1930's, the Federal Deposit Insurance Corporation was created to administer a bank deposit insurance fund, and was given certain limited powers over all insured banks, including national banks and State member banks, and special powers of supervision and regulation with respect to nonmember insured banks. As a result, each of the three agencies is primarily concerned with a certain class of banks; but each also has regulatory functions in specific areas which affect banks primarily under the jurisdiction of one or both of the other agencies. In addition, Congress has placed upon the Board of Governors important responsi-

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bilities in the field of credit and monetary policy with which bank supervisory and regulatory policies have a definite relationship.

In the circumstances, a layman examining an organization chart of the three agencies or a description of their functions would expect to find little evidence of coordination in their supervisory policies and would probably expect them to be working completely at cross purposes. There has been no specific directive from Congress requiring cooperation between them and, except that the Comptroller of the Currency is an ex officio member of the Board of Directors of the FDIC, each of the agencies is quite independent of the others. Actually, however, the agencies have accepted the need for cooperation as a practical matter and each of them has made its own contribution to this end.

In the field of bank supervision, which has to do with individual banks and is implemented by bank examinations, the three supervisory agencies appear to have achieved reasonably uniform standards for the appraisal of bank assets by bank examiners. This has resulted chiefly from the adoption of a written agreement between the three agencies and the National Association of Supervisors of State Banks, first in 1938 and revised, in detail but not in principle, in 1949. In such matters as the chartering of banks, admissions to deposit insurance or to membership in the Federal Reserve System, and grants of permission to establish branches, a great deal of coordination has been likewise attained.

Serious problems of coordination have arisen from the fact that the three agencies are authorized under the law to issue and interpret regulations applicable to the classes of banks under their respective jurisdictions which relate to the same general subject matter and also from the fact that as to certain matters one of the agencies may possess regulatory authority with respect to a class of banks primarily under the jurisdiction of another agency. Even here, however, a considerable degree of uniformity has been accomplished.

Both in connection with supervisory and examination policies and the issuance and interpretation of regulations, coordination has resulted from constant efforts to foster discussions and consultations between the agencies both at top level and at the staff level. The 1938 agreement with respect to bank examination policies is an excellent example of the cooperation that may be accomplished through such methods.

A common understanding of mutual problems at the staff level has been substantially aided by the fact that in several districts the Federal Reserve banks have provided office accommodations for the chief national bank examiners of the Comptroller's office and also for the corresponding field representatives of the FDIC. In the case of the FDIC, however, differences in areas covered by the various districts from those in Federal Reserve districts made more cooperation difficult in some regions.

There are, of course, certain particulars in which complete coordination and uniformity with respect to examination policies as well as regulatory functions have not yet been achieved. That all reasonable steps should be taken to increase cooperation in these areas is obviously desirable. However, in proposing additional means of achieving closer cooperation, each of the three agencies would natu-

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rally be influenced by the special functions and objectives which have been assigned to it by the Congress.

While it is natural to consider the possibility of ex officio relationships between the agencies concerned as a means of encouraging increased coordination of policies, such relationships are subject to certain inherent disadvantages. An officer attached to a particular agency is unlikely to devote adequate attention to all of the problems of another agency served by him in an ex officio capacity; and he is often unable to attend meetings of the other agency with regularity or to participate as fully as would be desirable in its deliberations.

4. In what cases, if any, have the policies of other Government agencies that lend and insure loans to private borrowers not been appropriately coordinated with general monetary and credit policies?

A large number of Federal corporations and agencies have independent responsibilities for making credit available to private borrowers. Congress has given some agencies certain powers to make loans and other agencies powers to insure or guarantee loans made by banks and other private financing institutions. (A few have authority both to lend and to guarantee loans.) In some cases the lending or loan-insuring functions are related primarily to specific purposes such as aid to agriculture, homeowners, and veterans, and in other cases they are intended primarily to make credit available on risks and terms not ordinarily accepted by private lenders.

Altogether the operations of these agencies play an important role in influencing the supply, availability, and cost of credit to private borrowers and consequently in the effectiveness of national credit policy. The aggregate volume of credit obtained by private borrowers in domestic fields through the aid of Federal financing agencies more than doubled in the 3 years 1946–48, and totaled more than $20,000,000,000, at the end of 1948, as shown in the attached table. About three-fourths of the outstanding credit was home mortgage loans, most of which had been extended by private lenders under guarantees or insurance of the Federal Housing Administration and the Veterans' Administration. Nearly one-fifth of the total represented various types of credit to farmers, a substantial part of which had been extended by the Rural Electrification Administration, the Commodity Credit Corporation, and the Farmers' Home Administration. A small remaining amount consisted largely of Reconstruction Finance Corporation loans to businesses. Most of the credit reflected the financing operations of the 13 agencies listed in the table, but some 13 other agencies also made or insured loans.

Domestic loans and loan guaranties and insurance by Federal corporations and credit agencies

[In millions of dollars]

	Outstanding Dec. 31, 1948	Change during:		
		1948	1947	1946
Total	20, 520	+5, 553	+4, 553	+1, 805
Loans	5, 286	+949	+592	−278
Loan guaranties and insurance	15, 234	+4, 603	+3, 962	+2, 083

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Domestic loans and loan guaranties and insurance by Federal corporations and credit agencies—Continued

[In millions of dollars]

	Outstanding Dec. 31, 1948	Change during:		
		1948	1947	1946
To aid homeowners and housing, total	15,860	+4,171	+4,024	+1,778
Loans:				
Reconstruction Finance Corporation	184	+51	+110	−26
Federal National Mortgage Association	199	+195	−1	−2
Home Owners' Loan Corporation	369	−117	−151	−216
Federal home loan banks	515	+79	+142	+99
Public Housing Authority	295	+17	−1	−7
Other	22	−43	+39	+6
Loan guaranties and insurance:				
Federal Housing Administration	7,276	[1] +2,489	[1] −886	[1] −379
Veterans' Administration	7,000	+1,500	+3,000	+2,300
To aid agriculture, total	3,792	+1,368	+469	+159
Loans:				
Federal Farm Mortgage Corporation	80	−30	−40	−93
Federal intermediate credit banks	426	+89	+63	+42
Banks for cooperatives	305	+30	+44	+35
Commodity Credit Corporation	620	+439	+173	[2] −1
Rural Electrification Administration	999	+265	+206	+120
Farmers' Home Administration	523	−32	−32	[3] −10
Other	6	−2	−1	−6
Loan guaranties: [4]				
Commodity Credit Corporation	673	+574	−14	[2] +22
Veterans' Administration	160	+35	+70	+50
To aid industry, total	575	+36	+78	−11
Loans:				
Railroads (RFC)	140	−7	−23	−53
Other industry:				
RFC	272	+31	+91	+2
Other agencies	38	+7	−10	−43
Loan guaranties:				
RFC	([5])	([5])	([5])	([5])
Veterans' Administration	125	+5	+20	+90
Loans for other purposes, total	293	−22	−18	−125
To States and Territories:				
RFC	137	+14	+14	−10
Other agencies	86	+11	([6])	−5
Other:				
RFC [7]	47	−39	−29	−59
Other agencies	23	−9	−2	−49

[1] Excludes loans insured under Title I of National Housing Act.
[2] Estimated.
[3] Includes emergency crop and feed loans, which were handled by the Farm Credit Administration until Oct. 31, 1946.
[4] Excludes a small amount of loans insured by the Farmers' Home Administration.
[5] Not available.
[6] Less than $500,000.
[7] Reflects largely loans to businesses for nonwar purposes.

NOTE.—Loans outstanding represent gross amounts and are based on figures published by the U. S. Treasury Department; groupings of agencies are by Federal Reserve. Loan guaranties and insurance represent principal amount of loans outstanding and are based on reports and information from the respective agencies. The number of agencies included in "Other" and not already listed in the table is as follows: To aid agriculture, 4; to aid homeowners, 2; to aid industry, 3; and other purposes, 4.

The powers given by Congress in connection with the activities of these Federal agencies are primarily to meet special problems. No general provision has been made to coordinate the numerous credit activities with over-all credit policy of the Government.

In approaching this aspect of Federal credit agencies we should take into account the important nonmonetary purposes that are served by the lending activities of these agencies and the fact that nonmonetary considerations may be compelling in determining the policies of individual agencies. At the same time it should be borne

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in mind that the credit extended does become a part of the country's money supply and can interfere with or facilitate the effectiveness of national credit policy. At times, moreover, monetary effects of the credit activities of Federal agencies may be a major consideration of the Government in determining the over-all contribution of its numerous and varied activities to accomplishing the objectives of the Employment Act of 1946.

For such reasons, considerations of the bearing of the lending and loan-insuring policies of Federal agencies on general credit policy should not be ignored. These agencies have varying degrees of discretionary authority which can be used to influence the volume of credit extended. It would be desirable, moreover, that those responsible for general credit policy be fully informed at all times as to the probable effects of various loan or loan-insuring programs on the supply of credit, so that general credit policy could be formulated in the light of these prospective developments.

For a number of years there has been increasing recognition of the desirability of bringing the policies of the various lending and loan-insuring agencies into closer relation with each other and with general credit policy. In testifying before the Senate Banking and Currency Committee on May 11, 1949, I emphasized "* * * the need for some mechanism of policy coordination on the domestic financial front as we have available through the NAC on the international financial front."

Such a mechanism would permit consideration of those policies of the agencies that affect the extension of credit to private borrowers with a view to bringing about a greater consistency among the agencies and a greater consistency with over-all credit policy. It could also inform the President and the Congress as to the extent to which lending and loan-insuring policies of Federal agencies are compatible with each other and with the objectives of the Employment Act of 1946. Other aspects of a domestic financial advisory body are discussed in the reply to question VI–6.

> 5. What changes, if any, should be made in the powers of the Federal Reserve to lend and guarantee loans to nonbank borrowers? Should either or both of these powers be possessed by both the Federal Reserve and the Reconstruction Finance Corporation? If so, why? If not, why not?

Small business is of vital importance to the maintenance of a flourishing national economy under our system of competitive private enterprise. It is essential, therefore, that all credit-worthy small businesses should have access to adequate sources of financing.

In general, current working capital requirements of small businesses are met by their local banks. However, the usual sources of short-term credit may not be adequate in times of financial depression or in abnormal times such as occurred during the defense and war periods. Moreover, an important need of the smaller independently owned business enterprises in normal times is for longer term funds for such purposes as plant modernization and the purchase of machinery and equipment. As a rule, the owners of small enterprises prefer to obtain such funds on a loan rather than on an equity basis.

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Whether the need is for current working capital or for longer term funds, the use of the private banking system should be encouraged in the financing of small business enterprises. It is obviously desirable that loans to businesses should be made as far as possible by local banks dealing with local concerns with whose problems they are familiar. Governmental agencies should function in this field only when adequate financing is not available from the customary private sources of credit, and then chiefly with a view toward helping to restore and maintain normal credit relationships between business concerns and their local banks.

It was on this basis that Congress in 1934, during a depression period, in the same statute authorized both the Federal Reserve banks and the Reconstruction Finance Corporation to assist in the financing of business enterprises.

The 12 Federal Reserve banks, as permanent credit institutions, are especially qualified to provide financial assistance to business enterprises through the regular banking channels. With their 24 branches, the Reserve banks constitute a regional organization to which financing institutions and businesses in all parts of the country have convenient access. Because of their long experience in the credit field and their daily relationships with banking institutions, they are thoroughly familiar with credit needs and problems of both banks and businesses. For these reasons, the Reserve banks are especially fitted to assist local banks in making credit available to borrowers who, though otherwise meritorious, may present credit risks of a character which banks will not ordinarily accept; and, by such aid, the Reserve banks can help to restore and maintain normal credit relationships between such borrowers and the banks. The Reserve banks gained additional valuable experience in the field of business loans as the result of their active participation in the wartime V-loan program under which guaranties of war production loans aggregating nearly 10½ billion dollars were processed.

Notwithstanding their qualifications for the task, the Reserve banks have been handicapped in carrying out their industrial-loan function by the restrictive provisions of section 13b of the Federal Reserve Act. Under present law, they may make commitments and loans only for working-capital purposes, only to "established" business, and only with maturities not exceeding 5 years. These are severe limitations upon the ability of the Reserve banks to render effective assistance in meeting the requirements of smaller businesses.

Unless appropriate changes are made in the law to place the authority of the Reserve banks in this field on a more effective basis, I believe that it would be preferable to repeal the present limited authority of the Reserve banks in its entirety.

If it is the desire of Congress to utilize effectively the services of the Federal Reserve System in the extension of financial assistance to small business in time of need, the Reserve banks should be authorized to enter into participations and commitments with financing institutions with respect to loans made to business enterprises, on a basis under which a Reserve bank might assume not more than 90 percent of the risk involved and under which loans would not be limited solely to working-capital purposes or restricted to established businesses. The maximum maturity on any such loan should be fixed at 10 instead of 5 years. It would be the policy of the Federal Reserve to have the

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local bankers assume as much of the risk as possible. The Reserve banks would be prepared to release to the banks at any time within the life of the loan any part of their participation.

Without entering into details, there are certain other changes in the law which would be desirable. Thus, the aggregate amount of participations and commitments by all the Federal Reserve banks outstanding at any one time might be appropriately limited to, say $500,000,000; and, in order to assure the availability of credit to the smaller businesses, it might be provided that the aggregate amount of participations and commitments individually in excess of $100,000 could not exceed $250,000,000. Also, the existing appropriation of approximately $139,000,000 for the industrial loan operations of the Reserve banks should be repealed and amounts heretofore received by the Reserve banks for such operations should be returned to the Treasury, so that henceforth the Reserve banks would utilize only their own funds in providing assistance to business enterprises.

It is my view that both the Federal Reserve banks and the Reconstruction Finance Corporation may, without inconsistency, operate together in providing financial assistance for business enterprises, provided, however, that there is written into the law a provision which would require the Reconstruction Finance Corporation, before it extends financial assistance to a business enterprise, to consider whether such assistance is available, not only from commercial banks, but through the Reserve banks. This would be in the nature of a clarification of the present statutory requirement that the Corporation shall render financial assistance only if it is "not otherwise available on reasonable terms."

As a source of extraordinary financial assistance, it is appropriate that the Reconstruction Finance Corporation should make loans of a kind, which, because of the size of the loan or the type of operation involved, are not ordinarily suitable for banks and which are not participated in by the Reserve banks. Examples are to be found in the financing of railroads, air carriers and large public projects, and in the loans made by the Corporation for disaster relief. Aside from loans of this type, the Corporation's principal objective should be to provide needed financial assistance to small businesses in those exceptional circumstances in which regular credit facilities, including those of the Reserve banks, are inadequate.

With the qualification mentioned above, there is ample room for the functioning of both the Federal Reserve banks and the Reconstruction Finance Corporation in providing credit assistance to business, provided, of course, that their functions in this field are coordinated with national credit policies and are not exercised in competition with private financing institutions.

6. What would be the advantages and disadvantages of establishing a national monetary and credit council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

In view of the large role which Government financial agencies have come to play in influencing the supply, availability, and cost of credit to private borrowers, as discussed in the answer to question VI-4, I am sure that some mechanism for effecting a closer harmony between

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them would serve a constructive purpose. The specific objectives of an appropriate council, in my opinion, should be to promote consistency in the policies of Federal agencies extending loans, loan insurance, and loan guaranties, and consistency of such policies with the general stabilization program of the Government in accordance with the objectives of the Employment Act of 1946. Such a council should have only consultative and advisory functions. It would serve in some respects as a domestic counterpart of the National Advisory Council on International Monetary and Financial Problems. However, there are important differences in the problems to be considered by the two agencies and there would necessarily be significant differences in organization and operation.

With the existence of such a council, each of the present Federal credit agencies would continue to exercise the authority and discharge the responsibilities which have been especially delegated to it by the Congress, but its policies and operations would have the benefit of joint study in the light of national monetary and credit needs and over-all stabilization policies. Furthermore, over-all monetary and credit policy could be formulated in the light of a clearer current picture of the various Federal financing programs and the prospective effects of such programs on the supply of credit.

A council such as I have in mind could help to achieve a more harmonious domestic financial program within the existing framework and without impairing the essential operating flexibility of the various agencies. In fact, it seems reasonable to expect that each of the agencies would gain greater long-run effectiveness as a result of a more definite and systematic mechanism for interagency discussion relating to the appropriateness of policies (from the standpoint of general economic stability) and the coordination of credit functions.

Such a council might be established by statute, as in the case of the National Advisory Council on International Monetary and Financial Problems, or it might perhaps be established on a less formal basis by executive action of the President. A statutory provision for the council would have the advantage of definite recognition by the Congress but would have the disadvantage of making it more difficult for the council to evolve gradually in working out an effective advisory and coordinating mechanism in the domestic field.

Because of the diverse interests and difficult problems involved, it would be desirable to provide ample flexibility for the functional evolution of the proposed council. In addition some problems of integrating the council's activities with those of the NAC would doubtless arise and these would need to be resolved on an empirical basis. It is entirely possible that considerable experience would be needed before such a council could be given its most effective form and function. Therefore, it would be well to test out the operation of a domestic lending advisory council under executive authority before attempting to make it the subject of specific statutory definition. If it should be covered by statute at this time, it would be desirable to limit the statute to broad outline, leaving ample room for adaptation in organization and operation. In general, it would seem undesirable to attempt at this time any close integration of activities of the proposed council with those of the already successfully operating National Advisory Council. Such integration in time might prove to be a

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constructive step, but some period of operation in the domestic field should be allowed to determine the wisdom of that course.

The council, in my opinion, should comprise the top officials of Federal departments or other agencies having recognized interests or responsibilities in the credit field. Membership should not be too large. Agencies not regularly members would be expected to participate in the consideration of matters relating to their responsibilities.

VII. Deposit Insurance

1. What changes, if any, in the laws and policies relating to Federal insurance of bank deposits would contribute to the effectiveness of general monetary and credit policies?

As the agency primarily responsible for monetary policy, the Federal Reserve System is vitally interested in the functioning of the deposit-insurance program, which has as a primary objective the removal of one of the major threats to public confidence in monetary institutions and hence to general monetary stability. Deposit insurance is one of the important reforms intended to improve monetary stability by the banking legislation of the 1930's. Many of these were aimed at preventing another drastic shrinkage in the money supply such as occurred between 1929–33.

To that end the Board of Governors was authorized, among other things, to vary reserve requirements within certain limits, the Federal Reserve banks were authorized to grant credit on any sound bank asset, and provisions for the issuance of Federal Reserve notes were liberalized. These changes in System authority, while providing necessary capacity in the banking system to cope with adverse conditions, deal only indirectly with one factor which in the past has greatly aggravated cyclical developments on the downward side, namely, panic conditions among depositors. Deposit insurance is the instrument which Congress set up to prevent that considerable part of a liquidating process which is due to panic withdrawal of funds by the general public.

When the insurance program was established there was little experience and information on which to develop a genuine basis for insuring bank depositors against loss. At that time, consequently, insurance coverage, rates of assessment, and the assessment bases all had to be set more or less arbitrarily. We now have more than 15 years of successful experience in operating a national deposit-insurance program. During this period our economy and our banking structure have undergone great changes. In view of our experience with deposit insurance and the important changes that have occurred over the past decade and a half, it seems appropriate to review and perhaps to revise certain of the judgments that were originally made with respect to deposit insurance.

There are several points at issue which might be considered in connection with such a reappraisal. The $5,000 limit of deposit-insurance coverage which was established when the program was set up has not been revised, but in the interim the price level has doubled, the average deposit account has more than doubled, and total bank deposits and average per capita income have nearly quadrupled.

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The rate of assessment burden on banks for deposit insurance has not been changed since 1935, although subsequent changes in the banking system have tremendously reduced the possibility of another major banking crisis and in every year of operation assessment receipts of the FDIC have dwarfed its nominal losses. If the deposit-insurance reserve is not to be increased indefinitely, the insurance assessment rate should be geared to actual loss experience.

Some months ago the Board was asked by Congress for an expression of views concerning proposed legislation regarding the deposit insurance program, and accordingly the Board asked its staff to undertake a study of certain aspects of the program. This study has been circulated for comment to persons throughout the Federal Reserve System and now incorporates many of their suggestions. A copy was also sent several weeks ago to the Federal Deposit Insurance Corporation. In view of that agency's primary responsibility, I am naturally hesitant about offering a more specific answer to the committee's question regarding deposit insurance until I have had the benefit of their review.

VIII. Earnings of the Federal Reserve Banks and Their Utilization

> 1. Describe briefly the process by which the Federal Reserve banks create money, the kinds of money created, and the amount of outstanding money on June 30 of the various years since 1935 that owed its existence to its creation by the Federal Reserve. Include a description of the process and the extent of money creation by the Federal Reserve—(*a*) by dealing in Government debt; (*b*) by dealing in private debt of various kinds.

For the purpose of replying to this question, money will be defined as bank deposits, both demand and time at commercial and savings banks, and currency in circulation outside banks. The amounts of these money components or kinds of money which were outstanding on June 30 dates, 1935–49, are shown in the attached consolidated condition statement for banks and the monetary system. It will be noted from the consolidated statement (third line from the bottom) that on June 30, 1949, total deposits and currency amounted to approximately $172,000,000,000, compared with 53 billion in 1935 and nearly 80 billion in 1941. (For references to discussions of the definition of money, to more complete analyses of the sources and processes of monetary expansion and contraction, and to explanations of the figures referred to in this answer, see note attached to this answer and entitled "Technical References.")

In analyzing the sources of this money supply and its expansion, it is necessary to distinguish between those sources which supply reserve funds to banks and those which are extensions of credit by banks to the public. The first group includes monetary gold stock, Treasury silver purchases and other Treasury currency, and Federal Reserve bank credit. These elements may also be a direct source of money for the nonbanking public, but their principal significance is that they supply funds to banks, which may be used either to build up basic reserves or to obtain additional currency without depleting reserves. These basic reserves in turn provide the means for extensions of credit to the public through loans or the purchase of invest-

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ment securities by banks. Under a fractional system of reserves the amount of credit eventually extended by the banking system as a whole can be many times the amount of reserves added. This process is briefly explained below.

On June 30, 1949, as may be noted from the attached consolidated statement for banks and the monetary system, the total amount of deposits and currency was $172,000,000,000, or $119,000,000,000 more than on June 30, 1935. Of this increase nearly $20,000,000,000 was in the form of currency and nearly 100 billion in demand and time deposits. Specific items on the asset side of the statement, which portray in a sense the way in which the money supply has been created, cannot be directly related to those specific items on the liability side which represent the money supply; there are other so-called liability items representing principally the capital funds of the banking system. However, an examination of the consolidated statements over the period since 1935 provides a reasonably clear picture of the extent to which credit extension and other factors have been responsible for the expansion of the money supply.

The various asset items showed the following approximate increases:

	Billion dollars
Gold and Treasury currency	17
Holdings of United States Government securities:	
Federal Reserve banks	17
Other banking institutions	63
Bank loans and other securities	29

Thus it is evident that the principal source of monetary expansion in this period was purchases of Government securities by the banking system. The Federal Reserve purchased part of these securities directly and, thereby, along with the gold inflow, made it possible for banks to meet the heavy wartime demand for currency and at the same time purchase additional amounts of securities and expand their loans. To a large extent this monetary expansion was essential to finance the war and the postwar readjustment. It could have been diminished (1) through increased taxes to meet the Government's war cost; (2) through larger sales of securities to nonbank investors rather than to banks; or (3) to a small extent by more restraint in lending by banks, particularly in the postwar period.

The process by which Federal Reserve operations increase total deposits or currency outstanding and thereby create money may follow a variety of alternative courses at various stages. Hence any brief description must necessarily be illustrative rather than definitive. A typical sequence of events might arise where a nonbank holder of Government securities wishes to sell such securities and the Federal Reserve System in carrying out monetary and credit policy purchases the securities. Utilizing the established broker merchanism, the manager of the system open market account would purchase the securities for the account of the System. These securities would be paid for by the Federal Reserve Bank of New York by a Federal Reserve check, which the broker would deposit in his account at a commercial bank. That bank in turn would deposit this money in its reserve account at the Reserve bank. The effect of such a transaction is to create an additional deposit to the credit of the seller of the securities and also a corresponding increase in a member bank's reserve balance

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at the Reserve bank. Thus, not only is the total money supply increased but also the total of bank reserves, thereby providing the basis for a further multiple expansion of deposits. The process and the final effect, while varying in details, would be broadly similar in the case of any other payment by the Federal Reserve to a bank depositor.

In the case of an advance by the Federal Reserve to a bank or the purchase of securities by the Federal Reserve from a bank, the result would be an increase in member bank reserve balances, but no direct or immediate increase in a depositor's balance at a commercial bank. The additional reserves would, however, as in the other cases, supply the basis for a multiple expansion of credit.

The ability of the banking system as a whole to create money arises from the fact that when an individual bank using funds deposited with it expands loans or investments, an additional deposit is thereby created. This deposit is likely to be transferred from one depositor to another and from one bank to another without generally being withdrawn from the banking system. If the initial deposit is in the form of new reserve funds, as in the example given above, the bank retains the portion of reserves required to be kept against the additional deposits and lends or invests the remainder. These proceeds are then deposited either in another bank or in the same bank and carry with them reserves that become the basis for a further extension of credit. The extent of the potential multiple expansion that may result through this process from any increment of new reserves is determined by the amount of such new reserves available to banks, by the ratio of reserves to deposits which banks are required to maintain by law or by practices which they may observe as a matter of custom or judgment, and the forms in which the money is held. In the United States at present the ratio averages between 7 and 8 to 1.

Whether the potential expansion takes place also depends on the availability of loans and investments which the banks regard as acceptable. Receipts also have an influence on the result in that they may choose to hold their funds as deposits or take them in the form of currency, or to pay off a loan at (or buy securities from) a bank. In the last case, the banks would continue to have capacity to expand credit. During the 1930's banks had large excess reserves which were not used as a basis for further credit expansion because of the absence of demand for loans or of satisfactory investments.

It should be kept in mind that no individual bank can take a given amount of reserve funds and extend 5 to 10 times as much credit. This would be possible only in the unlikely case that the new credits remained indefinitely on deposit in that bank. As pointed out above, it is because the credits advanced are generally kept on deposit in some bank that the banking system as a whole can bring about a multiple expansion of credit and of money on the basis of a given amount of reserves.

Although it is incidental to the specific question, it may be relevant to point out that an important role of the Federal Reserve System

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is that of giving elasticity to the currency component in the money supply. The public may elect to hold its money either as deposits in banks or in the form of currency, and the relative amounts held in deposits and in currency are entirely determined by the preferences of the public. As public need or preference for currency increases and depositors withdraw cash banks are able to supply the demand by drawing upon their balances at the Reserve banks in exchange for currency, which the Federal Reserve can provide, if necessary, by issuing Federal Reserve notes. Banks replenish reserve balances, if necessary, by borrowing from, or selling securities to, the Federal Reserve. Before the establishment of the Federal Reserve System the supply of currency was limited and any increase in circulation caused a corresponding reduction in the basic reserves of the banking system, thus leading to forced liquidation and frequent monetary crises. Since the establishment of the System, a desire of the public to have more of its money in the form of cash rather than of bank deposits can be satisfied through Federal Reserve action without contraction in the volume of money or in the adequacy of bank reserves. An increase in the demand for currency can be met, without decreasing bank reserves, by discounting with a Federal Reserve bank or by the sale of a security to such a bank; and a return flow of currency can be used to liquidate a discount at or to purchase a security from a Federal Reserve bank and thus not add to bank reserves. This is the basis of currency elasticity in our banking system.

TECHNICAL REFERENCES

The composition and derivation of the figures given in the table is described in detail in Banking and Monetary Statistics, Board of Governors of the Federal Reserve System, Washington, D. C., 1943, pages 11–12, and in Morris A. Copeland and Daniel H. Brill, Banking Assets and the Money Supply Since 1929, Federal Reserve Bulletin, January 1948, pages 24–32.

It should be particularly noted that the figures include data for mutual savings banks and the Postal Savings System, as well as for the commercial banking system. This is because of the difficulty of drawing a precise line between savings deposits in these various groups and between savings deposits and demand deposits. The bulk of the process of money creation through credit expansion takes place through commercial banks. For a discussion of the problem of defining money see Woodlief Thomas, Money System of the United States, in Banking Studies, Board of Governors of the Federal Reserve System, Washington, D. C., 1941, pages 295–305.

For further discussion of the sources of bank reserves and for the process of credit expansion, see The Federal Reserve System, Its Purposes and Functions, chapters II and VIII, Board of Governors of the Federal Reserve System, Washington, D. C., 1947, and also the above-cited chapter on Money System of the United States in Banking Studies.

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Consolidated condition statement for banks and the monetary system, end of June dates, 1935–49—All commercial, savings, and Federal Reserve banks, the Postal Savings System, and Treasury currency funds [1]

[In millions of dollars]

Item	End of June dates														
	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949
ASSETS															
Monetary reserve	11,622	13,106	14,868	15,676	18,991	22,976	25,773	26,050	26,465	25,277	24,358	24,809	25,818	28,097	29,063
Gold stock	9,116	10,608	12,318	12,963	16,110	19,963	22,624	22,737	22,388	21,173	20,213	20,270	21,266	23,532	24,466
Treasury currency	2,506	2,498	2,550	2,713	2,881	3,013	3,149	3,313	4,077	4,104	4,145	4,539	4,552	4,565	4,597
Bank credit	47,565	51,823	53,197	50,877	53,325	55,050	61,387	67,932	96,563	125,517	153,992	163,485	156,297	157,958	156,491
Loans, net	20,191	20,627	22,391	20,965	21,310	22,346	25,305	25,080	22,234	25,361	27,948	31,570	38,373	45,299	47,148
U. S. Government obligations	17,498	20,743	20,605	20,409	22,483	23,389	26,984	34,226	66,434	92,609	118,041	122,740	107,873	101,451	97,428
Commercial and savings banks	14,258	17,323	16,954	16,727	18,770	19,689	23,539	30,299	57,740	75,737	93,655	95,911	82,679	76,774	74,877
Federal Reserve Banks	2,433	2,430	2,526	2,564	2,551	2,466	2,184	2,645	7,202	14,901	21,792	23,783	21,872	21,366	19,343
Other	807	990	1,125	1,118	1,162	1,234	1,261	1,282	1,492	1,971	2,594	3,046	3,322	3,311	3,208
Other securities	9,876	10,453	10,201	9,503	9,532	9,315	9,098	8,626	7,895	7,547	8,003	9,175	10,051	11,208	11,915
Total assets, net	59,187	64,929	68,065	66,553	72,316	78,026	87,160	93,982	123,028	150,794	178,350	188,294	182,115	186,055	185,554
LIABILITIES AND CAPITAL															
Total adjusted deposits and currency	49,070	53,910	56,592	55,966	60,151	66,124	73,400	80,126	102,113	116,666	138,403	157,821	164,140	165,695	165,626
Currency outside banks	4,783	5,222	5,489	5,417	6,005	6,699	8,204	10,936	15,814	20,881	25,097	26,516	26,299	25,638	25,266
Demand deposits adjusted [2]	20,433	23,780	25,198	24,313	27,355	31,962	37,317	41,870	56,039	60,065	69,053	79,476	82,186	82,697	81,877
Time deposits adjusted [3]	22,650	23,677	24,638	24,985	25,530	26,171	26,576	26,005	28,684	33,688	41,596	48,710	52,263	53,982	55,224
Postal savings deposits	1,204	1,231	1,267	1,251	1,261	1,292	1,303	1,315	1,576	2,032	2,657	3,119	3,392	3,378	3,259
U. S. Government balances	3,779	4,329	4,204	3,762	4,299	3,248	4,008	4,314	10,771	22,452	27,259	16,500	3,437	5,435	4,049
Treasury cash	2,866	2,497	3,445	2,303	2,563	2,186	2,275	2,187	2,268	2,296	2,279	2,251	1,314	1,327	1,307
At commercial and savings banks	811	1,142	666	599	792	828	753	1,837	8,048	19,506	24,381	13,416	1,367	2,180	2,304
At Federal Reserve banks	102	690	93	860	944	234	980	290	455	650	599	833	756	1,928	438
Foreign bank deposits, net	230	473	731	301	991	1,375	1,949	1,624	1,928	2,433	2,378	1,894	1,657	1,727	1,927
Total deposits and currency	53,079	58,712	61,527	60,029	65,441	70,747	79,357	86,064	114,812	141,551	168,040	176,215	169,234	172,857	171,602
Capital and miscellaneous accounts, net	6,108	6,217	6,538	6,524	6,875	7,279	7,803	7,918	8,216	9,243	10,310	12,079	12,882	13,200	13,952
Total liabilities and capital, net	59,187	64,929	68,065	66,553	72,316	78,026	87,160	93,982	123,028	150,794	178,350	188,294	182,115	186,055	185,554

[1] Treasury funds included are the gold account, Treasury currency account, and exchange stabilization fund.
[2] Demand deposits, other than interbank and U. S. Government, less cash items reported as in process of collection.
[3] Excludes interbank time deposits; U. S. Treasurer's time deposits, open account; and deposits of Postal Savings System in banks.

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2. Prepare a statement showing the earnings of the Federal Reserve banks as a group and the utilization of those earnings for each year since 1939. Show separately the earnings on United States Government securities and on other credit, dividends to member banks, payments to the Treasury, and additions to surplus.

Current earnings of Federal Reserve banks, 1939–48

Year	U. S. Government securities	Discounts and advances	Purchased bills	Industrial loans	Commitments to make industrial loans	All other	Total
1939	$36,903,367	$60,898	$2,323	$615,169	$128,577	$790,331	$38,500,665
1940	42,174,224	51,188		451,501	97,672	763,220	43,537,805
1941	40,151,501	55,934		399,319	90,270	683,071	41,380,095
1942	51,404,012	64,521		474,370	101,050	618,751	52,662,704
1943	68,089,456	151,915		414,281	48,904	601,159	69,305,715
1944	102,809,518	724,113		302,980	22,045	533,173	104,391,829
1945	139,552,881	1,977,081	110	100,755	12,533	566,186	142,209,546
1946	147,124,827	2,497,339	42,872	37,676	15,298	667,021	150,385,033
1947	155,563,861	2,194,546	3,890	60,438	19,205	813,626	158,655,566
1948	298,903,034	4,370,951		42,099	14,385	830,349	304,160,818

Earnings and expenses of Federal Reserve banks, 1939–48

Year	Current earnings	Current expenses	Net earnings before payments to U. S. Treasury [1]	Dividends paid	Paid to U. S. Treasury (sec. 13b)	Paid to U. S. Treasury (interest on Federal Reserve notes)	Transferred to surplus (sec. 13b)	Transferred to surplus (sec. 7)
1939	$38,500,665	$28,646,855	$12,243,365	$8,110,462	$24,579		−$425,653	$4,533,977
1940	43,537,805	29,165,477	25,860,025	8,214,971	82,152		−54,456	17,617,358
1941	41,380,095	32,963,150	9,137,581	8,429,936	141,465		−4,333	570,513
1942	52,662,704	38,624,044	12,470,451	8,669,076	197,672		49,602	3,554,101
1943	69,305,715	43,545,564	49,528,433	8,911,342	244,726		135,003	40,237,362
1944	104,391,829	49,175,921	58,437,788	9,500,126	326,717		201,150	48,409,795
1945	142,209,546	48,717,271	92,662,268	10,182,851	247,659		262,133	81,969,625
1946	150,385,033	57,235,107	92,523,935	10,962,160	67,054		27,708	81,467,013
1947	158,655,566	65,392,975	95,235,592	11,523,047	35,605	$75,223,818	86,772	8,366,350
1948	304,160,818	72,710,188	197,132,683	11,919,809		166,690,356		18,522,518

[1] Current earnings less current expenses, plus profits on sales of U. S. Government securities and other additions to current net earnings, and less transfers to reserves for losses and contingencies and other deductions from current net earnings.

NOTE.—Each annual report of the Board of Governors contains a detailed statement of earnings and expenses of the Federal Reserve banks for the year.

3. What changes, if any, should be made in the ownership of the Federal Reserve banks? In the dividend rates of Federal Reserve stock?

This question is understood to refer to the ownership of the capital stock of the Federal Reserve banks. While this stock is owned by the member banks and they receive a 6-percent statutory dividend thereon, the Federal Reserve Act prescribes the ownership of this stock and the organization and operation of the Reserve banks in such manner that the relationship of the stockholders to the banks is quite different from that ordinarily existing between a corporation and its stockholders. Furthermore, in the event of liquidation of a Federal Reserve bank, any surplus remaining after the payment of all debts becomes the property of the United States.

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The basic provisions of law with respect to the ownership of Federal Reserve bank stock and dividends on such stock have remained unchanged since the Federal Reserve Act was originally passed in 1913. These provisions have worked reasonably satisfactorily and I would not recommend that they be changed at this time.

4. What changes, if any, should be made in the legislative provisions relative to the disposal of Federal Reserve earnings in excess of expenses?

Federal Reserve banks are essentially public-service institutions. They are operated for the benefit of commerce, industry, and agriculture—for the general economy of the country—and not for the purpose of making a profit.

The creation of Federal Reserve bank credit through lending and through purchases of securities incidentally yields an income to the Reserve banks. Ordinarily this income is sufficient to cover the general expenses and statutory dividend requirements of the Reserve banks and leave a balance, although some of the Reserve banks in certain years have operated at a loss. Such earnings as may accrue are an incidental result of monetary and credit policies which are designed, first and last, to serve the general public interest.

Because of their special character, the earnings of the Reserve banks are, and should be, treated differently from those of ordinary institutions. When the Reserve banks have a reasonable cushion of capital and surplus to protect their operations, as they now have, a large percentage of their earnings above expenses and statutory dividend requirements should be paid into the United States Treasury.

That is now being done under existing law. Therefore, I do not believe any change is needed at the present time in the provisions regarding the disposition of such earnings.

However, it may be of interest to review some of the background of the present procedure and explain some of the details of how it works.

The Federal Reserve Act as originally enacted in 1913 provided for the payment by the Federal Reserve banks of a portion of their net earnings to the United States as a franchise tax. As amended in 1919 the act provided that all net earnings should be paid into a surplus fund until it was equal to the subscribed capital of the Reserve bank, which is twice the amount of its paid-in capital, and thereafter 10 percent of net earnings should be paid into the surplus and the remaining 90 percent should be paid in to the United States as a franchise tax.

Under these provisions of law the Federal Reserve banks, to the end of 1932, paid franchise taxes to the United States Treasury amounting to $149,000,000, and at that time they had accumulated surplus accounts of $278,000,000, as compared with subscribed capital aggregating $302,000,000. By the Banking Act of 1933, which established the Federal Deposit Insurance Corporation, Congress required each Federal Reserve bank to pay an amount equal to one-half of its surplus on January 1, 1933, as a subscription to the capital stock of the FDIC (the stock provided for no dividend and was later retired by the FDIC paying the amount to the Treasury). These stock subscriptions amounted to $139,000,000 and reduced the surplus of the Federal Reserve banks to an equivalent figure, or considerably less

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than one-half of their subscribed capital. Congress, therefore, included a provision in the Banking Act of 1933 which eliminated the franchise tax of the Federal Reserve banks in order to permit them to restore their surplus accounts from future earnings.

Net earnings for the next 10 years were relatively small, and at the end of 1944 the combined surplus accounts of the Federal Reserve banks were less than 80 percent of their subscribed capital. During the next 2 years, however, net earnings increased substantially, due primarily to large holdings of Government securities accumulated through open market operations which were necessary to carry out System policies in the public interest. At the end of 1946 the subscribed capital of the Federal Reserve banks was about $374,000,000, of which half was paid in, and their combined surplus was about $467,000,000.

Under the circumstances the Board concluded in 1947 that it would be appropriate for the Federal Reserve banks to pay into the United States Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend. For this purpose the Board invoked the authority granted to it by section 16 of the Federal Reserve Act to levy an interest charge on Federal Reserve notes issued to the Federal Reserve banks and not covered by gold certificate collateral. The Board established on such Federal Reserve notes interest charges equal to approximately 90 percent of the net earnings after dividends of each of the Reserve banks, and consequently the Reserve banks have been paying into the Treasury approximately 90 percent of their net earnings since January 1, 1947.

Under this procedure, which is still in effect, Federal Reserve banks have paid approximately the following amounts into the Treasury from their net earnings: For the year 1947, $75,000,000; for the year 1948, $167,000,000; and for the year 1949 to September 30, $147,000,000; the aggregate for this period being $389,000,000. On September 30, 1949, the subscribed capital of the Federal Reserve banks was about $414,000,000, of which half was paid in, and the aggregate surplus was about $494,000,000.

As stated before, I believe that a large percentage of the earnings of the Federal Reserve banks above expenses and statutory dividend requirements should be paid into the United States Treasury in present circumstances. Since this is now being done under existing law, I see nothing to be gained by amending the statutory provisions on the subject.

Appendix to Chapter II

August 1949.

QUESTIONNAIRE ADDRESSED TO THE FEDERAL RESERVE BOARD

I. Objectives of Federal Reserve policy

1. What do you consider to be the more important purposes and functions of the Federal monetary and credit agencies? Which of these should be performed by the Federal Reserve?

2. What have been the guiding objectives of Federal Reserve credit policies since 1935? Are they in any way inconsistent with the objectives set forth in the Employment Act of 1946?

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3. Cite the more important occasions when the powers and policies of the System have been inadequate or inappropriate to accomplish the purposes of the System.

4. Would it be desirable for the Congress to provide more specific legislative guides as to the objectives of Federal Reserve policy? If so, what should the nature of these guides be?

II. Relation of Federal Reserve policies to fiscal policies and debt management

1. To what extent and by what means are the monetary policies of the Federal Reserve and the fiscal, debt management, and monetary powers of the Treasury coordinated?

2. Cite the more important occasions since 1935 when Federal Reserve policies have been adjusted to the policies and needs of the Treasury.

(*a*) What were the principal areas of agreement and what were those of conflict between the two agencies?

(*b*) In what way were the differences adjusted?

(*c*) When there were differences of opinion between the Secretary of the Treasury and the Federal Reserve authorities as to desirable support prices and yields on Government securities, whose judgment generally prevailed?

3. What were the principal reasons for the particular structure of interest rates maintained during the war and the early postwar period?

4. Would a monetary and debt management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?

5. In what way might Treasury policies with respect to debt management seriously interfere with Federal Reserve policies directed toward the latter's broad objectives?

6. What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury objectives and policies in the field of money, credit, and debt management?

(*a*) What changes in the objectives and policies relating to the management of the Federal debt would contribute to the effectiveness of Federal Reserve policies in maintaining general economic stability?

(*b*) What would be the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board? Would you favor such a provision?

III. International payments, gold, silver

1. What effect do Federal Reserve policies have on the international position of the country? To what extent is the effectiveness of Federal Reserve policy influenced by the international financial position and policies of this country? What role does the Federal Reserve play in determining these policies? In what respects, if any, should this role be changed?

2. Under what conditions and for what purposes should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effect would an increase in the price of gold have on the effectiveness of Federal

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Reserve policy and on the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

3. What would be the principal advantages and disadvantages of restoring circulation of gold coin in this country? Do you believe this should be done?

4. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

IV. Instruments of Federal Reserve policy

1. What changes, if any, should be made in the law governing the reserve requirements of member banks? In the authority of the Federal Reserve to alter member bank reserve requirements? Under what conditions and for what purposes should the Federal Reserve use this power? What power, if any, should the Federal Reserve have relative to the reserve requirements of nonmember banks?

2. Should the Federal Reserve have the permanent power to regulate consumer credit? If so, for what purposes and under what conditions should this power be used? What is the relationship between this instrument and the other Federal Reserve instruments of control?

3. What, if any, changes should be made in the power of the Federal Reserve to regulate margin requirements on security loans?

4. Should selective control be applied to any other type or types of credit? If so, what principles should determine the types of credit to be brought under selective control?

5. In what respects does the Federal Reserve lack the legal power needed to accomplish its objectives? What legislative changes would you recommend to correct any such deficiencies?

V. Organization and structure of the Federal Reserve System

1. In what respects, if at all, is the effectiveness of Federal Reserve policies reduced by the presence of nonmember banks?

2. What changes, if any, should be made in the standards that banks must meet in order to qualify for membership in the Federal Reserve System? What would be the advantages of such changes?

3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies? In the size, terms, and method of selection of the Board of Governors? In the Open Market Committee? In the Boards of Directors and officers of the Federal Reserve banks? What would be the advantages and disadvantages of the changes that you suggest?

VI. Relation of the Federal Reserve to other banking and credit agencies

1. What are the principal differences, if any, between the bank examination policies of the Federal Reserve and those of the FDIC and the Comptroller of the Currency?

2. To what extent and by what means have the policies of the Federal Reserve been coordinated with those of the FDIC and the Comptroller of the Currency where the functions of these agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination? To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks?

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3. What would be the advantages and disadvantages of providing that a member of the Federal Reserve Board should be a member of the Board of Directors of the Federal Deposit Insurance Corporation? Would you recommend that this be done? Should the Comptroller of the Currency be a member of the Federal Reserve Board?

4. In what cases, if any, have the policies of other Government agencies that lend and insure loans to private borrowers not been appropriately coordinated with general monetary and credit policies?

5. What changes, if any, should be made in the powers of the Federal Reserve to lend and guarantee loans to nonbank borrowers? Should either or both of these powers be possessed by both the Federal Reserve and the Reconstruction Finance Corporation? If so, why? If not, why not?

6. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

VII. Deposit insurance

1. What changes, if any, in the laws and policies relating to Federal insurance of bank deposits would contribute to the effectiveness of general monetary and credit policies?

VIII. Earnings of the Federal Reserve banks and their utilization, 1940–

1. Describe briefly the process by which the Federal Reserve banks create money, the kinds of money created, and the amount of outstanding money on June 30 of the various years since 1935 that owed its existence to its creation by the Federal Reserve. Include a description of the process and extent of money creation by the Federal Reserve—

(*a*) By dealing in Government debt;
(*b*) By dealing in private debt of various kinds.

2. Prepare a statement showing the earnings of the Federal Reserve banks as a group and the utilization of those earnings for each year since 1939. Show separately the earnings on United States Government securities and on other credit, dividends to member banks, payments to the Treasury, and additions to surplus.

3. What changes, if any, should be made in the ownership of the Federal Reserve banks? In the dividend rates on the Federal Reserve stock?

4. What changes, if any, should be made in the legislative provisions relative to the disposal of Federal Reserve earnings in excess of expenses?

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CHAPTER III

REPLIES BY THE PRESIDENTS OF THE FEDERAL RESERVE BANKS

Introduction

Copies of the questionnaire appearing as an appendix to this chapter were sent to the presidents of all 12 Federal Reserve banks in order to give each a chance to register his ideas, and every president did submit his own reply to the subcommittee. But in order to conserve time and effort the Reserve banks appointed a special research committee made up of their own personnel to draw up a set of draft replies. As it turned out, most of the Reserve bank presidents agreed substantially with the System answers. It has therefore been possible to conserve space and publishing costs without undue sacrifice of content by reproducing the System answer to each question, and by including the replies of the individual Reserve bank presidents only where they differ substantially from the System answer or add significantly to it. Mere differences in phraseology and minor differences in content and emphasis have not been included.

I. Objectives of Federal Reserve Policy

The System answer

The basic continuing objective of Federal Reserve policy has been to promote economic stability at high levels of employment and production. This general objective underlies the wide variety of phrases that have been used in the past four decades to describe the System's purposes in general and enumerate them in detail.

Agreement on this basic objective is clear, for example, in the following statements, even though the first was made in 1913 by the chairman of the Senate Committee on Banking and Currency and the second in 1946 by the Board of Governors:

> Senate bill No. 2639 is intended to establish an auxiliary system of banking, upon principles well understood and approved by the banking community, in its broad essentials, and which, it is confidently believed, will tend *to stabilize commerce and finance*, to prevent future panics, and place the Nation upon an era of *enduring prosperity*.[1]
>
> It is the Board's belief that the implicit, predominant purpose of Federal Reserve policy is to contribute, insofar as the limitations of monetary and credit policy permit, to an economic environment favorable to the *highest possible degree of sustained production and employment*.[2]

This broad objective on which there is agreement covers a number of intermediary and more detailed objectives. It is with respect to

[1] Statement of Robert L. Owen, chairman of the Committee on Banking and Currency of the U. S. Senate, appearing at p. 1 in Sen. Doc. No. 117 of the 63d Cong., 1st sess. (The strategic words have been italicized.) See also p. 3 of S. Rept. No. 133 of the same session.

[2] Thirty-second Annual Report of the Board of Governors of the Federal Reserve System, p. 1. (The strategic words have been italicized.)

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these intermediary objectives and their relative importance that there will always be significant differences of opinion. Judgment with respect to guiding objectives of policy is necessarily based on the experience of the System in developing such guides to meet widely different conditions and developments. A brief review of some of the significant aspects of this experience is a suitable background to consideration of specific questions concerning objectives.

Initially it was believed that the System would make the greatest contribution toward stable prosperity if the Federal Reserve banks limited their discounting to self-liquidating paper "arising out of actual commercial transactions." The Federal Reserve Act was based on the so-called real-bills doctrine. The Federal Reserve Board was given power to define paper eligible for discount. The importance of this power arose from the belief that the proper definition of "eligibility" was fundamental to achieving the objectives of the System. The regulations, and particularly the elaborate rulings, with respect to eligibility reflect this belief that proper administration of Federal Reserve credit depended on the characteristics of the paper accepted for discount.

Experience did not bear out these sanguine hopes and beliefs. The First World War could not have been financed on the basis of the real-bills doctrine. The act in fact was amended in 1916 to authorize the Reserve banks to make advances to member banks upon notes secured by Government securities as well as eligible paper. Developments after the First World War demonstrated that eligible paper itself can be issued in amounts sufficient to finance a boom, that self-liquidating paper is not liquid in an emergency, and that its liquidation in large amounts can accentuate a depression.

This experience did not result in basic changes in the law concerning eligibility, but it did confirm the inadequacy of eligibility rules as a means of promoting economic stability. During the decade of the twenties, the System authorities developed open-market operations and changes in discount rates as coordinate instruments of monetary policy. They sold securities and increased rates when business and speculative activity appeared excessive; they bought securities and reduced rates in times of business depression. The powers of the Reserve banks to discount and make advances were not enlarged substantially until the depression of the early 1930's, when experience demonstrated that eligibility rules were a positive deterrent to aiding banks suffering from large losses of deposits. The initial enlargements were on an emergency basis only. The orginal principle of regulating credit through eligibility rules was not abandoned in the law until 1935, when it was provided that—

> Any Federal Reserve bank * * * may make advances to any member bank on its time or demand notes * * * which are secured to the satisfaction of such Federal Reserve bank.

Experience with the real-bills doctrine adds important support to the conclusion of the System that the law should specify only general objectives. To establish intermediate objectives as final goals is likely in practice to produce unforeseen and undesirable results. Automatic, specific legal directives on credit policy are inappropriate and inadequate alternatives to judgment based on experience. Some observers, of course, take a different view on the ground that the particular doctrine was poorly chosen and that another specific intermediary

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objective would produce the best results. They minimize the importance of the fact that the real-bills doctrine had widespread support, Its inclusion in the law seriously limited the ability of the System to act appropriately in a critical period. In view of this experience, it does not appear appropriate to give absolute priority to any single intermediary objective, however cogent the arguments that may presently be made in its support.

A large number of specific criteria have been suggested from time to time, either singly or in specific combination, as a means of achieving appropriate monetary policy without the use of judgment by the authorities. Thirteen such possible criteria were listed in a questionnaire prepared by the Senate Committee on Banking and Currency in 1939.

Most of these criteria have been found useful by the System authorities from time to time in indicating conditions calling for action. But none of them, singly or in specific exclusive combination, has been found adequate to serve as an unerring guide to policy. It is frequently true, of course, that developments in one or more of these guides to policy, however unwelcome, are beyond the scope of powers now vested in the Federal Reserve System or likely to be vested in any central banking organization.

Reply of Allan Sproul, Federal Reserve Bank, New York

In any general statement outlining the principal objective of Federal Reserve policy, namely, the promotion of economic activity at high levels of production and employment, stress must be placed on the two-way aspect of monetary controls. At times monetary ease will be appropriate, and, at other times, monetary restraint. Some of the enthusiasts for a "full-employment policy" have occasionally implied a need for continuous stimulation of the economy from the monetary sector. This would probably mean the use of monetary powers to promote a state of perpetual inflation; a self-defeating policy. The objective of stable economic progress is best pursued by checking the stimulating influence of new money creation in the face of inflationary tendencies, whatever their cause, and bringing about some restraint, insofar as this can be done by monetary action, before the danger point has been reached. The general answer to your first question was deficient, perhaps, in not making this point.

Your first question under subsection 1 of section I was also deficient in that it seemed to recognize a number of Federal monetary and credit agencies with coequal powers. The development of a national monetary and credit policy is the responsibility of the Federal Reserve System, given to it by the Congress. This is not a function which can be split up and passed around. Many of the activities of other Government agencies engaged in making particular types of loans, or guaranteeing loans, or conducting bank examinations, or "insuring" bank deposits, have a bearing on the way this policy actually works out; but monetary control, as such, is the System's responsibility. It is only the service functions performed by the Federal Reserve System which are comparable to the operations of these other agencies. The distribution of these incidental servicing duties among governmental agencies can be largely determined by administrative convenience, and historical precedent, so long as there are arrangements for consultation to avoid undesirable differences in policies

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and practices. But over-all responsibility for holding the reserves of the banking system, and for influencing the creation of credit by varying the cost and availability of those reserves according to the monetary and credit requirements of the economy, can only reside in the one agency designated by Congress as the national monetary authority. The Federal Reserve System is not just one of a number of Federal agencies; its duties and responsibilities range over the whole of our economy and touch the lives of all of our people.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The basic continuing purpose of the Federal Reserve System has been to promote economic stability at high levels of employment and production. The future of our free competitive economic organization depends on the degree to which this goal is achieved. The problems of economic stability, however, are complex. Despite centuries of intense effort and study, we have not yet found satisfying solutions. Experience should warn us that expectations that the Federal Reserve System or any other agency can produce stability in some simple, easy way will be doomed to disappointment.

Experience demonstrates that no single individual or institution holds a magic key to sustained prosperity. If our search for solutions is to be successful, all agencies must understand how the parts of our economy fit together and how they may be made to work together most effectively. It is not even possible to separate the parts with precision; they mesh so intimately that it is impossible to say, except arbitrarily, where one leaves off and another begins. Stability is inherently a collective responsibility.

It is not feasible to describe the role of all segments in promoting stability, but it is worth while to mention and describe a few to illustrate the nature of our problem. Since we have a money and credit economy, a heavy share of responsibility rests on those who determine fiscal and monetary policies. The three major agencies in these fields are the Congress, the Treasury, and the Federal Reserve System.

The Congress is responsible for expenditures and receipts and therefore for the cash surplus or deficit of the Federal Government. The Members of Congress are subjected to continuous pressures to increase expenditures for particular purposes and to reduce or eliminate particular taxes. Many individual decisions to tax and spend are made with reference to merits other than their contribution to stability. Obviously there are other merits of varying importance, including some that may be considered compelling. At the same time, however, if too many important decisions are based on other considerations, economic stability may inadvertently be sacrificed in the process. In that event, expenditures and receipts, and therefore deficits and surpluses, are likely to be merely the sums of items that have been determined with little reference to the totals. Yet the totals as well as the individual items have widespread repercussions on economic stability.

The Treasury takes up where the Congress leaves off. Decisions of earlier Congresses largely determine the magnitude of the debt, and decisions of the current Congress largely determine the rate of increase or decrease in the debt. A basic responsibility of the Treasury is the management of the public debt and the cash balance. The Treasury is naturally interested in maintaining public confidence in Government securities and in financing them as cheaply as possible. The rate

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paid on Government securities, however, affects much more than the cost of servicing the debt. It influences also the willingness of investors to hold the securities and the flow of expenditures throughout the whole economy. Too low a rate stimulates expenditures and exerts an upward pressure on prices of goods and services, including those purchased by the Government. The debt-management policies of the Treasury, therefore, have important influences on economic stability.

The Federal Reserve System has primary responsibility for monetary policy. It influences the flow of expenditures in the economy primarily through use of instruments which affect the supply, availability, and cost of money. A program of monetary ease—increasing the supply and availability and reducing the cost—tends to encourage expenditures, and a program of monetary restraint tends to discourage expenditures. Federal Reserve policy, therefore, is an extremely important but by no means the only force influencing the flow of expenditures.

The policy of each of these major fiscal, debt management, and monetary agencies influences and, in turn, is influenced by those of the others. It may either reinforce or impair their effectiveness. At the over-all level, in a period of inflation, for example, congressional action which produces a surplus would make easier both the Treasury's problem of managing the debt and the System's task of restricting credit. A deficit, on the other hand, would aggravate the problems of both the Treasury and the System.

The full network of relationships between the three agencies is not limited to aggregates, such as the size of the surplus or deficit. For example, the maturity distribution of outstanding Government securities as well as the size of the debt conditions monetary policy. There are circumstances, of course, such as deficits arising from wartime finance, under which the public interest prevents the activities of one agency from reinforcing those of the others. Nevertheless, promotion of economic stability depends on pursuit of coordinated and complementary policies on the part of the three agencies.

There is a tendency to focus almost exclusive attention on fiscal, debt management, and monetary policies as unique ways in which to achieve economic stability. It is therefore particularly important to recognize the inevitable relationship to this problem of actions by others. This inherent relationship may be illustrated with an example chosen from the field of labor-management relations. Negotiations in a basic industry that result not in a new contract but in a work stoppage clearly jeopardize the stability of the whole economy. An actual work stoppage affords a clear-cut demonstration that monetary and fiscal policy alone cannot assure stability. Such policies cannot make up the loss in output.

Labor-management negotiations affect economic stability even when they result in new contracts without work stoppage. Such contracts affect not only the distribution of income between the contracting parties but also the amount of income to be distributed and ultimately the flow of expenditure through the entire economy. If, for example, the rates generally are set too high, the monetary and fiscal authorities are likely to be confronted with choosing between permitting an expansion in the money supply to support higher costs and rising prices on the one hand and unemployment on the other. If, on the other hand, rates generally are set too low, the monetary and fiscal authori-

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ties may be faced with choosing between equally undesirable alternatives. The important point is not the exact alternatives confronting the monetary and fiscal agencies but that no monetary and fiscal policy, however well conceived and executed, can achieve economic stability in the face of inappropriate contracts.

Pricing policies of corporations also have an important bearing on economic stability. The effects of maintaining prices by reducing output and employment in the face of declining markets are very different from those resulting from reductions in prices. Similarly, decisions of business with respect to investment in plant, equipment, and inventory influence the flow of expenditures and the level as well as the character of economic activity.

Decisions of individuals affect economic stability. Federal Reserve policies affect the amount available for expenditure. Individuals decide whether and for what they will spend. In the aggregate, personal income accounts for roughly four-fifths of gross national product, so that the total of individual decisions with respect to consumption, saving, and investing exerts a powerful influence not only on the distribution of our productive resources but also on the general level of economic activity. If, when resources are fully employed, people generally spend and invest more than their income—by borrowing and perhaps calling on past savings to do so—they will enlarge the flow of spending without enlarging correspondingly the flow of goods and services. The effect is inflationary.

These few illustrations from fields outside the fiscal, debt management, and monetary areas have been analyzed in order to emphasize the comprehensive nature of the responsibility for economic stability. One may view the role of the private, nonfinancial sector of our economy as a whole. This sector, like the governmental sector, may operate with a cash surplus or a cash deficit. The net effect will be reflected in changes in the indebtedness of the private sector to the banking system. An excess of receipts over expenditures exerts a depressing effect and an excess of expenditures over receipts exerts an inflationary effect. It is possible, of course, to construct so-called models of our economic system, which make it appear that appropriate fiscal and monetary policy would exactly offset the net results of all nonmonetary decisions and thus produce economic stability at a high and continuously rising level of employment and production. The basic weakness of such models is that they omit many of the fundamental characteristics of the human world in which we live.

It is clear also that the very essence of stability lies in timing. An act that contributes to stability under one set of conditions will aggravate instability under another set. Thus a governmental, or a private, cash surplus contributes to stability when we are threatened by excess expenditures; but such surpluses add to depression when we are already threatened by inadequate demand. Proper timing, in turn, presupposes flexibility or the ability and willingness to change a program of action to suit conditions as they develop.

A direct responsibility for promoting economic stability rests on those who determine fiscal, debt management, and monetary policies. It is important, however, to comprehend that these agencies cannot separately or collectively do the whole job.

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1 (*a*). What do you consider to be the more important purposes and functions of the Federal monetary and credit agencies?

The System answer

The broad over-all purpose of Federal monetary and credit agencies is to assure that money and credit will contribute as much as possible to an economic environment favorable to the highest possible degree of sustained production and employment. The general policies and programs directed toward this purpose are described in answers to other questions. Basically, they are concerned with adjusting the supply, availability, and cost of money to the changing needs of the economy.

In addition to this general purpose, these agencies perform specific functions with respect to credit aspects of particular segments of the economy and also provide many related services indispensable to efficient operation of a money and credit economy. Any attempt to give in abbreviated form these specific functions and related services is bound to be inadequate. Several major groups of them, however, may be described.

One important group consists of those services that are needed to assure that the public may at all times exchange freely the various types of money (deposits, currency, coin). This service involves a large number of functions, such as coinage, printing and engraving, issuance, redemption, deposit insurance, bank supervision, provision of reserves.

Another group of services is provision for an efficient means of effecting payments and settling balances—machinery for clearing and collecting checks and noncash items, such as maturing obligations.

Yet another necessary service is providing the Government with an efficient means of handling its vast financial operations.

Among the specific functions with respect to credit aspects of particular segments of the economy is that of assuring the availability of funds to qualified borrowers for designated purposes on reasonable terms.

1 (*b*). Which of these should be performed by the Federal Reserve?

The System answer

Determination of which of these functions should be performed by the Federal Reserve, as the agency charged with paramount responsibility for the national monetary and credit policy, is a matter not only of logical nicety but also of conditions as they have developed in the United States. For example, a strong logical case can be made for having only one type of currency and having that currency issued by the Federal Reserve. However, so long as other types of currency are strictly limited to an amount far below the minimum total currency requirements of the country, they create no serious difficulties, although they are an unnecessary complexity in our monetary system.

Assignment of particularly important functions that are performed by more than one Federal agency is discussed in answers to the relevant questions below.

With these qualifications in mind, the major functions that should be performed by the Federal Reserve are:

Determination and administration of the over-all monetary and credit policy of the country.

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Participation in operations and decisions relative to the international position of the country and the international value of the currency.

Holding the legal reserves of commercial banks.

Issuing and redeeming currency.

Providing facilities for the collection and clearance of checks and other items incidental to the flow of payments.

Supervision of member banks.

Service as fiscal agents of the United States Government.

2 (a). What have been the guiding objectives of Federal Reserve credit policies since 1935?

The System answer

In 1935 the Nation was still short of full recovery and the System continued the policy of monetary ease which it had been following since the beginning of the depression. By 1935 this policy was being implemented not by positive action of the System but by allowing imports of gold to have an easing effect. In 1936 and 1937, while continuing the general program of monetary ease, the System increased reserve requirements to avoid the likelihood of future injurious credit expansion based on the large excess reserves accruing from continued gold imports. In 1938 the System participated in the general program for economic recovery by reducing Reserve requirements.

In the interval between the outbreak of war in Europe and the attack on Pearl Harbor, the principal objective of System policy was, first to exert a stabilizing influence against the uncertainties of the early war period, and then in 1941 to restrain the gradually developing inflationary pressures.

After 1941, the emphasis shifted to assuring the Government that it would be able to raise the funds it needed to finance the war effort with a minimum of disturbance to economic stability. Developments during this period are given in more detail in the answers to the questions in section II below. The more specific guiding objectives were to secure as much of the needed funds as possible outside the banking system, to provide the banking system with the reserves needed to acquire the residual amount of securities, and to avoid the necessity of financing the war at progressively rising interest rates.

After the war the System continued to pursue the general objective of restraining monetary expansion to the extent this could be done without creating unstable conditions in the market for Government securities. Restraint in the postwar period was exercised by the System not only directly but also in cooperation with the Treasury, especially in the administration of the large cash surplus. The collection of the funds by the Treasury reduced the privately owned money supply. The transfer of these funds from commercial banks to the Federal Reserve banks absorbed reserves. Since the funds were used primarily to redeem maturing issues held by the System, the banks were put under pressure in order to replenish their reserves. Increases in Reserve requirements on several occasions in 1948 put banks under similar pressure. Other measures of credit restraint taken by the System were discontinuance of a preferential rate on discounts secured by short-term Government securities in April 1946, gradual increases in yields on short-term Government securities and in discount rates

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beginning in July 1947, reduction in the support prices of longer-term Government securities in December 1947, and reimposition of the regulation of consumer installment credit.

Early in 1949, when evidence accumulated that inflationary pressures had been checked, the System inaugurated a program of relaxing the restraints on credit. The first steps were relaxation in restrictions on consumer credit and stock-market credit. These were followed by successive reductions in member bank Reserve requirements. On June 28, 1949, the Federal Open Market Committee announced that it would thereafter "be the policy of the Committee to direct purchases, sales, and exchanges of Government securities by the Federal Reserve banks with primary regard to the general business and credit situation."

2 (*b*). Are they in any way inconsistent with the objectives set forth in the Employment Act of 1946?

The System answer

The guiding objectives of Federal Reserve credit policy are thoroughly consistent with the objectives set forth in the Employment Act of 1946. Section 2 of this act provides:

> The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

In addition, section 4 (c), which defines the duty and function of the Council of Economic Advisers to the President, includes the following provision:

> to develop and recommend to the President national economic policies, to foster and promote free competitive enterprise, to avoid economic fluctuations or to diminish the effects thereof, and to maintain employment, production, and purchasing power.

Federal Reserve policy has generally been directed to these same objectives throughout the life of the System. Thus, during both the First and the Second World Wars the objective of national policy was to achieve victory and the essential consideration of the System was to assure war financing with a minimum of disturbance to economic stability. In the interval between the two wars, the System tried to mitigate economic fluctuations by easing credit when employment, production, prices, and purchasing power were declining, and by firming credit when the economy was experiencing inflationary tendencies which threatened subsequent collapse.

For 3 years after the termination of the Second World War the System exercised such restraint on inflationary expansion as it could without, however, risking the disruptive effects on the economy that might have followed had serious disorder been permitted to develop in the Government securities market. Finally, as evidences of recession appeared early in 1949, it relaxed restraint on credit to help maintain production and purchasing power.

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3. Cite the more important occasions when the powers and policies of the System have been inadequate or inappropriate to accomplish the purposes of the System.

The System answer

Adaptation of the Federal Reserve System to changing conditions is frequently reflected in amendments to the law. An indication of the frequent need for adjustment is the fact that the Federal Reserve Act has been amended in 27 of the 35 years that the System has been in existence. Many of the changes, of course, have been relatively minor in character; but some of them have been fundamental.

Early illustrations of inadequate authority occurred during the inflationary boom and subsequent depression that followed the First World War. In the fall of 1919, the Reserve System was deterred from adopting a policy of restraint for several months because of Treasury opposition to any action that might interfere with the "digestion" of the Victory loan. After the collapse of the inflation, it would appear (with the benefit of hindsight) that a more appropriate policy would have been to ease credit sooner and more vigorously. At the time, however, the gold holdings of the Reserve banks were near the legal minimum. Without a change in the law or a suspension of reserve requirements, therefore, the System was not in position to expand.

In an effort to promote general stability, the System in 1928 and 1929 described its twofold objective in these words:

> The problem was to find suitable means by which the growing volume of security credit could be brought under orderly restraint without occasioning avoidable pressure on commercial credit and business.

Its powers, however, were inappropriate to accomplish this dual objective. This defect was ameliorated by authorizing the Board to prescribe margin requirements with respect to loans on securities and to prohibit certain types of financing of security trading.

The powers of the System were inadequate and to some extent inappropriate to deal with the depression that began in 1929. In large part the legal limitations were based on the real bills doctrine, described above. The eligibility provisions of the Federal Reserve Act limited unduly the amount of credit the Reserve System could extend. Such limitations, after numerous modifications, were finally removed in 1935. Similarly, the collateral requirements for Federal Reserve notes severely restricted the extent to which the System could engage in open-market operations. These limitations were alleviated in 1932 for a temporary period. After several extensions of time, the provision allowing Government securities to serve as collateral was made permanent in 1945.

At various times, as described in section IV below, the power of the System to absorb actual or potential excess reserves has been inadequate because of the magnitude of additions to reserves arising from sources such as gold inflows, because the Board's authority over reserve requirements applies only to member banks, and because use of open-market operations and discount rates was inhibited by a desire to avoid interference with the management of the public debt and adverse effects on the public's appraisal of Government obligations.

There are also a number of existing legal impediments to effective and efficient operation of the System. Although none of these is as serious in itself as the limitations that have been described, collectively

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they add to a considerable total. Among these limtations are: Inadequate legal authority to regulate bank holding companies effectively; too rigid capital requirements for membership and for member banks with branches; unnecessary requirements concerning segregation of collateral against Federal Reserve notes; unnecessary prohibition against a Federal Reserve bank paying out notes of another Federal Reserve bank; and expiration on June 30, 1950, of authority of the Federal Reserve banks to purchase Government obligations directly from the Treasury.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

On the whole, I agree with the draft reply and even with the statement that—

> the power of the System to absorb actual or potential excess reserves has been inadequate because * * * use of open-market operations and discount rates was inhibited by a desire to avoid interference with the management of the public debt and adverse effects on the public's appraisal of Government obligations.

I believe the statement to be a correct representation of the facts with regard to the attitude of a majority of those in the System charged with responsibility for policy but I am not fully in sympathy with that position because, as I indicate in my reply to question II–1, below, I believe more determined steps could and should have been taken to absorb some of the excess reserves through use of open-market operations and a more flexible policy as to support prices of governments.

4. Would it be desirable for the Congress to provide more specific legislative guides as to the objectives of Federal Reserve policy? If so, what should the nature of these guides be?

The System answer

The way in which our economy actually operates and the role of money and credit in those operations are extremely complex. The relative importance of specific objectives will vary, depending on actual developments.

It is almost certain that no single specific objective of Federal Reserve policy would prove equally appropriate for prosperity and depression, for defense, war, reconstruction, and peace. An alternative to the single specific objective is a list which enumerates a number of specific objectives. Such a list may be either illustrative or inclusive. If it is illustrative only, it accomplishes nothing that would not be accomplished by a statement of more general objectives. If such a list is meant to be inclusive, however, it may either be made so extensive—to cover all foreseeable circumstances—as to be in effect a general direction, or it may be so short as to omit desirable objectives.

Such considerations bolster the conclusion based on the actual operation of the System under widely changing conditions over a long period of time that legal directions as to objectives will accomplish most in the long run if they are general in character. Experience has demonstrated that enactment of permanent detailed rules does not prevent undesirable developments, but it may and almost certainly will hinder, as it has in the past, the handling of critical conditions that were not anticipated at the time the legislation was enacted.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

Experience has demonstrated that enactment of permanent detailed rules does not prevent undesirable developments, but it may and almost certainly will hinder, as it has in the past, the handling of critical

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conditions that were not anticipated at the time the legislation was enacted. Yet another danger is that detailed legislative rules encourage the public to expect more than can in fact be accomplished. The inevitable disappointment creates new problems.

The congressional declaration of national economic policy in the Employment Act of 1946 is general rather than specific. It would be desirable, as is indicated in the answer to question VI–6, to direct all fiscal, monetary, and credit agencies to promote these same objectives.

II. Relation of Federal Reserve Policies to Fiscal Policies and Debt Management

The System answer

Federal Reserve policies are carried out through the System's influence upon the cost and availability of credit. Government securities now account for more than one-half the dollar volume of credit instruments outstanding in the economy. Clearly, any congressional action which results in increasing or reducing the volume of Government debt, or any Treasury decisions concerning the management of that debt, will necessarily condition the effectiveness of the general credit policies undertaken by the Federal Reserve System. Furthermore, since direct action in the money market by the Federal Reserve System is mainly exercised through purchases and sales of Government securities, and since Reserve System action to influence the availability of credit affects interest rates, the Federal Reserve System is at all times affecting the environment in which Treasury financing activities take place.

Moreover, System influence upon the cost and availability of credit is, in turn, significant as an influence upon the flow of expenditures in the economy. Government has become an increasingly important contributor to aggregate expenditures in recent years, and rising taxes have caused major shifts within the spending stream. Government expenditures and taxes, therefore, exert influences upon the flow of money and income which may, at times, run parallel to those exerted by monetary and credit policy, and which may at other times have contrary effects—thereby increasing those disturbances to economic stability which monetary policy attempts, within modest limits, to offset.

Broadly speaking, while the fiscal policy which emerges from the grand aggregate of all congressional decisions on expenditures and taxes should be roughly consistent with the general aim of restraining inflation, or moderating deflation, no precise and flexible use of fiscal policy is practicable. Treasury financing of the deficits which result from congressional action, or the Treasury's use of surpluses as they arise, can always, however, be conducted in ways which are more or less consistent with general credit policy.

The same is true for the Treasury's management of the outstanding Government debt. In its decision on the types of securities to be offered, their term, and their yield, the Treasury exerts a direct influence upon conditions in the money market. It is in this sector, probably to a much greater extent than in that of congressional action concerning expenditures and taxes, that fruitful possibilities exist for coordination between Treasury policy and the national monetary and credit policy. Even with full and harmonious coordination, however,

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it must be recognized that these form but one of the many complexes of influences acting upon the money market, and through that market upon the general state of inflation, deflation, or sustained prosperity in the economy. Neither the Treasury nor the Federal Reserve System can ever assume responsibility for guaranteeing the maintenance of economic stability at high levels of employment and production; their influence, however, should be coordinated toward promoting achievement of that objective.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

Government securities now account for more than one-half of the dollar volume of credit instruments outstanding in the economy. Clearly, any congressional action which results in increasing or reducing the volume of Government debt, or any Treasury decisions concerning the management of that debt, will necessarily affect the results of credit policies undertaken by the Federal Reserve System. Furthermore, since the Federal Reserve System operates mainly through purchases and sales of Government securities, its actions are at all times affecting the environment in which Treasury financing activities take place.

Both System and Treasury policies affect the flow of expenditures in the economy. Government, because of the sharp rise in its receipts and expenditures in recent years, has direct influence over a major segment of the spending stream. Through its control over expenditures and taxes, the Government affects both the amount and the direction of the income-expenditure flow. Fiscal actions of the Government may run parallel to the actions of the monetary authorities, thus tending to supplement monetary policy, or they may tend to counteract the effects of money and credit policy.

Management of the outstanding Government debt is an important force in the money market, which may affect reserves and the money supply. Treasury decisions as to the types, maturities, and rates on securities to be offered exert a direct influence on conditions in the money market. The Federal Reserve actions affecting the supply and cost of credit influence the rate of interest and terms the Treasury must offer on new security issues. Debt management may affect the volume of bank reserves and the money supply. If new issues are offered on terms which are attractive mostly to banks, the tendency is to increase bank holdings and the money supply and vice versa.

Federal Reserve policies and fiscal and debt-management policies are closely interrelated. Either agency is in a position to influence the success of the policies of the other. While neither the Treasury nor the Federal Reserve System can assume full responsibility for guaranteeing the maintenance of economic stability at high levels of employment and production, their policies should be directed toward the achievement of this basic objective.

1. Would a monetary and debt management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?

The System answer

A policy of permitting higher interest rates during the period from January 1946 to late 1948 would have enabled the Treasury and the Federal Reserve System to pursue an even more restrictive monetary and debt-management policy than that which was actually undertaken.

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The objective of such a policy would have been a more effective restraint upon the supply and availability of borrowed funds in an effort to restrain certain expenditures in our economy financed by funds obtained in the credit and capital markets; a rise in interest rates would have been the concomitant (and not the precise objective) of such a policy. An appraisal of monetary and debt-management policies which would have produced higher interest rates must consider not only the more obvious direct effects upon inflationary pressures, but also the costs, uncertainties, and possible adverse effects of such alternative policies.

A more restrictive monetary and debt-management policy in the postwar period would have included higher rates on short-term Government securities, higher yields on Government bonds (with some prices probably below par), and lessened purchases of Government securities in the open market on behalf of the Federal Open Market Committee. The supply of reserve funds available to commercial banks as the basis for loan expansion would have been reduced. Life-insurance companies and other institutional investors would have had to accept capital losses in attempting to sell Government securities, and this might have discouraged transfer of some of their investments into corporate bonds, State and local government obligations, and mortgages.

The effectiveness of such a restrictive policy in restraining inflation must be appraised in terms of the many strong factors giving rise to the underlying inflationary condition. During the war individuals and businesses accumulated large holdings of money and Government securities as a result of the wartime deficits and the increase in the public debt. Heavy deferred demands and acute needs for many goods gave rise to tremendous expenditures. A rising spiral of costs and prices was supported by use of past savings and high incomes as well as by credit expansion. All these factors together gave rise to a situation in which total demand by consumers, businesses, and governments exceeded the capacity of the economy to supply goods and services. A restrictive monetary and debt-management policy resulting in higher interest rates would have restrained more effectively those expenditures which depended upon the use of borrowed funds. Total demands for goods and services might well have remained high, however, and some degree of inflation was inevitable as a result of the war.

The widespread repercussions throughout the economy in other directions, apart from lessening the contribution of new credit toward inflationary pressures, must also receive attention in considering a policy of higher interest rates. Such an alternative monetary and debt-management policy might have brought about grave disturbances in the market for Government securities, with damaging repercussions on our entire financial mechanism, as well as seriously adverse effects upon public confidence in the Government's credit. The interest cost on the public debt would have been increased, and the Treasury's refunding operations made more difficult. A policy of higher interest rates might have led to panic selling of marketable obligations, loss of confidence in financial institutions, and perhaps large redemptions of savings bonds. Moreover, a policy of higher interest rates might have had such restrictive effects on private financing as to bring about a sharp down-turn in business rather than merely to restrain infla-

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tion. Thus while greater freedom of action with respect to interest rates might have permitted some desirable further restraint, the Federal Reserve System would, nonetheless, have been compelled to proceed cautiously, reversing itself if other dangers became important. While it is unfortunate that further tightening of rates was not permitted, no categorical answer can be given as to how much that approach could have accomplished in lessening inflationary pressures during the first three postwar years. A greater effort should, however, have been attempted.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The answer to the question as phrased is "Yes," but equally pertinent is the question: "At what cost?" The period January 1946 to late 1948 was characterized by a plethora of money and liquid assets and a scarcity of goods. Restrictions on civilian production during the war created both a large backlog of demand for goods and a large accumulation of money and Government security holdings with which to buy them. The tremendous flow of expenditures reflected not only a high level of incomes, but also the conversion of Government securities and other liquid assets into cash and an expansion of credit which was facilitated by large bank holdings of Government securities which could be sold to the Federal Reserve at approximately fixed prices. The result was a rising spiral of prices, costs, and profits.

The problem confronting Federal Reserve authorities was not only one of checking inflation. It was one of checking inflation without precipitating a depression. The objective was clear, but how it could best be achieved in the face of a huge and unstable Federal debt, a tense international situation, and a shortage of goods was not so clear.

Basically, there were two courses of action which the Federal Reserve authorities could have taken. They could have used open market operations and other available instruments primarily to limit the supply of bank reserves and check credit expansion, leaving the price of Government securities and interest rates free to seek their own level. The other alternative was to have pursued a twofold objective of maintaining a stable market for Government securities, limiting credit expansion insofar as this policy permitted.

The first program of action would have permitted the full use of open market operations and other instruments of Federal Reserve policy to limit the supply and availability of bank reserves. The primary restraint on inflation would have been exerted by a more effective limitation of the supply of bank reserves. A secondary restraint would have been a rise in interest rates, reflecting the shortage of funds, which might have tended to restrict the private demand for credit, especially for uses in which interest was an important part of total cost.

The greater freedom of action in checking inflation would have been gained, however, only by sacrifices in other directions. Sales of Government securities in an unsupported market by lending agencies shifting to loans and other investments would have resulted in a decline in the price of securities and a rise in interest rates. Fear of further declines might have started a wave of liquidation of marketable obligations and of redemptions of savings bonds. Once started such repercussions would have been difficult to stop, and a serious deflation might have been precipitated. The decline would have made

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more difficult the Treasury's large refunding operations, and any tendency to undermine confidence in Government credit would have been serious because of the tense international situation. The lowering or withdrawal of support prices would not have been a method by which anti-inflationary pressure could have been applied or released flexibly and gradually as desired.

An alternative course of action was to restrict credit expansion within the limits made possible by maintaining a stable market for Government securities. This alternative, the one chosen, interfered with actions to check inflation because Federal Reserve purchases in supporting the bond market were the major factor increasing bank reserves. Increases in reserves were counteracted by the cash redemption of Treasury securities held by the Federal Reserve System, by System sales of short-term securities, and by increases in reserve requirements. Permitting a somewhat flexible pattern of interest rates to develop enabled more effective action in checking inflation than would have been possible under a fixed pattern. A rise in short-term rates, even with the long-term rate pegged, enabled the Federal Reserve to sell short-term securities and absorb some of the reserves being created by purchases of bonds. Flexible short-term rates, therefore, tended to minimize the inflationary effects of the support program. Under either a fixed or flexible support policy, however, maintaining a stable market for Government securities resulted in sacrificing some control over the money supply and the ability of the authorities to check inflation.

The essential problem was one of choosing between alternatives. The advantages of a more effective anti-inflationary action were weighed against the dangers of a disorderly Government securities market. The System decided to avoid the latter.

Reply of Hugh Leach, Federal Reserve Bank, Richmond

Theoretically, higher interest rates represent an increase in the cost and a reduction in the availability of credit and therefore could have lessened inflationary pressures during this period. In practice, however, a higher interest rate policy would have been ineffective and inadvisable. In view of Treasury considerations of continued public confidence and low service cost relative to refunding, there was no possibility of marked changes in interest rates or of lessened purchases of Government securities by the System. As long as the System stood ready to purchase Government securities, reserves were available to the banking system and a higher interest rate policy in and of itself could not have been effective.

In addition, even assuming a policy designed to bring about increases in interest rates in both sectors of the market (with the System lessening purchases and with some bond prices going below par), there is a real question as to whether this would have been a major anti-inflationary factor. During this period it is obvious that the two primary causes of inflationary pressures were the volume of money already created and in the hands of business and individuals and the insufficient quantity of goods in relation to this existing money supply. Higher interest rate policy could hardly have reduced the volume of money already created and might possibly have had adverse effects upon increased production. Furthermore, any resultant tight-

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ening of reserves and bank lending might have been offset by an expansion in other types of credit reflecting a huge volume of liquid assets in the hands of nonbank investors. In retrospect, it appears that the intense demand for goods and services during this period relative to the existent shortages indicates that interest rate policy could not have substantially lessened these inflationary pressures.

With more specific reference to the policy followed, a review of the record as to the interest rate changes during this period reveals that System policy succeeded in bringing about an increase in the short-term rate within the practicable limits dictated by Treasury considerations. As to the long-term rate, however, it is believed that the maintenance of the $2\frac{1}{2}$ percent rate was fully justified by the public interest. Long-term rates were not, and should not have been, permitted to rise and bond prices to have been driven below par. Certainly, the unstabilizing effect on the market for Government securities, the possible upset to public confidence, the question of just how much selling would have occurred in the market, represented sufficient considerations outweighing the advantages from the standpoint of the anti-inflationary effect of such action. Thus, in view of the nature of the inflationary pressures during this period (which conceivably would have made any higher interest rate policy relatively ineffective) and the overwhelming necessity of considering market stability (which militated against any change in the long-term sector), a monetary and debt management policy producing higher interest rates would not have been effective or advisable from the standpoint of inflationary pressures.

Reply of William S. McLarin, Jr., Federal Reserve Bank, Atlanta

A restrictive monetary and debt-management policy resulting in higher interest rates would have restrained more effectively those expenditures which depended upon the use of borrowed funds, but the total demands for goods and services might nevertheless well have remained high, and some degree of inflation was certainly inevitable as a result of the war. On the other hand, such a monetary and debt-management policy might have brought about grave disturbances in the market for Government securities; the interest cost on the public debt would have been increased, and the Treasury's refunding operations made more difficult; it might have led to panic selling of marketable obligations, loss of confidence in financial institutions, and perhaps large redemptions of savings bonds and might have had such restrictive effects on private financing as to bring about a sharp downturn in business rather than merely to restrain inflation.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

Probably a monetary and debt-management policy which would have produced higher interest rates in 1946–48 would have lessened inflationary pressures. It should be pointed out, however, that the total demand for goods and services (including current demand as a result of high income, past savings, and credit, as well as deferred demand as a result of wartime restrictions) might have been almost as large even had credit been restricted more strongly. Credit restriction presumably would have curtailed demand which was dependent upon credit, but greater activation of the money supply already in existence (more rapid use of relatively idle balances) was possible.

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Thus no firm answer to the question is possible. Furthermore, the alternative to the policy pursued might have led to consequences more dangerous for the economy than the inflation which took place. This point is covered more fully in the answer submitted in the special System study.

Nevertheless, I believe that more rapid and stronger action with respect to short-term rates might have relieved the inflationary situation to some extent. Greater effort should have been made in this direction. My own feeling is that the open market committee's suggestions for quicker action on this front would have led to a more sound situation than actually existed under the policies pursued.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

This question can, of course, only be answered in the affirmative. The real issue is how much additional restraint would have been exercised by a monetary policy somewhat more restrictive in character. The at-one-time popular tendency to dismiss changes in interest rates as unimportant in influencing business activity is unrealistic. Interest rate changes are merely symptomatic or symbolic of the changed terms of availability of credit and funds, and the latter is important in a substantial way in the general business situation.

In view of the bond price-support commitment, monetary policy even so exercised a considerable degree of restraint during the postwar boom years. Through a judicious policy of periodically raising short-term rates, combined with an expert use of Treasury surpluses, considerable and continuous pressure was exerted on the money market. The former effect should, however, not be overgeneralized. A substantial part of its effectiveness is undoubtedly to be explained by the fact that changes in short-term rates injected considerable uncertainty about long-term rates. The longer and the more tenaciously the long yield rate is held, the less effective obviously is this uncertainty in exercising monetary restraint.

Reply of H. G. Leedy, Federal Reserve Bank, Kansas City

A policy of permitting higher interest rates during the period from January 1946 to late 1948 would have enabled the Treasury and the Federal Reserve System to pursue an even more restrictive monetary and debt-management policy than that which was actually undertaken. The objective of such a policy would have been a more effective restraint upon the supply and availability of borrowed funds in an effort to restrain certain expenditures in our economy financed by funds obtained in the credit and capital markets; a rise in interest rates would have been the concomitant (and not the precise objective) of such a policy. An appraisal of monetary and debt-management policies which would have produced higher interest rates must consider not only the more obvious direct effects upon inflationary pressures, but also the costs, uncertainties, and possible adverse effects of such alternative policies.

A more restrictive monetary and debt-management policy in the postwar period would have included higher rates on short-term Government securities, higher yields on Government bonds (with some prices probably below par), and lessened purchases of Government securities in the open market on behalf of the Federal Open Market Committee. The supply of reserve funds available to commercial banks as the basis for loan expansion would have been reduced. Life-

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insurance companies and other institutional investors would have had to accept capital losses in attempting to sell Government securities, and this might have discouraged transfer of some of their investments into corporate bonds, State and local government obligations, and mortgages.

The effectiveness of such a restrictive policy in restraining inflation must be appraised in terms of the many strong factors giving rise to the underlying inflationary condition. During the war individuals and businesses accumulated large holdings of money and Government securities as a result of the wartime deficits and the increase in the public debt. Heavy deferred demands and acute needs for many goods gave rise to tremendous expenditures. A rising spiral of costs and prices was supported by use of past savings and high incomes as well as by credit expansion. All these factors together gave rise to a situation in which total demand by consumers, businesses, and governments exceeded the capacity of the economy to supply goods and services. A restrictive monetary and debt-management policy resulting in higher interest rates would have restrained more effectively those expenditures which depended upon the use of borrowed funds. Total demands for goods and services might well have remained high, however, and some degree of inflation was inevitable as a result of the war.

The widespread repercussions throughout the economy in other directions, apart from lessening the contribution of new credit toward inflationary pressures, must also receive attention in considering a policy of higher interest rates. Such an alternative monetary and debt-management policy might have brought about grave disturbances in the market for Government securities, with damaging repercussions on our entire financial mechanism, as well as seriously adverse effects upon public confidence in the Government's credit. The interest cost on the public debt would have been increased, and the Treasury's refunding operations made more difficult. A policy of higher interest rates might have led to panic-selling of marketable obligations, loss of confidence in financial institutions, and perhaps large redemptions of savings bonds. Moreover, a policy of higher interest rates might have had such restrictive effects on private financing as to bring about a sharp downturn in business rather than merely to restrain inflation. Thus while greater freedom of action with respect to interest rates might have permitted some desirable further restraint, the Federal Reserve System would, nonetheless, have been compelled to proceed cautiously, reversing itself if other dangers became important.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I am in agreement with the draft reply which states that such a policy would have enabled the Treasury and the Federal Reserve System to pursue a more restrictive monetary and debt-management policy than that which was actually undertaken. I also agree with the concluding sentences that it is difficult to conjecture how effective a policy of further tightness would have been during the three postwar years. In my opinion, some of the steps finally taken by the System should have been taken sooner. How far we could have gone without precipitating the undesirable consequences in the markets that some feared, no one knows. I have been disturbed by the

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extent to which people in key managerial positions in banks, insurance companies, trust companies, and elsewhere in the financial and business world, to say nothing of the lay public, appear to have accepted the doctrine that an invariable maintenance of Government bond prices at or above par is essential to the financial soundness of the country. To me, this is a doctrine out of keeping with the history of our financial past and unfortunate in the restrictions that it puts on the functioning of our financial machinery. I believe that a tighter policy could have been followed which would have permitted some issues to go moderately below par so that the country could have adjusted its thinking on the matter of money rates, security prices, and financial soundness to changing conditions. I recognize that such a program would have involved certain risks, but I believe they should have been taken.

While believing that a tighter policy should have been followed, I am by no means confident that it would have had any materially different effects than did the policy that was actually followed during the first three postwar years. As the draft reply states * * * a more restrictive policy would have restrained more effectively those expenditures which depended upon the use of borrowed funds. The most important of these expenditures were in construction and real estate and in business itself. Liberality in the use of credit in construction and real estate was fostered by congressional policy, and more restrictive Federal Reserve action might have resulted in a direct countermandate of the Congress or in congressional action to provide special governmental financing facilities, thus nullifying, at least in part, Federal Reserve action. Business demand for credit grew out of the need for inventories and additional or renovated plant and equipment. While some speculation in inventories may have occurred, most of the increase in the postwar period appeared to be necessary in order to permit industry and trade to function more efficiently. The expansion or renovation of plant and equipment reflected the need of business to expand capacity to meet the large postwar demand for goods and services, and we have a record of accomplishment in catching up with these demands which is highly praiseworthy.

A more restrictive monetary and credit policy might have led to a moderation in the rate of capital expenditures. A reduction in the rate of capital expenditures might have resulted in their being spread out over a longer period of time, so that they might not have reached such a high peak in 1948 and might not have declined so much in 1949. Had such been the case, inflationary pressures from this source might have been reduced and a more stable employment situation might have occurred. On the other hand, capacity would not have been increased so much, and thus the inflationary pressures resulting from consumer demand might have been maintained over a longer period and have been reflected in higher prices. Criticism of our business leadership might also have been more severe because of an alleged slowness in expanding capacity to a point adequate to serve the needs of the Nation. Only a few months ago the steel industry was under such attack.

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2. In what way might Treasury policies with respect to debt management seriously interfere with Federal Reserve policies directed toward the latter's broad objectives?

The System answer

Treasury determination of rates of interest on Government securities and Federal Reserve policies which influence the money market are necessarily very closely related. Federal Reserve policies designed to encourage credit expansion would make it possible for the Treasury to offer lower rates of interest on new issues of Government securities. On the other hand, Federal Reserve policies designed to restrain credit expansion might make it necessary for the Treasury to offer higher rates of interest on new issues.

Federal Reserve policies are likewise affected by Treasury determination of the rates of interest on new issues of Government securities and a necessity of avoiding action which might impair public confidence in Government securities. Heavy private demands for credit and capital funds might bring about selling of Government securities by banks, life-insurance companies, and other institutional investors in order to obtain funds to meet such demands. In these circumstances, the Federal Reserve would have to buy Government securities in the market if Treasury rates of interest on new securities were to be supported and if prices and yields on outstanding issues were to be maintained within a narrow range. Federal Reserve purchases of Government securities from commercial banks create new reserve balances, and Federal Reserve purchases of Government securities from nonbank investors create both new reserve balances and new deposits as well. Such additions to reserve funds and the money supply might be inflationary, unless offset by other actions, such as increases in reserve requirements or use of a Treasury cash surplus to retire Federal Reserve holdings of Government securities.

The choice of securities offered by the Treasury may likewise interfere with Federal Reserve policies. For example, the supply of Treasury bills at a given rate might be increased in circumstances where commercial banks and nonbank investors were not willing to acquire a corresponding additional amount of Treasury bills. This situation would necessitate either higher bill rates or Federal Reserve acquisition of Treasury bills in the market, bringing about expansion in member-bank reserve balances (whether or not such an expansion should be consistent with the current phase of Federal Reserve policy).

3 (*a*). What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury objectives and policies in the field of money, credit, and debt management?

The System answer

The close relationship of monetary policy and debt management will continue to require a high degree of cooperation and coordination between the Treasury and the Federal Reserve. The problem of coordination involves much more than administrative coordination of two agencies with different areas of operation and responsibilities. Coordination necessarily involves decisions as to alternative objectives and degrees of emphasis in policies. Attention is directed to three alternative ways of achieving close coordination of Federal Reserve and Treasury objectives and policies in the field of money, credit, and debt management, in addition to the fourth possibility discussed below in parts (*b*) and (*c*) of the present question.

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The present method of coordination of Treasury and Federal Reserve policies is that of consultation between policy-making and operating officials of the two agencies, largely upon a voluntary basis. This method of coordination rests upon recognition by the Treasury and the Federal Reserve of their mutual responsibilities in a cooperative effort to direct their respective policies toward common, broad objectives of national economic policy. It assumes that ocasional informal conferences and discussions can bring about adequate recognition of the objective of promoting economic stability at high levels of employment and production through monetary policy, as well as that of facilitating Treasury financing operations in public-debt management.

An alternative method of coordination of objectives and policies would be through congressional directive. Congress might require by legislation that the Treasury, in consultation with the Federal Open Market Committee, shall give due consideration to the effects of debt-management policies upon bank reserves and the money supply, in a manner consistent with the objectives set forth in the Employment Act of 1946.

A third method of coordination would be the establishment of a National Monetary and Credit Council somewhat along the lines proposed by the Hoover Commission. This proposal is discussed below in the answer to question VI–6, concerning the relation of the Federal Reserve to other banking and credit agencies. Such a council would have as members the Secretary of the Treasury, the Chairman of the Federal Open Market Committee, and representatives of the agencies engaged in domestic lending or loan-guaranty activities. The council would provide, among other things, for regular consultations within the council among the Treasury, the Federal Reserve, and other affected agencies concerning the Treasury's fiscal and debt-management policies and the Federal Reserve's monetary and credit policies.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The problem of coordination is not primarily one of setting up some formal mechanism for consultation between policy-making officials; rather, it is one of establishing a common set of values and purposes. Coordination is unlikely if the two agencies are working toward different objectives. In former years, low interest cost and technical efficiency in handling the debt were the major objectives of management. Economic effects were largely ignored. Today, debt-management operations are so vast and their economic effects so great that economic stability must be given primary consideration if debt-management policies are to assist rather than obstruct monetary and credit policies.

We already have, in the Employment Act of 1946, a general congressional directive establishing economic stability as the common objective of national economic policy. It is our conviction that coordination of fiscal, debt-management, and monetary policies would be promoted by specific congressional directive to those responsible for policies in these areas.

Reply of W. S. McLarin, Jr., Federal Reserve Bank, Atlanta

One method of coordination would be the establishment of a National Monetary and Credit Council somewhat along the lines proposed

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by the Hoover Commission, having as members the Secretary of the Treasury, the Chairman of the Federal Open Market Committee, and representatives of the agencies engaged in domestic lending or loan-guaranty activities. The council would provide, among other things, for regular consultations within the council among the Treasury, the Federal Reserve, and other affected agencies concerning the Treasury's fiscal and debt-management policies and the Federal Reserve's monetary and credit policies.

3 (*b*). What would be the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board?

The System answer

The principal advantage of providing that the Secretary of the Treasury should be a member of the Board presumably would be that it might facilitate coordination of debt-management policy with monetary or credit policy. It would provide an opportunity for the Secretary of the Treasury to hear and participate in discussions of credit policies by the Board of Governors of the Federal Reserve System, and the Federal Open Market Committee and to discuss with other members of the Board and the Committee the Treasury financing and debt-management policies that would be most appropriate in the light of Federal Reserve credit policies.

The principal disadvantage would be that it would tend to strengthen the suspicion that Federal Reserve policies were being influenced unduly by consideration of facilitating Treasury financing and the management of the public debt. It would probably be suspected, rightly or wrongly, that the influence of the Secretary of the Treasury would be exerted in the direction of low interest rates to hold down the interest cost on the debt, even at times when the appropriate credit policy would be one of restraining credit expansion with the probable accompanying result of raising interest rates.

Reply of W. S. McLarin, Jr., Federal Reserve Bank, Atlanta

The principal disadvantage, not offset by any corresponding advantage, would be that it would tend to strengthen the suspicion that Federal Reserve policies were being influenced unduly by considerations of facilitating Treasury financing and the management of the public debt. It would probably be suspected, rightly or wrongly, that the influence of the Secretary of the Treasury would be exerted in the direction of low interest rates to hold down the interest cost on the debt, even at times when the appropriate credit policy would be one of restraining credit expansion, with the probable accompanying result of raising interest rates.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

The principal advantage of placing the Secretary of the Treasury on the Board would be the theoretical gain in mutual understanding. Actually the Secretary, when he was on the Board, found little time to attend Board meetings; and, consequently, the presumed advantage was minimized. However, new problems arising from the magnitude of the public debt make Federal Reserve policy and action much more important to the Secretary than was the case when he was a member of the Board.

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3 (*c*). Would you favor such a provision?

The System answer

While we do not believe that membership of the Secretary of the Treasury in the Board of Governors would, in fact, mean undue emphasis in the determination of Federal Reserve policies on Treasury financing considerations, we are inclined to believe that establishment of a national credit advisory council of the sort suggested in the reply to question VI (6) would be a better method of promoting greater coordination of monetary and debt-management policies. Past experience suggests that the many demands on the time of the Secretary of the Treasury are likely to prevent his regular, or even frequent, attendance at the meetings of the Board. Furthermore, the Secretary could hardly be expected to devote the considerable amount of time to meetings of the Board that is taken up by discussion of the internal affairs of the Federal Reserve System. Consequently, it is questionable whether the presumed advantage of the Secretary's membership on the Board would, in fact, be realized. Two prominent former Secretaries of the Treasury, who served also as members of the Federal Reserve Board, Carter Glass and William McAdoo, later took the position that the Secretary of the Treasury should not be ex officio a member of the Board.

Reply of W. S. McLarin, Jr., Federal Reserve Bank, Atlanta

No. Some better method of coordination should be found.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The major problem of coordination between the Federal Reserve and the Treasury is that it be on a basis where neither has the dominant, overriding influence. The verdict of history may be that in the postwar years inflation control was more important than maintaining Government bond prices. In that case it may seem that Treasury influence in monetary affairs during this period has been excessive even in view of the legacy of war financing problems. While much can and has been done through informal consultation, the almost inevitable result has been that Treasury preferences have been accorded excessive weight. Having the Secretary of the Treasury as a Board member does not seem to be the answer to this problem. Here the Secretary of the Treasury tends to be in the status of a "poor relation" since, in any formal sense, the Board could always outvote the Treasury. It is not surprising, therefore, that this device, during its period of existence, was not found to be particularly useful. The Secretary's chronic absence from Board meetings can be presumed to be circumstantial evidence of this unbalanced relationship.

This problem might be met by the establishment of a National Monetary Council somewhat along the lines of the Hoover Commission recommendation. Through this device not only potential conflicts between the Federal Reserve and the Treasury policies but also divergent policies between the Federal Reserve and lending agencies can be aired and minimized. This has the considerable advantage that all agencies meet on roughly equal terms, and a formalized clearing arrangement is thereby provided.

This is not, however, a panacea. It does not guarantee the elimination of policy conflicts. Its greatest weakness, in fact, might be the illusion of having come to grips with hard decisions through the

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mirage of a new organizational set-up. The basic question is one on which public opinion must make up its mind. There are times when easy money and credit and stable prices cannot both be had. It is essential not to lose sight of the fact that what are often called Treasury-System conflicts are really the periodic incompatibility of these conflicting objectives. And these conflicts are not automatically eliminated by putting the contending parties on a new commission. It must, of course, be emphasized that a great deal can be accomplished through continuous and informal consultation at the top level if there is a genuine will to keep in mind the whole public interest.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

A congressional directive setting up a common objective for Federal Reserve and Treasury policies is proposed above as a means of achieving a better coordination of monetary and debt-management policies. If this were done, it would not be necessary to make the Secretary of the Treasury an ex officio member of the Federal Reserve Board to accomplish the same purpose. Two former Secretaries of the Treasury, Carter Glass and William G. McAdoo, after having served as ex officio members, expressed the opinion that the Secretary of the Treasury should not be a member of the Federal Reserve Board.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

On balance, I would not favor placing the Secretary on the Board. The anticipated greater coordination of policy would not necessarily take place. I believe a small National Monetary and Credit Council would be a preferable step.

4. What changes in the objectives and policies relating to the management of the Federal debt would contribute to the effectiveness of Federal Reserve policies in maintaining general economic stability?

The System answer

The Federal Reserve System has a vital interest from the point of view of its responsibilities for monetary and credit policy in the broader consequences and implications of Treasury financing. The objectives and policies relating to the management of the Federal debt should give due emphasis and consideration to the effects of debt management on bank reserves and the money supply, both directly and indirectly through restraints upon the exercise of Federal Reserve policies.

The following aspects of debt management are of importance in this respect:

(1) Freedom to permit adequate flexibility in interest rates and prices of Government securities in response to changing economic conditions would definitely contribute to the effectiveness of the Federal Reserve policies directed toward the objective of maintaining general economic stability. Adherence to a rigid pattern of rates and prices in times of large private demands for credit and capital funds may require Federal Reserve purchases (in maintaining orderly markets for Government securities) in an amount which lessens the effectiveness of Federal Reserve policies aimed at restraining the supply and availability of bank reserves and the money supply. Again, maintenance of a wide margin between short-term and long-term rates on marketable securities

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through Federal Reserve intervention encourages "playing the pattern" and results in undesirable monetization of the Federal debt through sale of short-term securities to the Federal Reserve in order to purchase longer-term higher-rate issues.

(2) The choice of types of securities in new money or refunding operations must be such as to appeal appropriately and at the right time to bank and nonbank investors. For instance, offering of a particular type of security might necessitate Federal Reserve support and bring about undesirable extension of Federal Reserve bank credit. In inflationary periods, particular emphasis is needed upon the offering of securities which will appeal to nonbank investors, thereby minimizing the transference of public debt to the Federal Reserve System. In periods of business recession, the Treasury should offer types of securities mainly appropriate for banks. It would be undesirable to offer long-term securities at higher interest rates instead of short-term securities at lower interest rates at a time when the Federal Reserve System was endeavoring to introduce easy money policies in an effort to combat recession.

(3) Consideration should be given to the offering of securities which will encourage stable holdings by nonbank investors. For example, it has been suggested that attention be given to the issuance of long-term bonds in a nonmarketable form, redeemable on demand prior to maturity at a discount so as to give a lower yield if not held until maturity. Through these issues an appropriate rate could be paid for genuine long-term savings, but the Treasury would not have to pay a high coupon rate to purchasers who hold for a short period only. Successful use of such issues would also permit a reduction in the amount of long-term marketable securities outstanding. It is the marketable issues which necessitate Federal Reserve support in maintaining orderly conditions in the Government securities market.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The major peril here to avoid is that debt management policies inadvertently sterilize monetary policy—a major problem in the immediate postwar years. This has in fact emerged as the major postwar monetary-fiscal problem. While our experience with this problem at its present magnitude is still brief, some conclusions do seem to emerge.

(*a*) Appropriate variations in interest rates (particularly short-term rates) can be an instrument of monetary policy without saddling the Treasury with excessive additions to debt service charges. Much was done along this line in the immediate postwar years. It seems clear, however, that more could have been accomplished had the Treasury not been reluctant so long to adopt this policy.

(*b*) Some greater degree of flexibility in the price of marketable securities can help to minimize the conflict of debt management and monetary policy. Our experience with this problem during the postwar period clearly suggests that a great deal might have been gained by some greater downward flexibility in the price of marketable securities even to a level but slightly below par.

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(c) The less willingness there is to pursue the policies mentioned above, the more will the conflict between debt management and monetary policy have to be minimized through some sort of a variant of the certificate reserve proposal.

The reason for this is clear. The requirements of Government bond price stabilization policy and monetary policy directed toward high-level economic and price stability are inconsistent during periods of inflationary pressure. During such periods the demand for credit will presumably be relatively heavy. To restrain undue credit expansion and, therefore, inflationary tendencies, restrictive monetary policy is required. This means putting enough pressure on the money and capital markets to make funds less readily available. Here the dilemma becomes evident. If such pressure should become really restrictive, banks and financial institutions will tend to unload Government securities in favor of higher yielding private loans, debentures, and securities. The prices of Government securities will accordingly tend to fall and yield rates rise or the Federal Reserve must come to their rescue with necessary purchases. This creates excess reserves and, therefore, an easy monetary policy, a result which is precisely at variance with what would be appropriate for the inflationary situation. The inevitable result, therefore, will be some added creation of bank reserves, some further credit expansion, some added inflationary pressure generally and some further deterioration in the real value of the bonds.

To minimize this problem and still adhere to the policy of supporting the price of Government securities, some procedure to "pin down" holdings of these securities will be required. The secondary or certificate reserve proposals, as proposed during the postwar boom by the System, constitute a partial method of dealing with the solution. Through this plan banks would be required to hold Government securities up to a certain proportion of their deposits. On the other hand, this is not the whole solution since banks are not the only holders of marketable securities. In fact, it is well to remember that from June 1947 to December 1948 holdings of Government securities by insurance companies were reduced by 3.5 billion dollars, as insurance companies were shifting out of governments in favor of more attractive yield rates on private securities. This forced the Federal Open Market Committee to purchase large quantities of bonds in order to support the bond price level. Therefore, it seems clear that such a plan must envisage the inclusion of other financial institutions such as life insurance companies also, as well as banks or other remedies must be found.

The real policy issue here must presumably be settled by Congress and public opinion rather than by the monetary authorities in a restricted sense. It is important for the public to realize that adherence to the policy of supporting the price of Government securities leads toward some such program of pinning down the Government debt unless it is preferred to allow the inflation to run unchecked—or allow some greater downward flexibility in the price of Government securities.

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(*d*) The important thing is that the usefulness of the monetary policy not be sold short through belief in the inevitable transcendency of debt management policy.

Reply of W. S. McLarin, Jr., Federal Reserve Bank, Atlanta

The objectives and policies relating to the management of the Federal debt should give due emphasis and consideration to the effects of debt management on bank reserves and the money supply, both directly and indirectly through restraints upon the exercise of Federal Reserve policies, in accordance with the objectives of the Employment Act.

The following aspects of debt management are of importance in this respect: Freedom to permit adequate flexibility in interest rates and prices of Government securities in response to changing economic conditions would definitely contribute to the effectiveness of the Federal Reserve policies directed toward the objective of maintaining general economic stability.

The choice of types of securities in new money or refunding operations must be such as to appeal appropriately and at the right time to bank and nonbank investors.

Consideration should be given to the offering of securities which will encourage stable holdings by nonbank investors.

5 (*a*). On what occasions, if any, since 1929 have the Government's fiscal policies militated against the success of the Federal Reserve in attaining its objectives?

The System answer

The years since 1929 have seen a succession of depression, inadequate recovery, defense and war, postwar boom, and abatement of inflationary pressures. By and large, the Government's fiscal policies during these years have been in the same direction as Federal Reserve policies. Frequently, however, the Government's fiscal policies have been inadequate in extent or have not comprised an entirely consistent program from the standpoint of stability and growth in the economy.

In retrospect, the depression of 1929–33 probably should have been met by a more vigorous fiscal program, involving greater increases in emergency Government expenditures. Again, efforts to balance the budget through increases in tax rates and the imposition of new taxes were futile and unsound at a time of severely depressed business conditions.

The financing of the war provided another example of inadequate fiscal action. Particularly during the first years of the war, Federal tax receipts were below the levels urgently needed from the standpoint of more effective wartime economic policy, as well as for restraint of postwar inflationary tendencies. Higher wartime levels of taxation would have lessened wartime deficits and would have eased to some extent, therefore, the present dilemmas in Federal Reserve policy resulting from the size and nature of the wartime increase in the public debt. Moreover, a greater share of that debt probably should have been placed outside the banking system.

The achievement of substantial cash surpluses in fiscal 1947 and 1948 and their use to retire bank-held debt provided an example of effective fiscal action which greatly aided the Federal Reserve in seek-

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ing to attain its objectives. However, the very high level of Federal expenditures itself provided a substantial inflationary stimulus. Moreover, the anti-inflationary effect of budget policy in the postwar boom would have been heightened by exclusive use of cash surpluses in retirement of Federal Reserve holdings of Government securities.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The period since 1929 included a depression, a war, a postwar inflation and, more recently, an abatement of inflationary pressures. In general, Government fiscal policies did not seriously interfere with the success of Federal Reserve policies during this period. In retrospect, of course, instances may be cited in which fiscal policy could have been more effective in contributing to their success.

The financing of World War II provides one illustration. It was important from the standpoint of preventing inflation that Treasury expenditures be financed as far as possible out of current income. If taxes had been increased sooner and a larger proportion of war expenditures had been financed by taxation, the wartime deficit would have been less, the Federal debt would not have been as large, and the problem of restraining postwar inflation would have been lessened.

In the postwar period certain governmental fiscal policies conflicted with Federal Reserve action to check inflation. For example, taxes were reduced and large cash payments were made to veterans at a time when total spending was already too large in relation to the available supply of goods. The Government's program of very easy credit for housing tended to accelerate credit expansion at a time when Federal Reserve authorities were trying to restrict it.

From the standpoint of avoiding war and postwar inflation, Federal tax policy during the war could have been more effective. From the standpoint of civilian morale and incentives for maximum production, however, there were dangers in raising the level of taxation too high. Viewed as a means of helping the veterans who sacrificed much during the war, the cash payments and very easy home-purchase credit may seem justified. But when judged in relation to existing inflationary pressures, they were ill-timed.

Reply of W. S. McLarin, Jr., Federal Reserve Bank, Atlanta

The depression of 1929–33 probably should have been met by a more vigorous fiscal program, involving greater increases in emergency Government expenditures. Efforts to balance the budget through increases in tax rates and the imposition of new taxes were futile and unsound at a time of severely depressed business conditions. On the other hand, during the first years of the war, Federal tax receipts were far below the levels urgently needed from the standpoint of more effective wartime economic policy, as well as for restraint of postwar inflationary tendencies. Higher wartime taxation would have lessened wartime deficits and would have eased to some extent, therefore, the present dilemmas in Federal Reserve policy resulting from the size and nature of the wartime increase in the public debt. An example of effective fiscal action which greatly aided the Federal Reserve in seeking to attain its objectives was the achievement of substantial cash surpluses in fiscal 1947 and 1948 and their use to retire bank-held debt.

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5. (b) What type of fiscal policy would best supplement monetary policies in promoting the purposes of the Employment Act?

The System answer

The high level of Federal expenditures and taxes and their importance in the economy make appropriate fiscal policies of substantial importance in promoting the purposes of the Employment Act. Much more is involved than the dollar amounts of cash surpluses or deficits. Consideration must also be given to the absolute levels of Federal expenditures (both in terms of purchases of goods and services and transfer payments), to the types of taxes imposed, and to Government loan guaranties.

The fiscal policies of the Government are affected by developments in the economy and in turn will influence the level of economic activity. Fiscal policies therefore should be in the right direction as must monetary policies, which are more flexible, in promoting the purposes of the Employment Act. In good times and especially in periods of inflationary pressures, surpluses should be achieved and used for retirement of bank-held Federal debt. High levels of income and profits provide an opportunity for scaling down the public debt which should be utilized. There should be restraint in periods of high employment upon Government expenditure programs which can be deferred.

In bad times there will be necessitous increases in expenditures, such as constructive public works programs deferred in periods of prosperity. Tax rates should clearly not be raised in periods of business recession, because such action would accentuate the problem of unemployment and low production. Tax revenues under the existing tax rates will decline in bad times, of course, as incomes and profit levels decline.

Attention must be given to certain undoubted dangers and limitations which are attached to the growing reliance upon fiscal policies. There are strong pressures on behalf of higher governmental expenditures and lower taxes, irrespective of the current economic situation. A difficult but vital distinction must be made between short-run increases in Government expenditures to combat recession and long-range decisions as to continuing programs of Government action. The incentive impact of taxation upon the attractiveness of increased income, and hence upon private expenditures, demands greater attention. Uncertainties of economic analysis and economic forecasting limit the possibilities of appropriately adjusting fiscal policies to each current short-run economic situation. There is need alike for sharpened tools of fiscal management both in the executive branch and in Congress, and for greater public understanding of the fiscal process. Above all, care must always be exercised to avoid exaggerating the usefulness of fiscal policies alone. If stability is to be achieved at a high level in a private enterprise economy, there must be emphasis as well upon price and wage policies, and upon monetary policies.

Reply of Joseph A. Erickson, Federal Reserve Bank, Boston

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Reply of Allan Sproul, Federal Reserve Bank, New York

Fiscal policies, as has been indicated in the introduction to section II of the accompanying research study, are the result of the many individual decisions taken by Congress concerning governmental expenditures and taxes. With governmental expenditures now accounting for more than one-sixth of the gross national product, it is obvious that these congressional decisions will inevitably affect the volume and composition of total output. That is not to say, however, that expenditures

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and taxes can be rapidly increased or reduced in response to every change in the business outlook, with Government receipts and disbursements providing the balance needed for holding the economy at high and stable levels of employment and income. Even if Congress could ignore the special considerations giving rise to each major tax and expenditure item, adjustments would necessarily be slow moving and blunt in their effects.

What can be expected, probably, is that in periods of inflation Congress will be reluctant to increase any expenditures that would contribute further to inflationary pressures, and that most taxes would be held at relatively high levels. Conversely, in depressed periods Congress might emphasize expenditures for worth-while public projects and avoid the imposition of new taxes or tax rates that would seriously interfere with economic recovery. It seems highly impracticable to suppose, however, that taxes and expenditures already scheduled and in effect can be rapidly and substantially altered to offset changes in the general economic situation. Certainly such action would imply a swiftness of response, and an accuracy in forecasting, for which American experience has not yet furnished a promising precedent.

There is grave danger in any case in relying upon even a combination of fiscal policy, monetary policy, and debt management to cure instability in our economy. The stabilizing powers of monetary measures were exaggerated two decades ago. There has been some tendency to make the same mistake with respect to fiscal policies in recent years. While the fullest practicable coordination among fiscal, debt management, and monetary policies is desirable, and while such coordination can do much to promote economic stability, we should avoid deceiving ourselves or the public in the belief that all major economic disturbances can be corrected by these measures.

Granting the limitations then, what can be done? The field for administrative coordination is in the relations between the Treasury and the Federal Reserve System, and cannot readily include those major aspects of fiscal policy determined by congressional decisions. Each step taken by the Treasury in disposing of a current surplus, in financing a current deficit, or in replacing matured issues of Government obligations with new issues, has a direct influence on the money market—the same money market through which Federal Reserve credit policies are also being carried out. Generally speaking, there is a wide range of alternatives open to the Treasury when any of these steps is taken, and some of these alternatives will always be more nearly consistent with the current phase of credit policy than others.

For example, a cash surplus arising in a period when monetary policy is aimed at restraint might best be devoted (subject to the special technical factors which differ from case to case) to retiring Government securities held by the Federal Reserve banks because the transfer of funds will correspondingly reduce the reserves of the banking system. A cash deficit occurring in such a period (which would probably represent a failure of adjustment of fiscal policy to the economic situation) might best be met by the sale of new Government securities to the public, thereby absorbing funds from the inflated income stream, rather than by sale to the banks, which would enlarge the money supply, or indirect sale to the Federal Reserve

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banks, which would enlarge both the money supply and the reserves of the banking system (permitting a further multiple expansion of money and credit). The replacement of maturing issues at a time of monetary restraint also offers possibilities for greater or lesser consistency between debt management and monetary policy. Treasury insistence, for example, on adding to the supply of issues no longer attractive to the public, or even to the commercial banks, might force the Federal Reserve System to choose between its general policy of restraint and the apparent necessity of releasing additional reserve funds to create buyers for the new issue and protect the Government credit.

These are but three abbreviated illustrations of the inevitable connection between Treasury debt management and Federal Reserve action. Many more could be suggested. But it is clear even from these few hypothetical cases that the interrelationships are much too variable and complex to be suitable subjects for precise legislation. What the Treasury does in any of these situations is within the scope of its powers as defined by Congress; the indicated Federal Reserve policy would also be formulated consistently with the System's broad directives from Congress. The problem is one of administrative coordination within the framework of delegated powers. It may not always be possible fully to reconcile the aims of debt management and monetary policy, but every effort should be made to assure mutual consideration of problems and policies; and to avoid the sometimes easy assumption that one takes precedence over the other—that a Cabinet officer outranks the head of an independent agency and that Treasury views, therefore, should prevail.

While I agree with the skepticism expressed in the accompanying study over the practical usefulness of making the Secretary of the Treasury an ex officio member of the Board of Governors, I do feel that something might be done to give status to consultations between the Secretary of the Treasury and the representatives of the Federal Open Market Committee who discuss related debt management and credit problems. For that reason, I am inclined to endorse the proposal for a congressional directive on this matter, or for a national advisory council on domestic financial policy. Within such a group, not only debt management and monetary policy could be discussed, but also the experience of those Federal agencies which make credit directly available to agricultural, financial and business borrowers. Through the joint review of common policy issues it should be possible to achieve a degree of coordination, without suffering the grave disadvantages that would arise from subordinating any one of these agencies to the others.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The most important step in making fiscal policy an effective supplement to monetary policies in promoting the purposes of the Employment Act is to establish these purposes as the common objective. Those primarily responsible for fiscal and debt management policies—Congress and the Treasury—must accept economic stability at high levels of employment as their basic primary objective. Policies designed to promote narrower, secondary objectives, even though desirable in themselves, must be pursued only within the limits imposed by an over-all

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policy directed toward maintaining stability and a full utilization of resources.

Once this basic objective is accepted, the formulation of specific policies designed to achieve it will be greatly facilitated. In periods of depression fiscal policy can be a valuable supplement to monetary policy. Monetary policy can make funds available on easy terms, but business firms will not invest unless they think there is a good chance to make a profit. Fiscal policy can help get the economy off dead center if it results in the Treasury paying out more than it takes in and financing the deficit through the banking system. This not only increases the money supply but puts it into circulation via Government expenditures, thus tending to increase the total flow of expenditures and the demand for goods and services. On the other hand, in periods of inflation, fiscal policy, by effecting a Treasury cash surplus and using it to retire Treasury securities held mainly by the Federal Reserve System, can reduce bank reserves and the money supply available for expenditure. This also concentrates debt repayment in periods of high income when the public is best able to bear the additional burden. Thus, fiscal policies aimed at stimulating the flow of spending in periods of slack demand and restricting it during inflation, rather than always aimed at low carrying costs, would contribute materially to the success of Federal Reserve policies directed toward maintaining economic stability.

Monetary, fiscal, and debt management policies are only one sector of the front in the battle to maintain stability at high levels of income and employment. The policies in all of the major sectors of the economy should be coordinated toward our No. 1 problem of winning the battle against business fluctuations and of maintaining production, employment, and incomes at high levels. Success requires that we move ahead on all fronts.

III. International Payments, Gold, Silver

1 (*a*). What effect do Federal Reserve policies have on the international position of the country?

The System answer

To the extent that the Federal Reserve System is successful in exerting a stabilizing influence on the economy of the United States, it contributes also to the success of the international policies of this country and hence to a strengthening of its international position. Owing to the industrial predominance of the United States and its importance as an importer of raw materials (and also as a consumer of some types of imported finished goods), economic conditions here have far-reaching effects on economic conditions throughout a large part of the world, and hence upon the success of this country's efforts to promote world economic and political stability. An unrestrained boom here followed by a collapse and severe depression would have disastrous economic effects abroad which would involve the risk of political developments unfavorable to the United States. On the other hand, to the extent that Federal Reserve policies contribute to expansion of industrial activity in a situation such as the present one, the international trade of the United States will be stimulated, with beneficial effects abroad—on the British dollar problem, for example.

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In earlier days of unrestricted capital movements, speculative booms here, especially in the security markets, attracted foreign capital to this country to the detriment of the economies of foreign countries. In recent years, however, restrictions on capital movements by foreign countries, together with the use of powers granted the Reserve System to restrain the use of credit in such speculative waves, have minimized the danger of such disruptive developments.

Finally, Federal Reserve policies, through their effects on money market conditions, affect the terms of Treasury financing of Government expenditures, including expenditures for foreign aid and other aspects of this country's international policies. They also affect the ability of foreign countries and international institutions to borrow capital in the United States, and the terms of such borrowing, as well as the financing of private investments abroad by United States nationals.

1 (*b*). To what extent is the effectiveness of Federal Reserve policy influenced by the international financial position and policies of this country?

The System answer

The international financial position and policies of this country, through their effects on the demand from abroad for the products of our industries and agriculture and on the volume of purchasing power in the United States, may have an important influence on the effectiveness of Federal Reserve policy. To the extent that the international position of this country involves heavy gold inflows from abroad in payment for United States products, the effect is to add to the money supply and also to volume of purchasing power in the United States (wages, farm and other entrepreneurial income, and profits) at the same time that part of this country's production is being diverted to foreign use. Furthermore, gold inflows add to the volume of bank reserves and thus provide the basis for a secondary expansion of the money supply through credit expansion. Thus the tendency is to create or add to inflationary pressures here. A situation of this kind creates a problem for the Reserve System in its efforts to prevent an expansion of the money supply which is not paralleled by a growth in the supply of goods for domestic consumption. At the same time the Reserve System feels a responsibility for avoiding policies which might have restrictive effects on production and hence on the ability of this country to support the international economic and political policies of the Government.

The opposite type of situation may also arise—one in which there is a gold outflow which tends to reduce the money supply and bank reserves at a time when a shrinkage in the money supply (or even inability to extend it) may seriously hamper the financing of essential production and Government expenditures. For example, in the recent war period, when a moderate outflow of gold coincided with needs for the utmost utilization of the country's productive capacity and manpower and with a heavy drain on bank reserves caused by a rapid increase in currency circulation, it was necessary for the Reserve System to supply very large amounts of Federal Reserve credit to the banking system to prevent serious interference with the financing of the war effort.

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The ability of the Federal Reserve System to carry out effective credit policies is also greatly affected by Government policies relating to gold and (to a much smaller extent) by policies relating to silver. For example, the rise in the United States gold price in January 1934 from approximately $20.67 an ounce to $35 an ounce, was followed by a huge gold inflow and a correspondingly great expansion of bank reserves. This gold inflow was attributable only in part to the direct effects of the advance in the gold price in inducing a speculative inflow of capital to take advantage of an expected inflation here or the ultimate devaluation of the "gold bloc" currencies in Europe, and was more largely attributable to a flight of capital from Europe in fear of the Hitler regime and eventual war, and later to payments for war supplies by the countries at war with Germany. Nevertheless, the rise in the gold price greatly increased the dollar value of the possible gold inflow, first by stimulating greatly gold production throughout the world, and second, by increasing the unit value in dollars of existing gold stocks. The growth of bank reserves resulting from the gold inflow was so large and so rapid, that the Federal Reserve System would have been quite unable to exert any effective influence on the volume of credit and the money supply, but for the authority granted it by the Congress to increase member bank reserve requirements up to double the statutory requirements. And despite this authority, member banks at the end of 1940 held nearly $7,000,000,000 of excess reserves, an amount substantially greater than the System could have absorbed by the maximum use of its authority over reserve requirements and by the sale of all of its security holdings. It was only the huge financial requirements incident to this country's participation in the war that resulted in the regaining by the Reserve System of a position in which it could again exert an effective influence over the banking and credit situation in this country.

Meanwhile, the gold inflow and the resulting accumulation of bank reserves at a rate faster than the banks were able to use them had effects on the interest-rate structure in this country which have constituted a major source of difficulty for the Federal Reserve System in recent years. The shortest-term interest rates declined almost to zero, and long-term rates had a smaller proportionate reduction before the war. After a slight rise early in the war period, a structure of rates was fixed for the war financing which encouraged "playing the pattern of rates" and was a serious obstacle to the System's efforts to restrain further expansion of the volume of bank credit and the money supply in the postwar period.

1 (*c*). What role does the Federal Reserve play in determining these policies?

The System answer

The System plays an important role in the determination of the international financial policies of this country through the representation of the Board of Governors on the National Advisory Council. Advisory relations of the Board and the Reserve banks with the Treasury and the ECA, and occasional testimony before Congressional committees are other means by which it is able to exert some influence upon such policies. The System has also supplied trained men for various foreign missions to aid in carrying out the international economic policies of the United States.

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1 (*d*). In what respects, if any, should this role be changed?

The System answer

In view of the great effect on the System's position of policies such as that relating to the price of gold, it seems appropriate to emphasize the necessity of continued Federal Reserve participation in the determination of such policies if the System is to be able to carry out effectively the responsibilites placed upon it by Congress. However, no specific changes in the System's role are suggested at this time.

2 (*a*). Under what conditions and for what purposes should the price of gold be altered?

The System answer

Criteria for altering the gold price must depend upon the type of monetary standard in existence in the United States, and the standards prevailing in the rest of the world. Given a fractional reserve banking system, which supplies a dominant share of the total quantity of money, and given responsible control over the banking system by the Federal Reserve System (to provide the fullest practicable adaptation of the money and credit supply to the requirements of economic stability)—there are no apparent domestic "conditions or purposes" under which the price of gold need be altered. However, so long as the United States continues to rely upon gold as one medium for settling its balances on foreign account, a change in the gold price may be necessary on rare occasions as an adjustment to fundamental structural changes in the network of international trade and monetary relationships.

As a domestic consideration, it has been suggested that the gold price should be raised at present to correspond with the rise in the general level of commodity prices over the past decade. That is not a valid reason for raising the gold price. A rise in the gold price would be likely to result in a substantial increase in the reserve base of the banking system. And there is no reason why a sustained rise in the price level should be followed by an arbitrary increase in the reserve base, permitting additional deposit expansion and a further upward spiraling of prices. The rise in the United States gold price in 1934 brought it 69 percent above the previous level; United States wholesale prices have now reached a point 60 percent above the 1927–29 level. Moreover, the present United States gold stock is sufficiently large to support such further growth in the money supply of the country as may be needed for many years ahead.

So far as international factors are concerned, it is impossible to formulate in advance precise criteria for altering the gold price in response to structural changes which are, by their nature, unpredictable. In general, a persistent inflow of gold would, if there were no extenuating circumstances, suggest a need for lowering the dollar price of gold, since the self-correcting mechanism of a world-wide gold standard is not in operation. Conversely, given the monetary standards which appear likely to exist throughout the world, a long continued outflow of gold would suggest a basis for raising the dollar price of gold. In appraising the significance of those gold movements which do occur, however, a distinction must be made between gold movements resulting from underlying trade factors, or capital movements, and the gold flow which can be directly attributed to the level of the dollar price of gold.

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Even if evidence were to suggest that the gold price itself had been responsible for persistent one-way gold flows, no change in the gold price should be undertaken as a result of these international considerations until provision had been made to offset the possible harmful effects of the change upon the reserve base of the domestic monetary system. It would certainly be unwise to consider raising the gold price for such nonmonetary reasons as a desire to extend additional foreign aid to those countries which possess or produce substantial amounts of gold. Foreign aid should continue to be administered by Congress, with due regard for the legitimate needs of the recipient countries, rather than extended according to the more or less accidental distribution of existing gold stocks, or of gold-producing capacity. The fixed relation between gold and the dollar has become over the past 15 years the one firm element in a world of unstable currencies; that relationship should not be altered for transitory considerations.

2 (*b*). What consideration should be given to the volume of gold production and the profits of gold mining?

The System answer

There is no reason for the United States to give consideration to the volume of gold production, or the profits of the gold-mining industry, in reaching a decision concerning its gold price. Since gold is relied upon primarily as a convenient medium for settling differences on international account, rather than as the ultimate reserve base for most existing monetary systems, there is no special reason to regard the encouragement of gold production as a concomitant of monetary policy. Gold-producing countries which rely upon exports of gold for a significant portion of their foreign exchange earnings, rather than directing their resources more largely to the production of other export commodities, would undoubtedly take a different view of this question.

2 (*c*). What effect would an increase in the price of gold have on the effectiveness of Federal Reserve policy and on the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

The System answer

As noted above, the principal domestic consequence of an increase in the price of gold is an arbitrary increase in the potential reserve base of the banking system. An increase in the gold price to $50, for example, would increase the dollar value of the present United States gold stock by about 10 billion and give a "profit" to the Government of a like amount. Use of this profit by the Treasury in meeting Government expenditures would increase the money supply and add a corresponding amount to bank reserves, thereby providing the basis for a further large expansion of credit and of the money supply. If the Treasury were to hold idle its proceeds from the rise in the gold price, in deference to Federal Reserve policy, one of the major benefits claimed for a rise in the gold price would not be realized. In any event, the Treasury would be placed in a position to exert great influence upon the volume of bank reserves and thus (if there were not full cooperation between the Treasury and the Reserve System) to interfere seriously with the efforts of the System to maintain an effective credit policy.

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Furthermore, reserves would also be swelled as the regular gold inflow from abroad, recently at a rate of roughly $1,000,000,000 a year, would be valued upward by more than 40 percent. In addition, gold production throughout the world would be greatly stimulated and the additional output would, in all probability, flow largely to the United States. Thus, unless the System's authority over reserve requirements were further increased, permitting it to absorb the resulting additions to bank reserves by raising these requirements, the System would soon exhaust its power to exert an effective influence upon the expansion of credit and the money supply, even if it were to sell all of its earning assets through open-market operations aimed at absorbing the new reserves (thereby also losing its ability to earn an income sufficient to cover its expenses).

3 (*a*). What would be the principal advantages and disadvantages of restoring circulation of gold coin in this country?

The System answer

Several advantages of restoring gold coin circulation in this country have been suggested. The principal argument is that by opening this country's gold reserves to public withdrawal a certain discipline will be imposed upon Government spending and upon bank-credit expansion. It is said that whenever the public might sense dangerous developments, the reactions of many individuals would be to demand gold. With the monetary reserve being depleted, the Government would be restrained from deficit financing through drawing upon new bank credit; banks would likewise become reluctant to expand credit to the private sector because of the drain on their reserves; and the Federal Reserve would have been given a signal to exert a restraining influence upon the money supply. In this way, Congress, the Treasury, and the Federal Reserve System would be forced by indirection to accept policies which they would not otherwise adopt. It is also claimed that convertibility into gold would increase public confidence in the currency and have a stabilizing effect on the economy.

In effect, under a gold-coin standard the initiative for over-all monetary control would, through the device of free withdrawal of gold from the monetary reserve base, be lodged in the instinctive or speculative reactions of the public. Some segment of the public would, no doubt, take advantage of the accessibility of gold for many reasons. Conscientious resistance to large Government spending, or fear of inflation, may well be among these reasons. But speculative motives, a desire for hoards (however motivated), and such panic reactions as those set off by unsettled international conditions or monetary fright concerning the business outlook—all of these, and more, will be among the other reasons. The mechanism will not distinguish among motives. Whenever, for any reason, a few wealthy concerns or individuals, or a group of speculators, or the public at large, demand more gold, the reserve base of the monetary system will be reduced. Moreover, if only the dollar were convertible into gold while practically all other currencies were not, hoarding demands from all over the world would tend to converge upon this country's monetary reserves. Circumvention of the exchange controls of other countries would be stimulated, and dollar supplies which they badly need for essential supplies or for developmental investments would be diverted to the selfish interests of the hoarders.

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Even if a particular reduction should occur for desirable "disciplining" reasons, rather than for any of the others which will be continually affecting the reserve base, the impact of such gold withdrawals upon the credit mechanism is likely to be crude and harsh. Since the present ratio between gold reserves and the money supply is less than 1 to 5, and since a roughly similar ratio will be in effect so long as this country retains a fractional reserve banking system, any withdrawal of gold coins will tend to be multiplied many times over in its contractive effect on bank credit and the money supply. In a business recession, the Reserve System might undertake to offset this effect by adding to its holdings of Government securities, but, if the gold withdrawals attained sufficiently large volume, the shrinking reserve position of the Federal Reserve banks might eventually prevent them from continuing such operations.

It was in large measure to offset such arbitrary and extreme influences upon the volume of credit, and to make up for the inflexibility of a money supply based on gold coins (in responding to the fluctuating seasonal, regional, and growth requirements of the economy), that the Federal Reserve System was initially established. During the first two decades of its existence, the System devoted much of its attention to offsetting the capricious or exaggerated effects of the gold movements associated with continuance of a gold-coin standard, and as a consequence was handicapped severely in attempting to deal with the crises of 1920 and 1931. The System relied upon its rediscount rate and other limited operations to accomplish what it could. But when the gold-coin standard was eventually abandoned, it was because experience had shown that, at best, internal covertibility of the currency into gold was no help to the Federal Reserve System in its efforts to exert a stabilizing influence on the economy and, at worst, gold convertibility could at times actually prevent effective System operation. The occurrence of two of the worst depressions in the history of this country during the period when the United States was on the gold-coin standard (in the 1890's and the early 1930's) casts serious doubt on the claim that return to such a standard would have a stabilizing effect on the economy.

The high confidence in the currency of the United States today is a result primarily of the great productive power of the American economy and public confidence in this country's fiscal and monetary policies; our gold reserves have grown steadily as a counterpart of that superiority in production and that confidence in our national policies. Those reserves are readily available to meet any outward drain of funds to other countries, and are more than adequate to satisfy any outflow that could conceivably develop. Confidence in our currency is unquestioned. Only by undertaking to pay out gold coins to everyone, and subjecting our gold reserves to the inroads of speculation or whims of fancy, could we possibly create a danger of depleting our gold reserves to the point where general confidence in the currency might be jeopardized.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I am not in full apreement with the draft reply to this question. While I realize that it may not be practicable to restore circulation of gold coin in this country immediately when the rest of the world is not on the gold standard and when political and economic uncertainties throughout the world would be conducive to the hoarding of gold

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coin, I do believe that we could and should liberalize the provisions of law and regulation with respect to the ownership of gold by our citizens. I believe that steps could be taken to permit people to buy, hold, and sell gold more freely in this country without endangering our financial soundness.

3 (*b*). Do you believe this should be done?

The System answer

Because the discipline claimed for the gold-coin standard must necessarily be exerted with extreme harshness under a fractional reserve deposit system; because the mechanical arrangements which would permit such discipline would also necessarily open the way to a host of capricious influences upon the supply of money and credit; because ultimate responsibility for determining the amount of Government expenditures must rest with Congress and the electorate, rather than with any particular group of individuals; and because in the last analysis the responsibility for deciding to what extent credit expansion or contraction should be encouraged, in the light of any set of economic circumstances, ought to rest with the Federal Reserve System (as designated by Congress)—it would appear unwise to take any steps toward the restoration of gold-coin payments in this country.

4. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

The System answer

United States policy with respect to the purchase of silver for the monetary base is at present of minor significance. The policy does, however, rest upon an unsound principle. In effect, in order to subsidize silver producers, the Treasury is directed to buy silver at a price substantially above that on the world market, and in turn to issue small denomination paper notes at a rate which provides a profit to the Government. The silver subsidy differs, therefore, from other subsidy programs of the Government in that payments automatically increase the supply of currency (unless offset by Federal Reserve action) instead of being met out of the Treasury's general revenues.

The issues of public policy involved in the granting of subsidies to producers of silver, or of any other commodity, are properly considered by Congress, not by the Federal Reserve System. While it may be argued that an artificially high price for silver is a deterrent to the silverware, jewelry, and related trades, perhaps offsetting any gains which might flow to the silver producers, that is not a question of importance for monetary policy. The influence of the Federal Reserve System upon the money supply is disturbed, however, by the fact that the subsidy payments result in regular increases in the reserve base of the banking system. The annual increase is not large, to be sure; it has recently been less than $50,000,000 per year. Nonetheless, the Treasury's silver purchases do cause a continual increase in the reserve base, year by year, regardless of whether monetary policy is currently aimed at contracting or expanding that base.

So long as silver production is to be subsidized, Government purchases of silver should be handled in a manner comparable to that now followed for the stock piling of strategic materials, or to that used in crop support, and divorced from a direct relation to monetary

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reserves. Silver can, of course, continue to be used in the manufacture of metallic coins, just as many other metals are used today.

The monetary needs of the United States are served primarily by bank deposits and printed notes. The Federal Reserve System is charged with the responsibility of adjusting the money supply to the requirements of the economy, in accordance with general objectives such as those contained in the Employment Act of 1946. It is anomalous to continue automatically relating any segment of this money supply, however small, to the subsidy payments made for encouraging the production of silver metal.

Comments of Allan Sproul, Federal Reserve Bank, New York, on III as a whole

Until roughly two decades ago it was expected that the Federal Reserve System, as the Nation's central banking system, would exercise leadership in determination of international financial policies. That responsibility has largely shifted, in recent years, to the Treasury Department. It was expected that establishment of the International Monetary Fund would constitute another step in this trend toward direct governmental responsibility, by providing for a limited pooling of responsibilities among countries. The shift away from central bank responsibility has gone further in this country than in England or Canada, for example, or in any other leading country in which the central banks still retain appreciable autonomy in domestic matters.

It is within this narrowed framework that the Federal Reserve System exercises its responsibilities in the foreign or international field. It is represented in policy formation through the membership of the Chairman of the Board of Governors on the present National Advisory Council on International Financial Policy. That Council provides a meeting ground where international financial issues can be jointly reviewed, as they arise, by all of the affected agencies of Government. It has apparently enjoyed a considerable success in policy coordination during the 5 years of its existence.

There may be a question, however, as to whether the experience gained in conducting international financial transactions, which (so far as the Federal Reserve System is concerned) are largely carried out by the Federal Reserve Bank of New York, is given sufficient representation in this development of a coordinated approach to policy questions. My own feeling is that the aim of curbing the early dominance of the Federal Reserve Bank of New York in international financial matters, through the changes introduced in the Federal Reserve Act by the Banking Act of 1935, carried the reaction further than was necessary. That act, while open to various interpretations, has generally been construed by the Board of Governors as lodging full responsibility for policy formulation in the hands of the Board itself. There is little opportunity for the Federal Reserve banks (the Federal Reserve Bank of New York particularly) to have a voice in formulating the System's position on questions considered by the National Advisory Council on International Financial Policy.

It has seemed to me for some time that one major change in the locus of responsibility within the Federal Reserve System would overcome much of this and other difficulties. In line with recommendations below concerning domestic matters, the ultimate responsibility for the System's share in international financial policy might be placed in the Federal open market committee (or a similar group with a more

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appropriate name, representing both the Board of Governors of the Federal Reserve System and the Federal Reserve banks). This committee makes possible a unique blend between policy formation and the experience gained through translating policy into practical operation. The committee consists of the members of the Board of Governors (appointed directly by the President and serving full time in Washington) and the presidents of the various Federal Reserve banks, serving (with the exception of New York) in rotation. Thus, through the Federal open market committee each Federal Reserve bank would have a ready avenue for bringing into policy considerations the understanding and analytical competence which are acquired through intimate contact with the implementation of these policies. (And the vice chairman of the Federal open market committee or its equivalent, who has always been the president of the Federal Reserve Bank of New York, could be an alternate of the Chairman on the National Advisory Council.)

Question 3 of this section on international financial matters concerns the gold-coin standard. My 30 years of exposure to the problems of monetary control, as they present themselves to the Federal Reserve System, have been split about evenly between a period in which this country was operating with, and without, such a standard. From that experience I can confirm what is said in the attached document on the manner in which a gold-coin standard acts as a more or less automatic control over the reserve base of the monetary system, competing with the discretionary control which the Federal Reserve is expected to exercise. It seems to me that reliance upon two independent, and frequently incompatible, types of control over the reserves of our banking system is undesirable. If there is to be regulatory discretion to offset the automatic action from time to time, the automatic action cannot be relied upon to exert that type of dominant control which, so it is argued, would supersede decisions now made by Congress and the Federal Reserve System with respect to fiscal and monetary policies.

Moreover, it is important to recognize that the automatic discipline of a gold-coin standard is likely to be perverse, rather than consistent with the objective of economic stability. Discipline is necessary in these matters, but it should be the applied discipline of competent men, not the automatic discipline of self-interest on the part of a limited segment of the public applied to the monetary metal that constitutes the base of our entire monetary system. In the exuberance characteristic of inflation up to its final stages, for example, gold coins are likely to flow steadily into the monetary reserves of the country—providing a base for more and more credit expansion. Only when the crisis stage has been reached is a reversal likely. Thus, at a time when discretionary controls could begin restraint, the impetus of a gold-coin standard would be toward further expansion. When a delicate adjustment is necessary to moderate the shock of a collapse of inflation, the control exerted by a gold-coin standard would express itself through a great drain on the reserves of the banking system, tending to force hasty and chaotic liquidation of credit. A drain on gold reserves is likely to continue, moreover, throughout a period of depression, forcing a tightness in the availability of bank funds for lending, instead of permitting the monetary ease appropriate for such a period.

Having seen the distressing periods of 1920–21 and 1931–33, when deflation was aggravated by this perverse discipline of the gold-coin

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standard—despite the limited offsetting measures which the System was able to undertake under then existing legislation—I cannot be impressed by arguments (many of them of a most extravagant character) for restoration of a gold-coin standard in this country. Gold has a useful purpose to serve as a medium for balancing international accounts among nations, and perhaps as a guide to the necessary discipline required in the international field. It has no useful purpose to serve in the pockets or hoards of the people. The present large official holdings of the United States are a symbol of our towering international strength. To open our gold reserves to the drains of speculative and hoarding demands strikes me as both unwise and improvident.

IV. Instruments of Federal Reserve Policy

The System answer

The instruments of Federal Reserve policy fall into two major groups, those quantitative instruments which are designed to give the System a satisfactory degree of general control over the total volume, availability, and cost of bank reserves and those selective controls which are designed to supplement the various quantitative controls in such a way as to enable the Federal Reserve to operate in a particular sector of the market without direct influence upon other areas of the market when conditions develop that cannot be reached by the general or quantitative methods.

Instruments of quantitative control include those which affect primarily the volume of member bank reserves, such as open market operations and policies affecting the volume of Federal Reserve float; those whose major influence is upon the availability of reserves, such as changes in reserve requirements and policies and regulations regarding the eligibility or acceptability of bank assets as a means of obtaining access to Federal Reserve credit; and those which affect primarily the cost of bank reserves, such as discount rates and buying and selling rates on Government securities and on acceptances.

The only instrument of qualitative or selective control which the Federal Reserve can use at this time is the authority to establish and change margin requirements on listed securities. In the past, of course, the System has exercised control over consumer credit, and from time to time other selective instruments of control, such as controls on real-estate financing and on trading in the commodity markets, have been suggested.

An appraisal of the effectiveness or the adequacy of instruments of Federal Reserve policy must take into consideration the particular circumstances in which the use of each instrument is most effective, and the interrelation of the different instruments. Each instrument is important to the extent that it is essential in rounding out the entire framework of control in such a way as to contribute to the achievement of the objectives of Federal Reserve policy. For instance, the authority to change reserve requirements is an instrument needed only be cause, under conditions which have been experienced and which may reoccur in similar or different form, the absence of such authority would tend to prevent the System from maintaining effective control

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over the money supply. The power to change reserve requirements—or the use of any other instrument of control—should be considered as a tool which, when used with other appropriate instruments, tends to make Federal Reserve policy more effective.

It is also important in appraising the adequacy of instruments of control to give proper weight to the whole broad set of economic conditions and factors which establish the framework within which the instruments of control must be used.

Developments during the late twenties led to a condition in the securities market that was beyond the effective control of the traditional instruments of the time. The subsequent grant of authority over margins was important only in that it tended to provide the System with an instrument of control to reach this particular sector of the market which the traditional general instruments were not effectively reaching.

Again, following the dollar devaluation in the mid-thirties large and continuing gold imports so increased the supply of available reserves as to place control over the volume of reserves beyond the limits of effectiveness of the instruments at the System's disposal. Authority to change reserve requirements became essential to restore a satisfactory degree of control to the System and to enable the System to use other more or less orthodox general instruments more effectively

Also, following the war, developments growing out of the magnitude of the public debt and the problems of debt management as they related to interest rates led to a set of conditions which tended to prevent the use of the System's instruments of control to such a degree and in such a manner as to assure Federal Reserve control over the volume of bank reserves. Additional power at that time was sought in the form of authority to raise reserve requirements beyond the limits in existing legislation. During this postwar period, largely as a result of the problems involved in dealing with the huge public debt, it has not been possible for the System to operate freely in the money market with traditional instruments of control because of the effect upon the rate structure and the Government securities market. Until recent months, System policy involved to a considerable extent the use of major instruments of control to maintain stability in the Government securities market, with a consequent marked loss of control over the volume of bank reserves. An alternative to this policy would have been use of instruments to attempt primarily to control the volume of bank reserves, even though such a policy might have involved a substantial decline of prices of Government bonds. It was this situation which led the Board of Governors to seek additional direct authority over reserve requirements to be in a position to absorb reserve funds arising out of the support program or from other sources, such as gold inflows. In other words, it has not been the policy of the System with respect to instruments of control to obtain additional authority merely for the sake of having that authority, but it has been the objective of the Federal Reserve to attempt to obtain such instruments of control as have appeared to be necessary in order for the System to exert an effective influence on the money market and to achieve its recognized objectives.

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1 (*a*). What changes, if any, should be made in the reserve requirements of member banks?

The System answer

The principal purpose of the requirement that member banks hold legal reserves is to enable the central bank to exercise an effective influence over the total volume of bank credit and the money supply. The central bank can limit credit expansion only if it has control of the amount of the required reserves and of the amount of assets available as acceptable reserves. Therefore, if the central bank is to discharge effectively its responsibility with respect to the control of bank credit and the money supply, it must have authority to fix within reasonably broad limits the reserve requirements of member banks and to require that they hold as legal reserves only those assets which are liabilities of the central bank. The requirement imposed upon member banks to hold a legal reserve of nonearning assets is, in a sense, a price that they must pay as their contribution toward the achievement of a satisfactory degree of national economic stability; in view of this fact, it is very important that reserve requirements be equitable as between different banks and as between different groups of banks, e. g., member banks and nonmember banks. In addition, reserve requirements should be founded on a sound economic basis and should be administratively feasible and simple.

The present system of member bank reserve requirements, based upon geographic location of banks with different reserve requirements against net demand deposits of banks located in central Reserve cities, Reserve cities, and other towns and cities, is a carry-over from the national banking legislation which was in effect when the Federal Reserve System was established. Higher reserve requirements for banks in Reserve cities and central Reserve cities were considered essential because of the substantial amounts of interbank deposits which tended to concentrate in those cities.

With the passage of time, however, it has become evident that mere geographic location does not determine the character of a bank's business. For instance, studies have shown that there are many so-called country banks which hold a substantial amount of interbank deposits and carry on a banking business similar to that done by some banks located in Reserve cities or central Reserve cities. On the other hand, there are Reserve city and central Reserve city banks which hold no substantial amount of interbank deposits but simply provide banking service for business and individuals in their localities. As a result, the present system of reserves frequently involves indefensible inequities and raises very difficult administrative problems.

Inasmuch as the purpose of reserve requirements is to enable the central bank to control the volume of bank credit, it can be contended with some basis that a single reserve requirement subject to variation within reasonable limits without differentiation as to bank or type of deposit might be effective in enabling the central bank to discharge its responsibility. However, a change from the present system of reserves to a system involving a single reserve requirement would be too disruptive, as large excess reserves would be created in central Reserve city banks, while huge deficiencies would appear at country banks. In addition, to a considerable extent, interbank deposits have some of the characteristics of bank reserves. While many fine shadings regarding different types of deposits might be made, from an administrative point of view it is desirable to classify deposits for reserve purposes as inter-

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bank deposits, other demand deposits, and time deposits. Such a deposit classification is readily understandable in the banking system, has the value of traditional acceptance, would provide the basis for an equitable system of reserves and, assuming appropriate discretionary authority to the central bank, would enable effective control over the limits within which expansion of the volume of bank credit could occur.

A system of uniform reserve requirements based upon the three major classes of deposits and involving the specific features outlined below is recommended to enable the Federal Reserve System to discharge its objectives more effectively, to eliminate inequities existing under the present reserve structure, to facilitate administrative control, and to conform to sound economic principles with respect to the control of bank credit in a dual system of private banking such as exists in this country.

1. Abolish central Reserve city and Reserve city designations of banks.
2. Establish reserve requirements uniform for all banks accepting deposits on the basis of type of deposits classified as interbank, other demand, and time deposits. Initial reserve requirements should be established at differential levels that would permit the transition to the new system to be made with a minimum unfavorable impact on individual banks and which would result in an aggregate volume of required reserves approximately equal to the amount required under the present system at the time of change.
3. The Federal Reserve should be authorized to change reserve requirements on any or all of the three classes of deposits within reasonably broad statutory limits.
4. Banks should be allowed to consider vault cash as required reserves. Since the purpose of required reserves is to influence the volume of bank credit, it is a matter of indifference to the central bank whether banks hold reserves in the form of central bank currency or reserve deposits with the central bank.
5. Banks should be allowed to consider as reserve that part of their balances due from other banks which those latter banks are required to hold as reserves against such balances. This provision would recognize the correspondent bank relationship as an established part of our banking system but would relate correspondent balances to reserves in such a way that a shift of funds by banks into or out of "due from banks" would not affect the total volume of the banking system's excess reserves.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

The major reason for reserve requirements, as we see it today, is to give the central bank influence over the total money supply. In exercising this influence, the central bank needs powers which enable it to vary the total amount of reserves available to the banking system and power to vary the legal relationship between the volume of reserves and the volume of deposits.

In a very real sense, the legal requirement to hold reserves may be viewed as a price paid, a contribution made, by the banks for greater economic stability. Consequently, reserve requirements should be set so that they do not bear more harshly upon certain groups of banks than upon others. In other words, the reserve burden should be shared equitably by all banks.

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The present method of fixing reserve requirements does not meet this test of equity and in addition has certain other disadvantages, both administrative and technical. A plan has been proposed (and is given in some detail in the special System study reply to this question) which would establish uniform reserve requirements for the banking system with different reserve requirements for the three major classes of deposits—interbank, demand, and time. This plan would seem to have administrative feasibility, and would eliminate inequities as between banks, many of which, solely because of geographic location, now have reserve requirements which do not match their actual operations. In addition, it would eliminate some of the technical difficulties in our present system of reserve requirements.

In May 1948 a joint meeting of the Board of Governors and the Conference of Presidents reviewed a staff report of a similar program which would change the method of assessing reserve requirements from a geographical to a "type of deposit" basis, and recommended it be given continuing study by all elements in the System (including the Conference of Chairmen and the Federal Advisory Council), and of consultation with commercial bankers and other interested parties. Thus, I would recommend consideration of a change in the manner of assessing reserve requirements, but not necessarily the specific plan as outlined in the special System study.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I am not in agreement with the recommendation contained in the draft reply. The present system of reserve requirements is by no means perfect, and from time to time the Federal Reserve System has had committees study this question. However, sufficient agreement to justify change has never been secured on any proposal for determining reserve requirements. Recently, a technical staff System committee submitted a proposal for a new system of reserve requirements based on type of deposits rather than on location of bank, as at present. The recommendation in the draft reply to your questionnaire is essentially that proposal. I do not believe that the particular proposal has been given enough study by the banking system and particularly by parties other than those directly connected with the Federal Reserve System to warrant its consideration at this time. The banking system has adapted itself to the existing method of reserve requirements, and banking relationships have developed around them. The advantages claimed for the proposal do not appear to me to be sufficient either in character or in probability of achievement to warrant the disturbance to the banks that would result in making the change. I would favor legislation permitting member banks to count vault cash as a part of their reserves. This would help to remove some of the present inequities claimed in the system of requirements. Otherwise, I am in favor of letting the entire question of reserve requirements rest unless there can be an approach made to the subject in a manner which would give opportunity for participation by a wide group of interested parties such as bankers' associations, State bank supervisors and others.

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1 (*b*). What changes, if any, should be made in the authority of the Federal Reserve to alter member-bank reserve requirements?

The System answer

As stated in the answer to the preceding question, the Federal Reserve should have authority to change reserve requirements within reasonably broad statutory limits. The limits within which such changes should be permitted would need to be changed from those existing in present legislation to limits consistent with the uniform reserve plan and the basic purposes underlying changes in reserve requirements. The upper limit of authority to fix reserve requirements on each of the different classes of deposits should not be so high as to destroy the advantages of a proportional system of reserve requirements, although the range of change above and below the initially established basic levels of reserves should be wide enough to assure the System of the ability to absorb or release reserves in sufficient amounts when necessary to prevent injurious credit expansion or contraction.

Although the following is not in the nature of a recommendation, it involves a proposal which may deserve consideration. In view of the desirability of retaining the advantages of the proportional system of reserves and because of the fact that increases in reserve requirements strike all banks equally, regardless of reserve position or their rate of credit expansion, it has been suggested that, to prevent an increase in bank credit beyond the amount outstanding on a given date, a reserve requirement somewhat, perhaps even substantially, higher than the reserve requirement on existing deposits be applicable to new deposits. This type of reserve requirement, which could be supplementary to the uniform reserve plan, would be more selective in nature than a general increase in reserve requirements and would avoid the unfavorable impact of a general increase in reserve requirements on banks not engaging actively in the expansionary development. This instrument might serve valuably under special circumstances, existing for comparatively short periods, when it might be desirable to restrict the expansive effects of bank reserves by reducing or conceivably even eliminating the multiple-expansion potential.[3]

1 (*c*). Under what conditions and for what purposes should the Federal Reserve use this power (to change reserve requirements)?

The System answer

The principal purpose for which the Federal Reserve should use the power to change reserve requirements is to adjust the total reserve requirements of the banking system in order to prevent serious credit expansion or contraction, control of which for one reason or another is beyond the limiting influence of other instruments. The power to change reserve requirements is a broadside weapon which reacts uniformly throughout the banking system, although its impact upon individual banks will vary, depending upon the reserve position of such banks at the time of change. It is an instrument that is well adapted to those occasions when, because of excessive banking liquidity (or tightness), it becomes necessary to absorb (or release) a comparatively

[3] The recommendation in this paragraph was not included in the statements made by the presidents of the Boston, New York, Philadelphia, Richmond, and St. Louis Federal Reserve Banks.

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substantial amount of reserve funds from (or into) the market. It provides a direct and positive means by which the availability of banking reserves for credit expansion by the banking system may be adjusted and other instruments made more effective than otherwise would be the case.

Any set of conditions which would result in an excessive flow of reserve funds into or out of the banking system beyond the control of the Federal Reserve through the use of other instruments of control might give rise to a situation calling for the use of the authority to change reserve requirements. For example, continuing gold movements in substantial amounts could lead to a condition of excessive liquidity or tightness in the banking system such as to require the use of this authority. A substantial return flow of currency to banks or a persistent currency drain from the banks might lead to similar situations. Developments during the postwar years, when a large volume of gold imports and sales of Government securities by banks and nonbanking investors added large amounts to available reserves, also gave rise to conditions calling for an increase in reserve requirements. It is possible that at times the magnitude of operations required to achieve an objective through open-market operations might be such as to be unduly disturbing to the money market or to threaten the Reserve System's capacity to continue them. Under such circumstances, a change in reserve requirements might absorb sufficient reserves to aid in making the more traditional instruments more readily effective. In general, as long as the Federal Reserve through the use of its other instruments of control is able to control the volume of reserves available to the banking system, it should not need to use the authority to change reserve requirements; but, when conditions develop causing the Federal Reserve to lose effective control over the volume of reserve funds, then it might become necessary to resort to changes in reserve requirements.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

It is impossible to foresee precisely all the conditions under which changes in reserve requirements, either separately or in conjunction with other instruments, would be the most appropriate tool. Experience with this instrument is limited, and we still have a lot to learn about its operation. We have, however, sufficient experience to correct one misconception. Changes in reserve requirements have been opposed by some because they assumed that the alternatives are a change in requirements and no other action by the System at all. The relevant comparison is that between the efficiency and effectiveness of changes in reserve requirements and of use of other instruments to achieve similar over-all results.

We have had sufficient experience to indicate some of the unique characteristics of the instrument which influence its peculiar appropriateness to certain developments. The following analysis should be viewed as illustrative of such developments rather than as a complete catalog.

A unique characteristic of changes in reserve requirements is that they affect all member banks directly and immediately. This is not true of either changes in discount rates or open-market operations. Individual banks may be wholly unaware that these instruments have been used, even when they feel the effects in the course of regular

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operations. They cannot remain unaware of changes in reserve requirements. Such changes are uniquely suitable when it is desired to influence the availability of funds at all banks.

Changes in reserve requirements are also particularly adapted to conditions in which the earning assets of the Federal Reserve banks are inadequate to absorb excess reserves. There are differences of opinion as to the wisdom of increasing reserve requirements in 1937. The differences, however, rest on the differences in judgment as to timing and the probability of an eventual undesirable expansion of credit. No one questions that the System had no other instrument adequate to halt undesirable credit expansion had it been a reality at the time.

Changes in reserve requirements also make possible a more flexible program of action when used in conjunction with other instruments.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

The authority to alter member-bank reserve requirements is a clumsy and unsatisfactory instrument of credit control. It affects all banks and requires or permits adjustments which may have unhealthy general effects and be harmful in many individual instances. The use of this authority, therefore, can be justified only in exceptional cases and calls for a degree of discrimination difficult of attainment. As the draft reply indicates, requirements should be altered only to take care of those situations in which excessive liquidity or tightness could not be compensated for by open-market operations without engaging in purchases and sales of such magnitude as to have seriously detrimental effects on money markets, security markets, and business and Government finance. Such situations would include unusually heavy and sustained imports or exports of gold. I believe, therefore, that the power itself should be used rarely and not as a substitute for ordinary open-market operations. On that basis I do not believe that additional powers or changes in existing powers are necessary. Bankers generally would appreciate our giving the matter a rest cure and letting them feel that they have a stable basis of reserves on which to operate.

1 (*d*). What power, if any, should the Federal Reserve banks have relative to the reserve requirements of nonmember banks?

The System answer

The Federal Reserve System should have the same authority over the reserves of nonmember banks as it has with respect to the reserves of member banks if it is to be able to carry out its responsibilities effectively. While it is recognized that this question is a highly controversial one, the several reasons in support of the answer given above are compelling.

The Federal Reserve System, as an agent of Congress, has the responsibility of controlling the volume of bank credit and the money supply in the national economic interest. That control can be achieved only if the Federal Reserve System has control over reserve requirements of the Nation's banks and the amount of reserves available to those banks. To subject only the member banks to Federal Reserve System control not only imposes inequitable restrictions on those banks relative to nonmember banks but also restricts the System's use of its authority due to the very real danger of loss of membership when-

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ever member-bank requirements become much more onerous than non-member-bank requirements.

It is virtually universally recognized and has been established in law that Congress should have the ultimate control over the money supply of the country. As far back as 1865 that power was demonstrated with the imposition of the 10-percent tax on the note issues of State banks. At that time, bank notes represented a substantial bulk of the money supply, and the Congress undertook a drastic step to bring within the scope of its control the power of money creation of the State banks. Today, by far the largest part of the Nation's money supply is the deposit currency created by the Nation's banks. Through the Federal Reserve System the Congress has ultimate control over that part of the money supply created by the central bank and the member banks, but it does not have control over that part of the money supply created by nonmember State banks. This defect in the system of control of the Nation's money supply reflects such an inconsistency with the generally accepted responsibility of the Congress as to make the need for its correction apparent.

It is sometimes contended that if nonmember banks were subject to the reserve requirements of the Federal Reserve System it would mean a step in the direction of breaking down the dual system of State and national banking that is firmly established in the banking tradition of this country. Such a position, however, is untenable. The very essence of the dual system of banking in this country lies in the recognized authority of the State and Federal governments to (*a*) charter banking organizations and (*b*) supervise those banks of their respective creation toward the end of assuring sound, safe, banking institutions. These vital aspects of the dual banking system would not be threatened if nonmember banks were subject to the reserve requirements of the Federal Reserve System.

Reply of C. E. Earhart, Federal Reserve Bank, San Francisco

It would be desirable for the Federal Reserve System to have the same authority over the reserves of insured nonmember banks as it has with respect to the reserves of member banks. It should be made clear that this authority would not impair minimum State requirements when they exceed System requirements. While it is recognized that this question is highly controversial, the several reasons in support of the answer given above are compelling. (The reason for suggesting insured nonmember banks instead of all nonmember banks rests primarily on legal, not economic, considerations.)

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I am in agreement with the draft reply to this question. However, I reiterate the position taken in my immediately preceding replies that the whole subject of reserves should be given a rest cure. If legislation should be considered, such legislation should include application of the same general type of reserve requirements to all banks.

2 (*a*). Should the Federal Reserve have the permanent power to regulate consumer credit?

The System answer

The Federal Reserve System should have the permanent authority to regulate consumer credit arising out of personal installment loans

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and installment sales of various types of consumers' durable goods. Such authority should be broad enough to provide discretionary power to the System in order to make possible the administration of the regulation with the needed flexibility. Experience during the past 8 years has proved that consumer installment credit control is administratively practical and is comparatively simple. Moreover, while in effect, the regulation received a high degree of compliance and, in general, was a factor in helping to hold the forces of economic instability in check.

The volume of consumer credit has grown tremendously since the early twenties, reflecting largely the increased demand for a steadily growing volume of durable goods and the increasing number of wage and salary earners who resorted to this type of credit as they became familiar with its advantages. The total amount of consumer credit outstanding and the amount of consumer installment credit in force have now reached such proportions as to hold potential danger of contributing to general economic instability if uncontrolled; moreover, the behavior of consumer installment credit at times in the past—the fluctuation in its outstanding volume—has been a factor in accentuating business-cycle fluctuations. During periods of rising and high business activity consumers have tended to supplement current income by an expanding use of consumer credit, thus exerting increased inflationary pressures. On the other hand, during periods of declining business activity, developments in the consumer-credit field have had the effect of aggravating the decline in effective consumer purchasing power, since consumers have been compelled to use current income to repay installment credits created during the preceding period of prosperity and high prices. Variations in the volume of consumer credit have been sizable in relation to total variations in national income and at times have corresponded roughly with fluctuations in industrial production.

Since consumer installment credit is so intimately related to the purchase, distribution, and production of durable goods, its trend and volume influence actively a very strategic sector of the economy. The automobile industry, producers of the various other major durable goods, and those producing a miscellany of so-called minor durables have become a very important direct factor in influencing employment, incomes, and national prosperity. Furthermore, the indirect influence of these consumers' durable goods industries is also notable as a result of the relations of these industries with a myriad of other large and small businesses which serve as their suppliers.

On the basis of past experience and with regard to the place of durable goods in the American scheme of things, it is reasonable to believe that the volume of consumer installment credit will continue its upward trend at a fairly substantial rate and that significant fluctuations in the outstanding volume of such credit will continue to occur around the growth trend. The growth of consumer credit can be a very constructive force in our economy, provided undesirable fluctuations are restrained and excesses are prevented; uncontrolled, however, it could conceivably become a very damaging force to the economy. As a solution, at least in part, to some of the problems involved in the extension and use of consumer credit, this form of credit should be subject to the control of the central bank.

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Reply of Joseph A. Erickson, Federal Reserve Bank, Boston

We prefer that a time limit of, say, 5 years be placed on this authority to permit review of the operation of this program under ordinary peacetime conditions.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The Federal Reserve System should have the permanent authority to regulate consumer installment credit because of the contribution which the exercise of that authority would make to the basic objective of economic stability.

The extent to which the regulation of this credit has helped to mitigate economic fluctuations since it was inaugurated in 1941 cannot be fully demonstrated. During the war such credit declined sharply while the regulation was in effect, but the extreme shortage of the durable goods customarily purchased on the installment plan was the principal factor in this decline. Up until the past year, the postwar period has been characterized by large current and accumulated demand, large reserves of liquid assets making liberal credit terms less necessary, and a general concern with respect to the future based on recollections of the post-World War I period which was conducive to conservatism on the part of both the grantors and the seekers of credit. Accordingly, credit expanded substantially during the period despite restrictions on terms so that the effectiveness of such restrictions has been widely challenged by interested groups.

It has been demonstrated that, in the absence of regulation, competitive influences drive down-payment requirements toward the minimum and maturities toward the maximum when business is expanding—as happened when the regulation was dropped in 1947—and that this tendency is reversed as business activity declines and creditors become cautious. This has the effect of increasing the funds available for spending when purchases generally are increasing toward the point when capacities may be strained and further spending power wasted in rising prices. Conversely, when buying declines, the amount of consumer income available for current purchases is further reduced by the payments on past debt, and with strict terms on new credits the money supply tends to shrink further.

The economic significance of these fluctuations is partly reflected in the amount of credit involved—$10,000,000,000—which is almost as much as the total real estate loans outstanding at all insured commercial banks and nearly two-thirds as much as the total of all such banks' commercial, industrial, and agricultural loans. Their impact on general stability, however, is greater than the dollar figures alone would suggest. This spending power represented by net additions to outstanding consumer installment credit is heavily concentrated in the field of automobiles and other durable goods. Such items by their nature involve large unit costs, are deferrable purchases, and come at the end of relatively long production cycles so that fluctuations in production and sales are greater than is true in the nondurable goods. Furthermore, the impact of changes in the market for the durable goods spreads widely through the long and complex chain of suppliers, with a substantial total effect upon business activity and employment.

Expansion in buying power through liberal terms on consumer installment credit has been regarded a factor in the excesses of 1929 and

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1937, with their subsequent recessions, even though the volume of credit involved was smaller and the variety and scope of the industries affected were not as great as is now the case. The importance of the durable goods industries and accordingly of the credit going into the market for these products may be expected to increase further as our economy develops and the benefits of our productive system spread over a wider range of income groups. As these cyclically responsive elements of the economy develop, the national objective of orderly expanding business and consumption becomes more and more important to society.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The answer to this question is not clear-cut. There are two powerful arguments in favor of permanent power to regulate consumer credit. Such types of credit are not susceptible to general measures of monetary control. The alternate expansion and contraction of consumer credit has furthermore augmented the cyclical swing of business activity.

On the other hand it is not clear that the alternate contraction and expansion of consumer credit (over and above what a reasonable administration of consumer credit regulation would permit in any case) has been a material factor in booms and busts. Because of the large number of organizations which directly or indirectly participate in the extension of consumer credit, an effective permanent administration poses formidable problems and would require a substantial staff. These considerations, together with the fact that selective controls in principle come close to being inconsistent with the democratic concept of freedom of choice, make it doubtful if such a permanent power can be justified even though there is a modest case for it on purely theoretical grounds.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I do not believe that the Federal Reserve should have permanent power to regulate consumer credit as I am not at all convinced that it is necessary, wise, or practicable thus to police this field of human activity. I am not satisfied that there are advantages to be derived from use of the power sufficient to offset the disadvantages inherent in an irritating interference with normal business transactions.

2 (*b*). If so, for what purposes and under what conditions should this power be used?

The System answer

The power to regulate consumer credit should be used for the purpose of maintaining a credit situation in that particular area which will contribute as much as possible to general economic stability. Power to control consumer credit should not be used in such a way as to prevent a normal, steady growth in the use of this type of credit consistent with a sound growth in the durable goods industries and in the economy as a whole. It should be used, however, to prevent an excessive use of credit in the consumer goods field, especially during periods of sharply increasing demand when the use of such credit tends to stimulate rising prices more markedly than it does the increase in the production of goods.

Looking back upon our experience with the use of consumer credit controls, it seems that such controls were needed and effective during

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the last quarter of 1941. During the war years, when the production of most consumer durable goods was discontinued for civilian consumption and when cash incomes were rising sharply, conditions were such that it is not possible to draw clear conclusions as to the usefulness or effectiveness of consumer credit regulation. With the end of the war, however, and the removal of various other wartime controls at a time when consumer demand for durable goods was very intense and the supply of such goods very meager, the use of consumer credit controls was important and effective.

These developments of the past several years show that there may be alternately occurring periods of a need for or a lack of need to exercise consumer credit controls, but in view of the probability that conditions will arise again in the future when consumer credit control would be desirable, the Federal Reserve should have the authority, in order to be in a position to exercise control promptly when it is needed.

Further discussion of the use of selective credit controls, including control over consumer installment credit, is presented in question 4, below.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The power should be used to minimize the extent to which fluctuations in consumer installment credit and the industries affected accentuate inflationary and deflationary excesses.

The questions of trade practices and charges and the problems of liberal terms per se we do not regard as matters of concern to central banking authorities. The importance of consumer credit to a highly industrialized economy with large productive capacity is such that it should be allowed to develop soundly as the industries which depend extensively upon it grow. Only as the volume expands unduly in relation to current conditions and specifically the capacities of the affected industries to meet demand or as the volume unduly contracts with waves of pessimism and excess caution should the central banking authorities take action.

The complex institutional structure in the area of consumer credit and the low cost of money relatively to the income from it make it impracticable to attempt by some simple, general instrument, such as a special discount rate, to control the flow of funds into the hands of credit grantors. The means must instead be directed at the flow out from credit grantors, which involves the setting of standard terms on individual transactions. The experience of the Federal Reserve System under Regulation W indicates that there is an exceptionally high degree of understanding and compliance with the basic terms of a consumer credit regulation, but the fact that more than 100,000 business establishments are directly affected in their millions of transactions suggests that the substantive provisions of any consumer installment credit regulation should be applied only on a so-called emergency and not a continuing basis.

Reply of C. S. Young, Federal Reserve Bank, Chicago

At best, consumer credit regulation can be most effective under conditions of inflationary pressures, and hence is not needed on a continuing basis. Since consumer credit control is discriminatory against persons with low incomes and limited cash resources, it is fitting that it be employed only in the most urgent instances. Moreover,

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competition through extension of credit is unduly limited by consumer credit control.

2 (*c*). What is the relationship between this instrument and the other Federal Reserve instruments of control?

The System answer

The authority to regulate consumer credit is not a substitute for the use of other instruments of Federal Reserve policy, nor should it be considered as minimizing in any degree the importance of continuing effective use of general controls. The authority to control consumer credit is in the nature of a supplementary type of control instrument, which, when used as needed as an adjunct to general controls, enables the System to achieve a more satisfactory control over the volume and use of credit.

If the general instruments of Federal Reserve policy can be used in such a manner as to result in a balanced credit situation not only from the standpoint of the economy as a whole but also from the standpoint of the particular area of the economy in which consumer credit is so important, then it would not be necessary to make use of this supplementary authority. There have been occasions, however, in the past—and it is only reasonable to assume that such occasions will arise in the future—when, despite the use of general instruments of control, unsound credit developments have occurred in the consumer durable goods area. Under such circumstances, when the general controls are not completely effective, it would be advantageous for the System to be in a position to use a supplementary control which would enable it to create a balanced credit situation in the particular area which, for one reason or another, may not be responsive to the effects of general control and in which the volume of credit is subject to wide fluctuations.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

This instrument should serve as a supplement to the other general or selective instruments of credit control to be aimed at a sector of the economy which either is not affected by the more general instruments or is out of balance with other sectors of the economy so that application of a general instrument affecting all is not appropriate.

3. What, if any, changes should be made in the power of the Federal Reserve System to regulate margin requirements on security loans?

The System answer

The authority of the Federal Reserve System to regulate margin requirements on loans for the purpose of purchasing securities registered on a national securities exchange has proved to be an administratively feasible and valuable selective instrument of Federal Reserve policy. This instrument of control has especially proved its value since the end of the war when, during a period of very strong inflationary forces which exerted their influence not only in the general money market but also in other sections of the economy, an excessive use of credit has been prevented in the security markets, with the result that the impact of inflationary forces in this particular area of the economy has been kept to a minimum. Looking back upon the monetary and credit conditions of the past 4 years, characterized as they have

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been by comparatively low and stable levels of interest rates, an abnormal condition of liquidity in the banking system, and, at best, an imperfect control by the central bank over the volume of bank reserves, it is very probable that the use of this direct authority to regulate the volume of credit flowing into the security markets averted a greater degree of inflation in those markets and a more severe liquidation, which might have had serious repercussions on the economy.

A favorable feature of the existing legislation on margin requirements is that the Board of Governors is given discretionary authority to prescribe lower or higher margin requirements as it deems necessary or appropriate for the accommodation of commerce and industry, with due regard to the credit situation, or to prevent the excessive use of credit in the securities markets. Such discretionary authority, which permits the Board to establish a flat margin requirement which in its judgment is appropriate under the economic conditions prevailing at the time, is not only administratively more feasible, but it is likely to be more effective in enabling the Board to achieve its objective than if the Board were limited to the dictates of an arbitrary, automatic formula. Policy decisions with respect to economic matters cannot safely be entrusted to the workings of an automatic mathematical formula.

It has been contended in some quarters that a weakness of the present authority is its failure to include, within its coverage, unregistered securities. While this factor deserves study, experience of the past 15 years does not seem to indicate that it has appreciably weakened the effectiveness of the Board's authority and control over the flow of credit into the security markets. In fact, it appears that changes in margin requirements applicable to registered securities have extended their influence in a general way to the markets for unregistered securities, thus accomplishing the desired objective without the burden of the administrative difficulty which might be associated with the attempt to extend legal control to unregistered securities. In addition, there are obviously opportunities under the regulations to evade established margins, but these represent fringe cases and have not prevented or impeded effective administration of the Federal Reserve authority.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

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preventing a degree of inflation in those markets somewhat comparable to that which appeared in other markets.

A favorable feature of the existing legislation on margin requirements is that the Board of Governors is given discretionary authority to prescribe lower or higher margin requirements as it deems necessary or appropriate for the accommodation of commerce and industry, with due regard to the credit situation, or to prevent the excessive use of credit in the securities markets. Such discretionary authority, which permits the Board to establish a flat margin requirement which in its judgment is appropriate under the economic conditions prevailing at the time, is not only administratively more feasible, but it is likely to be more effective in enabling the Board to achieve its objective than if the Board were limited to the dictates of an arbitrary, automatic formula. Policy decisions with respect to economic matters cannot safely be entrusted to the workings of an automatic mathematical formula.

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4. Should selective control be applied to any other type or types of credit? If so, what principles should determine the types of credit to be brought under selective control?

The System answer

As pointed out in the introductory statement to this group of questions dealing with instruments of Federal Reserve policy, selective credit controls are intended to enable the central bank to operate in a particular sector of the market that is not, for one reason or another, capable of being effectively reached at the time by the more orthodox general controls. It should be emphasized that the use of selective control is not a substitute for the use of general controls but instead should be considered as a supplementary type of control which, together with reasonably effective general controls, enables the Federal Reserve to fulfill its objectives and responsibilities with regard to the volume and use of credit more completely. Moreover, selective controls represent a means by which the central bank can influence, at least in some degree, the problem of velocity, for they enable the monetary and credit authority to exercise more effective control over the use of funds in a particular sector of the market than can be accomplished, as a rule, through the medium of general controls.

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An increase in the authority and use of selective credit controls appears to be more important under conditions when general controls are used in a manner to promote a comparatively stable, low interest rate structure. If the authority of the central bank from a practical point of view is to be restricted in any appreciable degree with respect to its freedom to use general controls to influence the availability and cost of credit, then the case for selective controls as supplementary instruments becomes more compelling. A comparatively low and stable interest rate structure induces expansionary tendencies and, in fact, poses a more or less continuous inflationary threat, and therefore under those circumstances it may be necessary for the central bank to be in a position to check promptly the danger of credit excesses in certain important segments of the economy.

Certain basic principles may be relied upon to determine whether a particular type of credit should be brought under selective control. First, how strategic and important to the stability of the general economy are the developments which might occur in the particular sector? Second, how extensive is the use of credit in that area of the economy and how widely does its volume fluctuate? Third, is it administratively feasible to exercise effective selective control in the particular area? Selective control in the regulation of consumer credit and in authority over margin requirements on registered securities can be strongly supported in terms of each of the three basic principles listed above. Other areas for which selective control has been suggested from time to time include real-estate financing and the commodity markets. In addition, of course, one might add selective control over such types of lending activity as farm loans and loans to business to finance inventories, but support for such control in either of these areas has not been extensive.

It is undoubtedly true that developments in the field of real estate and in commodity markets do have an important bearing and influence upon the course of the business cycle. From the standpoint of the first objective, one might conclude that these areas should be subject to selective control. Turning to the second objective, the very extensive use of credit in connection with real-estate financing and the fact that on numerous occasions in the past credit in that sector has been relatively free of control, with the consequence that serious excesses have developed and have caused marked instability in the real-estate markets, it would appear that the case for selective control is well established in terms of this second principle. In the organized commodity markets, however, credit is not used extensively in future trading. Inasmuch as the Commodity Exchange Commission already has rather extensive authority over speculative commodity trading and since additional authority over margins may be granted to the Secretary of Agriculture, it would not appear desirable for the Federal Reserve to have authority in this area.

From the standpoint of administrative feasibility, selective control over real-estate financing might pose serious difficulties. Of course, one approach to the problem would be through control over the amount of down payment required for the purchase of a piece of property. Control also might be extended to cover the period of amortization of the mortgage. There are certain obstacles under existing circumstances, however, which would tend to complicate effective System administration of real-estate credit. In the first place, there is a

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multiplicity of Federal agencies which are active in the housing field which do exert a considerable influence on real-estate developments. Secondly, the Congress has shown during the postwar years a strong desire to make credit available on very lenient terms for the purchase of certain classes of real estate. The trend toward Government housing subsidies—in fact, the entire program with respect to adequate housing, with public assistance if necessary—would militate against effective discharge of credit control responsibility.

If it were believed possible to administer selective control of real-estate financing in an objective manner as it may be administered in other areas, the case for including control in this area might be very strong. It is weakened considerably, however, by the problems mentioned above. Perhaps an alternative to selective control in this area would be a continuous and very close policy coordination between the various agencies having responsibilities in the field of housing and the monetary and credit authorities, so that the objectives of both groups would be coordinated and within reasonable limits pointed toward the same end. Although control of margins in the commodity markets would be administratively simple, the inconsequential use of credit in those markets does not justify Federal Reserve control.

For the various reasons indicated above, it is not recommended that selective control be extended at this time to types of credit other than consumer credit as developed in question 2.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

In the immediate postwar period the ballooning of urban mortgage credit may prove to have provided the largest legacy of troubles in the period ahead. Whether this, however, could be corrected by some sort of selective credit control should be given careful consideration. The magnitude of this problem is indicated by the $13,000,000,000 rise in home mortgage debt from 1945 to 1948 and the $8,000,000,000 rise in Government-guaranteed mortgages.

Selective credit controls should meet three fundamental requirements:

(*a*) The type of credit should be considered not to be susceptible to general monetary policy.

(*b*) It must be administratively feasible.

(*c*) The potential gains in economic stability must be of such overriding significance as to outweigh the inconsistencies in principle with the democratic concept of the right of the individual to choose within the framework of *general* rules.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

As pointed out in the introductory statement to this group of questions dealing with instruments of Federal Reserve policy, selective credit controls are intended to enable the central bank to operate in a particular sector of the market that is not, for one reason or another, capable of being effectively reached at the time by the more orthodox general controls. It should be emphasized that the use of selective tools is not a substitute for the use of general instruments but instead should be considered as a supplementary means which, together with reasonably effective general controls, enable the Federal Reserve to fulfill more completely its objectives and responsibilities with regard to the volume and use of credit. Moreover, selective controls represent a means by which the central bank can influence, at least in some de-

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gree, the velocity of circulation, for they enable the monetary and credit authority to exercise more effective control over the use of funds in a particular sector of the market than can be accomplished, as a rule, through the medium of general controls.

Certain basic principles should govern the types of credit that should be brought under control. First, how strategic and important to the stability of the general economy are the developments which might occur in the particular sector? Second, how extensive is the use of credit in that area and how widely does the amount fluctuate? Third, is it administratively feasible to exercise effective control in the particular area? Selective control in the regulation of consumer credit and in authority over margin requirements on registered securities can be strongly supported in terms of each of these three basic principles. Other areas for which selective credit controls have been suggested from time to time include real estate and the commodity markets. One might add such types of lending activity as farm loans and loans to business to finance inventories, but support for control in either of these areas has not been extensive.

It is undoubtedly true that developments in the field of real estate and in commodity markets do have an important bearing and influence upon the course of the business cycle. From the standpoint of the first objective, one might conclude that these areas should be subject to selective control. Turning to the second objective, the very extensive use of credit in connection with real-estate financing and the fact that on numerous occasions in the past credit in that sector has developed serious excesses causing marked instability in the real-estate markets would make it appear that the case for selective control is well established in terms of this second principle. In the organized commodity markets, however, credit is not used extensively in future trading. Moreover, legislation recently has been introduced in the Congress to grant to the Secretary of Agriculture authority to regulate margin requirements with respect to speculative transactions in commodity futures on commodity exchanges. Inasmuch as the Commodity Exchange Commission already has rather extensive authority over speculative commodity trading and since additional authority over margins may be granted to the Secretary of Agriculture, it would not appear desirable for the Federal Reserve to have authority in this area.

From the standpoint of administrative feasibility, selective control over real-estate financing might pose serious difficulties. Of course, one approach to the problem would be through control over the amount of down payment required for the purchase of a piece of property. Control also might be extended to cover the period of amortization of the mortgage. There are certain obstacles under existing circumstances, however, which would tend to complicate effective System administration of real-estate credit. In the first place, there is a multiplicity of Federal agencies which are active in the housing field which do exert a considerable influence on real-estate developments. Secondly, the Congress has shown during the postwar years a strong desire to make credit available on very lenient terms for the purchase of certain classes of real estate. The trend toward Government housing subsidies—in fact, the entire program with respect to adequate housing, with public assistance if necessary—

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would militate against effective discharge of credit-control responsibility.

If it were believed possible to administer selective control of real-estate financing in an objective manner as it may be administered in other areas, the case for including control in this area might be very strong. It is weakened considerably, however, by the problems mentioned above. Perhaps an alternative to selective control in this area would be a continuous and very close policy coordination between the various agencies having responsibilities in the field of housing and the monetary and credit authorities, so that the objectives of both groups would be coordinated and within reasonable limits pointed toward the same end. Although control of margins in the commodity markets would be administratively simple, the inconsequential use of credit in those markets does not justify Federal Reserve control.

For the various reasons indicated above, it is not recommended that selective control be extended at this time to types of credit other than consumer credit as developed in question 2.

5. In what respects does the Federal Reserve lack legal power needed to accomplish its objectives?

The System answer

The respects in which the Federal Reserve lacks legal power necessary for it to accomplish its objectives have been indicated in the statements presented in the discussion of questions IV–1, 2, and 4; they relate to bank reserves and to uses of credit in major special fields that are presently beyond the Reserve System's effective sphere of influence. Although, in the final analysis, the extension of credit rests with the individual commercial banks, insofar as the availability of central bank credit is concerned the System is in a position to create conditions which would make an undesirably restrictive credit situation unnecessary; on the other hand, the System is not always in a position to absorb bank reserves to the extent that might be necessary to prevent an unwarranted expansion in credit.

In addition, the System, at least under conceivable conditions, might not be in a position to control the volume of credit in certain important sectors of the economy. For example, there might be a recurrence of inflationary developments in the consumer-credit area which would require the use of a selective instrument to supplement the effects of the more general quantitative instruments. System control of credit in the real-estate field, while desirable from the standpoint of preventing credit excesses in that very important area, poses such problems at this time as to lead to the conclusion that the desired result perhaps should be sought, first, through a better coordination of the policies of the Federal Reserve and those agencies involved in the regulation and financing of real-estate activities.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

The Federal Reserve System at present lacks adequate powers to deal with bank reserves. On the upswing of the cycle its powers to absorb bank reserves and to curtail credit expansion are severely limited by the existing circumstances of a large Federal debt and the necessity to preserve reasonable order in the Government securities market. On the downswing its powers over bank reserves are not limited in anything like as great a degree. However, due to certain

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restrictions in the present legislation the System does not have adequate power to supplement credit granted by the banks with a system of guaranteed or direct loans to business.

The Federal Reserve System also lacks power to control credit volume in certain strategic areas of the economy. These are discussed in detail in the System-wide study answers to questions IV–2, 3, and 4.

Finally, there are a number of minor restrictions existing under present legislation which tend to hamper efficient operations of the Federal Reserve banks. For example, there is the provision in the present law which forbids a particular Reserve bank from paying out any notes but its own. No one of these minor restrictions is of any particular significance. Taken together, as noted, they tend to hamper efficient operations and thus to lessen the effectiveness of System action.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

Promotion of economic stability at high levels is the basic objective of the Federal Reserve System. Achievement of that objective, however, does not depend primarily on the legal powers of the System. A nation of free people can achieve stability only through self-discipline based on able leadership and widespread understanding of how our system actually operates and can be made to operate better. We cannot legislate ourselves into continuous prosperity. Inappropriate laws, however, hinder and appropriate laws promote achievement of stability.

The principal inadequacies of the Federal Reserve System are those with respect to reserve requirements of commercial banks as discussed in the answer to IV–1, and with respect to consumer credit as discussed in IV–2. It should be repeated, however, that mere increase of the authority of the System in these particulars will not produce, though it will assist in promoting economic stability.

6. What legislative changes would you recommend to correct any such deficiencies?

The System answer

Legislation should be enacted establishing the uniform reserve requirements for all commercial banks, including authority to change reserve requirements, as outlined in detail in question IV–1.

In addition, the Congress should grant authority to the Federal Reserve to exercise control over the volume of consumer installment credit by permitting the System to establish from time to time as needed minimum down payments and maximum maturity periods for installment credit transactions involved in the sale of durable goods and maximum maturity periods involved in credit transactions arising out of personal installment loans.

Finally, if a national credit council is established, it should be clear in the establishing legislation that it is the intent of Congress that the policies of the various lending and credit agencies involved in housing and real-estate financing—in fact, all lending and credit agencies—be coordinated reasonably well with the basic monetary and credit policies of the Federal Reserve.

Moreover, legislation creating such a council also should express clearly the intent and desire of the Congress with regard to the necessity of coordinating the monetary and credit policies and objectives

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of the Federal Reserve and the fiscal and debt management policies and objectives of the Treasury. If a national credit council is not established, the intent of the Congress regarding these particular problems which have become of first-rank importance should be expressed in connection with legislation relating to the general instruments of control of the Federal Reserve System or, if that is not appropriate, in any event in a general congressional statement of policy and intent.

Reply of Chester Davis, Federal Reserve Bank, St. Louis

I would favor consideration of a system of uniform reserve requirements on banks and legislation to make nonmember banks subject to the same reserve requirements as member banks; which would grant the System control over consumer credit; which would eliminate certain restrictions in guaranteeing credit granted to business; and which would eliminate the minor restrictions that hamper efficient operations throughout the System.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

Legislation should be enacted establishing uniform reserve requirements for all commercial banks, including authority to change reserve requirements, as outlined in detail in question IV–1.

In addition, the Congress should grant authority to the Federal Reserve to exercise control over the volume of consumer installment credit by permitting the System to establish from time to time as needed minimum down payments and maximum maturity periods for installment credit transactions involved in the sale of durable goods and maximum maturity periods involved in credit transactions arising out of personal installment loans.

Finally, it would be desirable for the Congress to direct the Treasury and all lending and credit agencies, as well as the Federal Reserve, to promote the objectives of the Employment Act of 1946.

Comments of Allan Sproul, Federal Reserve Bank, New York, on IV as a whole

Any economy, however organized, appears to need some degree of guidance, but a central problem in our country, and in all countries but Russia and its satellites, in fact, is how far such guidance or control can go without destroying the effective functioning of a private economy. In this country, with our traditions of individual enterprise, we seem to have preferred to keep such guidance to the practicable minimum, and to have it exercised largely through broad and impersonal controls—controls which affect the general environment, but do not extend to the regulation of individual transactions. One cornerstone of such a philosophy is an effective monetary policy. In making monetary policy work, to the full limits of its potentialities, we prepare one of the best possible defenses against the growth of control by intrusion.

But even in trying to make monetary policy work, there are dangers. Ends have a deceptive way of justifying means. The goal of making monetary policy work may present itself as the need for just one more power. The tests of such requests for further powers should always be: Are they really needed and will they, in operation, still leave a reasonably free functioning private economy? It is this latter test which sets the final limit on additions to the instruments of Fed-

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eral Reserve policy. But the first test is important as well: Is the proposed control really necessary, or is it perhaps a way of camouflaging either an unwillingness to take the action permitted by existing powers or an attempt to achieve varied, and possibly conflicting, objectives?

This test forms the basis for my one substantial disagreement with the views expressed in the accompanying treatment of section IV in the questionnaire. Under question IV–5, the document says "* * * the System is not in a position to absorb bank reserves to the extent that might be necessary to prevent an unwarranted expansion in credit." For a period of runaway inflation, that statement is probably correct, and perhaps, as I tentatively indicated at one time in testimony before the Senate Banking Committee, a provision allowing temporarily higher reserves against deposit increases (new deposits) might prove helpful in such circumstances. But for the type of inflationary situation through which we have just passed, I should think our present powers are adequate, provided they are used to the necessary extent.

What the drafting committee no doubt had in mind was the period of 1947 and 1948, when a conflict developed between system support of the Government security markets (which necessitated frequent purchases, and a corresponding release of reserves to the banking system) and the System's desire to put pressure on bank reserves in order to check credit expansion. This posed a difficult problem, but in my view a request for more powers was sidestepping the real issue, an issue which would have remained, and reemerged, once any new powers had been granted and put in operation. To have raised reserve requirements in an effort to lock up the new reserves created by support purchases would have been only the first step in a chain reaction. Banks would have sold more securities to the Federal Reserve in order to meet the higher requirements, while the attendant loss of earning assets (and other considerations) might have caused them to go on selling Governments in order to obtain funds for use in making profitable loans or purchasing non-Government securities. A further rise in reserve requirements would probably then have led to even more sales of securities to the Federal Reserve. Meanwhile, member banks alone would have carried the brunt of the attempted restraint, while many nonmember banks and all other financial institutions could have gone on selling Government securities to the Federal Reserve (thereby adding, as well, to bank reserves) and making new loans and investments as long as they were available and attractive.

The real problem lay in the System's acceptance of a degree of responsibility toward the prices of Government securities, which, however compelling in the early years of postwar transition, could not be continued indefinitely if credit policy was to assume its former role. As events transpired, Treasury surpluses and System redemptions of maturing securities, together with open-market sales of short-term securities, accomplished within the general framework of prices acceptable to the Treasury, reabsorbed most or all of the bank reserves created by System support purchases of other Government securities. As a result, apart from gold inflows which were only partially offset, member-bank reserves did not rise throughout these years by any more than the amount of those increases in reserve requirements which did occur. It is doubtful, moreover, whether the increases in reserve

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requirements in 1948 did any more than cause the sale to the Federal Reserve banks of an equivalent amount of Government securities—sales which presumably would not have occurred if it had not been for the increase in reserve requirements themselves.

For the future, it is even more important to point out that a flexible monetary policy, geared to the requirements of economic stability, must be permitted to reflect itself in changes in interest rates. If rates on Government securities are kept rigid, then all rates must be relatively rigid, because Government debt now constitutes more than one-half the total of all debt in the economy, and its behavior tends to dominate the structure of interest rates. So long as the System cannot allow moderate changes in rates to occur, as a result of its decisions to ease or tighten credit, then it cannot in fact accomplish an easing or a tightening of credit. The real decision must be made in terms of how far such fluctuation can be permitted. A resort to special powers to increase reserve requirements would, in my opinion, only conceal or delay recognition of this central fact.

I am not arguing, of course, for abandonment of System concern over the Government's credit. I do say, however, that it will be the compromises achieved between extreme forms of this concern, and concern over the other credit measures appropriate to sustained economic stability, which will determine the effectiveness of general credit controls in the future; not a reliance upon roundabout new powers which, in the end, will lead us back to recognition of the inherent need to compromise between two desirable, and sometimes inherently conflicting, objectives. This is not to say, however, that the Reserve System should not have authority to change the reserve requirements of the banks in order to meet fundamental changes in our banking system or in the reserve position of the banks. For example, long-continued gold inflows on a large scale, or a major reduction in the use of circulating currency, might be among the factors justifying a rise in requirements. Conversely, a substantial gold outflow, or a rise in currency circulation, may make a reduction of reserve requirements necessary.

On the other suggestions advanced in this section of the research study I have only passing comments. The recommendation under question IV–1 (*a*) for legislation permitting the establishment of uniform reserve requirements based on a type of deposit, rather than on a geographical location, is one which I assume the Federal Reserve bank presidents will wish to submit to the consideration of their directors, the Federal Advisory Council, the banks concerned, and others, perhaps, before taking a definite and final stand. My own view has been and still is that the uniform reserve proposal offers considerable promise as a measure of eliminating inequities in the present system, and should have your earnest consideration.

To the remarks on question IV–1 (*c*) I would add the amplifying footnote that changes in reserve requirements should be made only to meet fundamental changes in the reserve position of the banks, or to accomplish a major structural adjustment in the expansion potential of our fractional reserve banking system. I would not endorse the use of changes in reserve requirements to carry out short-term shifts in policy. Constant jiggling of reserve requirements is not the way to run a banking system. Open-market and discount operations are much better suited, as I see it, to the sensitive adjustments

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called for in effecting ordinary variations in bank reserve positions, and thus influencing the cost and availability of credit.

I would reinforce the conclusion that nonmember banks should be subject to the same reserve requirements as member banks (question IV–1 (*d*)) by asking why, as a matter of equity, should a free-riding group of banks be permitted to avoid the responsibility of contributing to national monetary policy, leaving the impact of such policy to be borne only by banks which are members of the Federal Reserve System? It is no answer, in my opinion, to say that only a small proportion of the bank deposits of the country are free of member-bank reserve requirements, and that the effectiveness of monetary policy is not at stake. Any institution which has been given the power to add to or subtract from the money supply of the Nation (as have the banks) should be subject to the monetary policies of the Nation. I would not emphasize the concern, expressed by the report, over the threat of withdrawal from membership because of differences in reserve requirements between member and nonmember banks; and, by the same reasoning, I would emphasize the view that no threat to the dual banking system is involved. Member State banks have lived within the System for years and have submitted to its reserve requirements without loss of identity.

As for the statement on margin requirements (question IV–3), I would merely add that one additional point of policy needs legislative clarification. That is whether or not imposition of a full 100-percent margin requirement is a violation of the principle Congress intended. Is it correct, in other words, to consider an administrative elimination of margins altogether as consistent with the setting of margin requirements? I present no opinion either way, at this time, but I do suggest that Congress might wish to remove a possible ambiguity concerning the uses to which this power should be extended.

In keeping with the first of the two tests outlined earlier in my remarks in this section, I am concerned over the dangers in any further significant extension of selective controls (such as those reviewed without endorsement under question IV–4). Whether the proposal is for special controls over the credit used in the commodity markets, in real-estate transactions, in inventory accumulation, or in other forms of business credit, the test must be the same: can the control be effectively administered through general regulations, without delving into the affairs of particular individuals? So far as loans for commodity trading are concerned, there is the additional consideration that these perform a unique economic function. They permit those hedging transactions and those truly speculative (as distinguished from gambling) transactions which are indispensable for modifying swings in the prices of basic commodities, as demand and supply factors fluctuate.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

As indicated in any replies to questions IV–1 and IV–2, I am opposed to the recommendations in the draft replies for legislation changing the method of determining reserve requirements and granting authority to the Federal Reserve to exercise control over the volume of installment credit. While a number of other changes could be suggested which would be conducive to more efficient and more economical operations, they are of minor significance to the achievement

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of Federal Reserve policy objectives. I believe that the System can do a good job under existing authority.

V. Organization and Structure of the Federal Reserve System

1. In what respects, if at all, is the effectiveness of Federal Reserve policies reduced by the presence of nonmember banks?

The System answer

The effectiveness of Federal Reserve policies is reduced by the presence of nonmember banks as a result of the fact (1) that those banks are subject to different reserve requirements than member banks and are subject only indirectly, if at all, to the influence of Federal Reserve policies, and (2) that nonmember banks do not have full access to Reserve-bank lending facilities.

As the Federal Reserve System, in exercising its general credit powers, influences the volume, availability, and cost of bank credit chiefly through the reserves maintained at the Reserve banks, the larger the coverage the more effective the policies and actions of the system. Thus, the effectiveness of the credit policies of the Federal Reserve System is increased with the increase in the number of banks that carry reserve balances with the Federal Reserve banks. However, the great disparity which generally exists between member- and nonmember-bank reserve requirements tends to discourage membership in the Federal Reserve System, and it must be recognized that this disparity could lead to termination of membership through shifts from national to State charters and withdrawal. Nonmember banks usually are subject to lower reserve requirements than member banks. They are permitted to hold their reserves at correspondent banks, those balances serving both as legal reserves and as correspondent balances, while member banks must maintain reserves with the Federal Reserve banks and, except for the largest city banks, generally also carry balances at correspondent banks. Moreover, in some States, nonmember banks are permitted to invest a portion of their reserves in interest-bearing public securities. The wider the spread between member- and non-member-bank reserve requirements, the greater the deterrent to membership and the danger of withdrawal become. The possibility of withdrawal from membership has to be taken into account by the Federal Reserve in considering increases in member-bank reserve requirements and tends to inhibit the System in making such increases.

The fact that nonmember banks have only limited access to Reserve-bank lending facilities could seriously interfere with the effectiveness of Federal Reserve policies in time of monetary crisis. One of the prime objectives in such a period is the maintenance of the liquidity of the commercial banks' earning assets and in turn the availability to the public of the funds that they have on deposit with the banks, so that the flow of payments in the economy will not be interrupted. The basic source of that liquidity is the lending power of the Federal Reserve banks. Nonmember banks have only limited access to those lending facilities and are largely dependent upon the lending facilities of the correspondent banks, which are inadequate in time of monetary crisis.

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Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The presence of nonmember banks and the possibility of becoming a nonmember bank constitute the principal safety valve through which State banks can escape if Federal Reserve pressure becomes too heavy. This is both good and bad. It is good in that an additional check is thereby placed on the possibility of arbitrary and excessive exercise of power by a policy agency. It is bad in that a policy of restraint, if such should become socially desirable as in 1946 and 1947, becomes accordingly more difficult because of the discrimination thereby imposed against State member banks. There is also the possibility that a sufficient number of member banks would become nonmembers, so that bank-credit pyramiding would occur in undesirable amounts. (Non-member-bank reserves are a portion of the deposits of member banks which are subject to the fractional reserve requirements set by the Board of Governors of the Federal Reserve System.)

There is no easy way out of this dilemma. A suggestion along the lines of that given in IV–1 (*b*) might provide the basis for a working compromise.

> 2. What changes, if any, should be made in the standards that banks must meet in order to qualify for membership in the Federal Reserve System? What would be the advantages of such changes?

The System answer

The present statutory requirements with respect to the capital stock required for the admission of State banks to membership should be eliminated. Instead, the adequacy of the bank's capital structure should be specified as one of the factors that the Board of Governors would be required to consider before giving its approval of the application of a State bank for membership, but there should be no specific capital requirements except a minimum of $50,000 paid-up capital stock subject to the exception that a bank organized prior to the time of the enactment of the proposed legislation might be admitted with a minimum of $25,000 paid-up capital stock. Under this proposal, the Board of Governors would exercise discretion with respect to the adequacy of the bank's capital structure in relation to the character and condition of the bank's assets and to its deposit liabilities and other corporate responsibilities.

Specific capital requirements also should be eliminated from the statutes with respect to the establishment or operation of domestic branches of State member banks. The establishment and operation of a domestic branch (where permitted by State law) should require the consent of the Board of Governors, which consent should be given only after consideration of the financial history and condition of the bank, the adequacy of the bank's capital structure, its future earnings prospects, the general character of its management, and the convenience and needs of the community to be served by the branch. These factors are the same as those which the Federal Deposit Insurance Corporation is required to consider before permitting the establishment of branches by nonmember insured banks.

The suggested change in the requirements for admission of State banks to membership would eliminate the present capital requirements based on the population of the town in which the bank is located, these requirements being generally the same as those required for

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chartering a national bank in the same location. Requirements based on population of the place in which a bank is located are not a reasonable measure of the bank's capital needs. In practice, such requirements prevent sound banks entitled to membership by other criteria from becoming members of the Federal Reserve System. The recommendation of a $50,000 minimum capital-stock requirement is made with a view to avoiding discrimination against the chartering of national banks. The provisions for an exception whereby banks organized prior to the enactment of the proposed legislation might be admitted with a minimum of $25,000 paid-up capital stock would not interfere with the chartering of national banks and would permit the admission of sound banks which otherwise would be denied membership.

Present capital requirements specify only capital stock and fail to take into consideration surplus and other accounts, which are part of the capital structure of a bank. In this way, a bank with a substantial and well-balanced capital structure may be ineligible for membership even though its capital structure is stronger than that of some bank that has the required amount of capital stock. A bank should have a reasonable amount of capital stock to be eligible for membership, but consideration also should be given to other capital accounts. If a nonmember bank has a sound investment and lending policy and its management is capable, it should not be denied membership in the Federal Reserve System if the only reason involved is lack of capital sufficient for it to become a national bank.

The suggested changes in requirements for the establishment or operation of domestic branches by State member banks also are made with a view to removing arbitrary capital requirements. At present, the law provides that a State member bank wishing to establish domestic out-of-town branches must have a minimum capital stock of $500,000, except for a smaller minimum in a few States of smaller population. In addition, the bank must have a capital at least equal to the minimum aggregate capital for establishing national banks in the various locations of the bank and its branches. The same requirements are applicable for the admission to membership of a State bank operating out-of-town branches, if such branches were established subsequent to February 25, 1927.

These legal provisions do not establish a proper measure of the capital needs of a bank, and in many cases they result in capital requirements not only in excess of the requirements under the laws of the State where the bank is located but also in excess of reasonable capital needs. In some instances, State banks with out-of-town branches have refrained from joining the Federal Reserve System, as it would have been necessary either to give up their branches or to increase their capital stock in excess of capital needs. In other instances State banks have withdrawn from membership when they wished to establish out-of-town branches and the statutory capital requirements were unreasonably large.

3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies? In the size, terms, and method of selection of the Board of Governors? In the open market committee? In the boards of directors and officers of the Federal Reserve banks? What would

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be the advantages and disadvantages of the changes that you suggest?

The System answer

The power to change member-bank reserve requirements within the limits provided by law and the power to approve rediscount rates established by the Federal Reserve banks should be transferred from the Board of Governors to the Federal open market committee. The transfer of the power to change member-bank reserve requirements to the open market committee was recommended to the Congress jointly by the Board of Governors, the presidents of the 12 Federal Reserve banks, and the members of the Federal Advisory Council on December 31, 1940.

The credit powers of the Federal Reserve System are not isolated or unrelated powers, and the decisions made and the actions taken with respect to these powers need to be properly coordinated if they are to be consistent and effective. Accordingly, the power to approve rediscount rates established by the Federal Reserve banks, the power to change member-bank reserve requirements, and the power to conduct open-market operations should be lodged in a single body rather than divided as at present between the Board of Governors and the Open Market Committee.

In placing such authority and responsibility in a single body the Open Market Committee becomes the logical choice by the nature of its membership, which includes both the entire Board of Governors and five Reserve bank presidents. The composition of this committee gives assurance of proper coordination of national and regional considerations. Moreover, Reserve bank representation on this committee gives added assurance that the practical experience of the Reserve banks in carrying out central banking operations will be given consideration in the determination and execution of Federal Reserve credit policies.

No changes appear to be necessary with respect to the size, terms, and method of selection of the Board of Governors. Moreover, no changes are recommended in connection with the boards of directors and officers of the Federal Reserve banks, as the present legal provisions appear to be satisfactory. It is important that men of outstanding ability should be interested in serving on the Reserve banks' boards of directors, and it is firmly believed that the continued service of such men is largely dependent upon the retention of sufficient autonomy in Reserve bank administration and sufficient participation in the consideration of System policies to make Reserve bank directorships challenging assignments to capable men.

Reply of Hugh Leach, Federal Reserve Bank, Richmond

No changes are recommended with respect to the size, terms, and method of selection of the Board of Governors, or the boards of directors of Federal Reserve banks as the present legal provisions appear to be satisfactory. It is believed, however, that the provision of law with respect to the first vice presidents of Federal Reserve banks should be eliminated. A more flexible organization would result if all senior officers under the president were designated as vice presidents. The directors would then be free to shift duties and responsibilities without the difficulties that might now arise because of the public recog-

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nition of one of the senior officers as the chief executive in absence of the president.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

Experience of the last three decades has confirmed the wisdom of the initial decision to set up a regional system of central banking rather than a centralized bank as such. Accordingly the System should continue to be organized on a basis which can to a maximum extent cash in on the advantages of this regional set-up. The American economy is exceedingly diversified. Monetary policy must be attained to take cognizance of this diversity. Greater familiarity with problems of the area, less hostility because of seeming remoteness and autocracy—these are important in the American setting. It would seem wise, therefore, to accord to the boards of directors of the regional banks as much power and responsibility for the operation of the Federal Reserve banks as is consistent with the requirements of a general national monetary policy. Within this framework certain specific questions can be raised.

(*a*) The Hoover Commission report for reducing the number of governors and delegating more of the routine activities to staff members deserves serious consideration.

(*b*) The terms of the members should continue to be long in order to provide some measure of System autonomy and independence, an independence which the whole history of central banking has clearly demonstrated to be in accord with social and economic welfare.

(*c*) Currently the Federal Reserve Act provides for boards of directors of the branches and at the same time makes the head office responsible for the operation of the branches. This leaves the branch boards of directors duly constituted and with no operational function or responsibility to perform. Accordingly it would seem desirable to reconstitute these branch boards as advisory committees which can serve as a desirable liaison with the public. This in fact is about the only function that they can perform currently. The alternative, changing the law to make branch boards responsible for the operation of branches, would virtually convert the branches into separate Federal Reserve banks.

Comments of Allan Sproul, Federal Reserve Bank, New York, on V as a whole

My comments on this section all relate to question V 3. I have previously urged upon the Joint Committee on the Economic Report that responsibility for all major credit policies should be in one body, and that the Federal Open Market Committee most nearly meets the requirements of our national plus regional central banking system. In this Committee, the Federal Reserve System has evolved a method for conducting policy deliberations that is uniquely in tune with our political and economic institutions. Government is directly represented through the Presidential appointees to the Board of Governors. Regional interests, and the lessons of experience "in the field," are represented through the rotating membership of the Federal Reserve bank presidents. (The president of the Federal Reserve Bank of New York is continuously a member, Congress having recognized the

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importance of the continuous participation of the head of the Federal Reserve bank, located in the principal national and international money market, in the proceedings of the Committee.) National policies are formulated without complete centralization of authority.

The Federal Open Market Committee evolved out of experience and, in its present form, has survived the tests of nearly 15 years; it has worked well. It already has been given (by the Banking Act of 1935) statutory responsibility for open-market operations, the most important single instrument of Federal Reserve policy. Personally, I continue to believe we should recognize the full potentialities of what is, actually, an extraordinarily successful innovation in the methods of democratic administration and policy formation. The practicality of a policy-making group including representatives of the Board of Governors and of the Federal Reserve Banks has proved itself. Such a body should have not only the powers mentioned in the attached document, but also ultimate responsibility over margin requirements and all other general aspects of credit policy, including the System's role in international financial policy. The regulatory duties under these various powers would continue with the staff of the Board of Governors and the Federal Reserve banks. The major gain would lie in bringing together in one group representative of the whole System, all significant policy formation; in bringing together authority for the exercise of powers which must be exercised in concert, which cannot be exercised in isolation.

Whether or not this major change in the organization of the System is accepted, I would endorse certain minor changes. The size of the Board of Governors, for example, could well be lowered to five members, with some increase in efficiency and an increased likelihood of being able to attract outstanding men to this service. Consistent with this change, the terms of members could be shortened to 10 years, with members eligible for reappointment. It would also be desirable to eliminate the present regional and vocational requirements for the selection of members, requiring only experience and competence for the job. So far as the structure of membership in the Federal Open Market Committee is concerned, it need not be altered by such a change in the size of the Board. The number of Federal Reserve bank presidents in the Committee could be reduced to four, or the possibility of parliamentary difficulties arising from the membership of five members of the Board and five Federal Reserve bank presidents could be resolved by providing that the Chairman of the Board and of the Committee cast a second vote if an even split should occur on any question. Based on past experience with a 12-member Committee, such an eventuality seems unlikely. As a general rule, votes indicating an even split would result in no action being taken. The Open Market Committee has rarely acted without the agreement of all but two or three members; usually action is unanimous.

One final observation on another aspect of question V3. While I see no need for change in the size, terms, and methods of selection of the boards of directors of the Federal Reserve banks, I would like to stress the very real contribution which these Boards make to the success of Federal Reserve operations and policy. The directors provide the Federal Reserve banks with a cross section of public sentiment in their regions. They furnish advice that reflects a wider range of experience than could practicably be assembled on the staffs of the

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Federal Reserve banks themselves. They provide the judgment of experienced management in passing upon the internal operating performance of the Federal Reserve banks. Nor is the relationship between the Federal Reserve banks and their directors all one way. The directors also gain an acquaintance with the purposes and the practical details of credit policy, which they in turn can pass on to their own communities and associates. In helping to create an awareness of the goals of monetary and credit controls, the directors can do much toward broadening the general understanding of Federal Reserve operations and toward the effectiveness of credit policy. Such intangible results cannot be measured, but they are of the greatest importance.

VI. Relation of the Federal Reserve to Other Banking and Credit Agencies

The System answer

Questions under this heading cover three aspects of Federal Reserve policy and operations:

(1) The Federal Reserve System has a major responsibility for national monetary and credit policy.

(2) The System has supplementary duties and authority with regard to the extension of credit to business.

(3) The System exercises limited supervisory powers over banks.

All of these activities bring it into contact with other banking, credit, and lending agencies of Federal and State Governments.

In a broad sense, all of the activities of the Federal Reserve System have been developed with a view to their contribution to national monetary and credit policy. While the authority to make direct loans to business (or to participate with other lending institutions in loans to business, to provide, in effect, guaranties on loans through agreements to purchase parts of those loans) was undoubtedly established by Congress to provide business with access to funds when ordinary sources were not available, the delegation of the authority to the Federal Reserve System is appropriate for two reasons. Practical lending skills and machinery already exist at the Federal Reserve banks, and further, the System is concerned over the effective functioning of our credit system so as to assure the availability of credit to accommodate commerce, industry, and agriculture, during periods in which breakdowns of normal credit arrangements may serve to defeat the objectives of a monetary policy designed to secure an optimum use of our economic resources.

From the viewpoint of the Federal Reserve System, therefore, the problems of relationships with other agencies should be viewed primarily on the basis of the System's major responsibilities for the determination of national monetary and credit policy and secondarily in terms of the details of operation of the various duties and tasks assigned to the System. From this dual viewpoint the System is concerned with coordination between the lending activities of Government and national monetary and credit policy. It is important that other agencies should not embark on unduly liberal lending policies at a time when the long-run economic welfare of the country calls for credit restraints. Conversely it would be unfortunate if the other lending

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agencies were to follow a policy of restriction at times when a policy of ease and expansion was desired. Experience indicates that this latter conflict is much less apt to occur than is the former.

The System is also concerned over the necessity of devising and maintaining bank supervisory policies of a type which will seek the proper objectives of supervision—maintenance of sound banks which can meet their obligations to depositors and provide the credit facilities essential to the most effective use of our economic resources—without, at the same time, exerting an influence in opposition to national monetary and credit policy, whether that policy calls for ease or restraint.

1. What are the principal differences, if any, between the bank examination policies of the Federal Reserve System and those of the FDIC and the Comptroller of the Currency?

The System answer

At present, there are no significant differences between the bank examination policies of the Federal Reserve System and those of other Federal supervisory agencies. As noted below, important differences do arise among the three agencies in the exercise of the supervisory function; that is, in the critical appraisal of the results revealed by bank examinations. To the extent that differences do exist among examination practices as such, we believe them to be primarily the result of differences in individual interpretations throughout the field, and differences in the attitudes and viewpoints of individuals or of supervisors in particular circumstances. All three agencies are concerned with the preservation of soundness of banks. They emphasize the maintenance of quality of assets and the conduct of the bank in accordance with practices which through years of banking experience have proved to be sound. They also emphasize the maintenance of adequate cushions of capital and valuation allowances to protect the bank. While differences in approach to the problem of adequate capital may exist, it is by no means certain that the differences are not due as much to personal attitudes and predilections as to differences in the interests of the agencies. Even here, however, the difficulties of determining adequacy of capital are stressed so frequently by each of the agencies that it is not too easy to ascribe to any one agency a particular approach to the problem. We believe it correct, however, to point out that the Comptroller of the Currency tends to emphasize the ratio of capital to risk assets, the FDIC tends to emphasize the relation of capital to total assets, while the Federal Reserve System tends to follow a more flexible policy in relating capital to the general character of the bank and the business which the bank is conducting. Considerable differences of opinion, however, would probably be found among the agencies as to the accuracy of this description of differences in attitude toward bank capital requirements.

In general, bank supervision and bank examination seek to protect the public interest in the banking system as a whole.

Primary consideration is given to protecting the customers of the banks, primarily the depositors. Some consideration is also given to the protection of (or rather the availability of services to) borrowers, but individual differences are more pronounced in this matter.

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Secondary consideration is given to the preservation of shareholders' equity, and the encouragement of its growth especially by the retention of a portion of earnings in the capital structure of each bank.

The accomplishment of these objectives is approached through periodic examinations of banks. An examination includes the following steps:

An analysis, appraisal, and classification of all the bank's assets according to their apparent soundness. This includes: Investments, loans, and other assets.

Study of each bank's practices with reference to its compliance with statutory requirements: Federal laws and regulations that are applicable; and State laws and regulations of State supervisory authorities that are applicable.

Verification of assets and liabilities to the bank's statement. Consideration of methods and operating practices under use by the bank including: The making of tests, the conduct of which is designed to forestall and discourage the beginning peculations by officers and employees; and the holding of meetings or conferences when necessary with officers and directors to review and consider bank policies, indicated trends, and the responsibilities assumed by bank management.

Review and appraisal of apparent abilities of the bank's management.

While significant differences do not now exist in examination policies and practices, differences in viewpoint with regard to supervision do exist and these differences have given rise to conflicts and may continue to do so in the future.

The Federal Reserve System has a broad responsibility and interest not only in the soundness of the banks themselves but also in the proper functioning of the monetary and financial system so as to maintain the flow of funds and contribute to an allocation of resources conducive to the most effective use of our economic resources. The Comptroller of the Currency, on the other hand, is interested in the chartering and supervision of national banks in order to maintain the strength and prestige of the national banking system and the strength and soundness of the individual national banks themselves. The FDIC as insurer has the responsibility of protecting its insurance risks in the individual banks. As a consequence, during periods of strain or crisis, policies and actions of these agencies in seeking to protect the immediate interests of the individual banks could run counter to those of the Federal Reserve System concerned with the preservation of the entire monetary and financial system including the satisfactory functioning of the money markets.

The System is concerned over the possibility of supervisory policies being so devised as to complicate the establishment of national monetary and credit policy, and, through conflicting objectives, to reduce the effectiveness of such policies. The monetary authorities affect the credit situation through influencing the availability and cost of money. Its actions, therefore, are reflected in money rates. Among the important series of rates are those shown by the yields on securities, chiefly bonds. Yields on bonds are in effect the reciprocal of the

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prices paid for those bonds. Any action by the national monetary authority, therefore, affecting interest rates is bound to have an effect on bond prices or bond values as reflected in the market. Actions of the supervisory authorities in determining eligibility of securities for bank investment and the values at which securities would be appraised also affect bond prices, money rates, and bank investment policies. As a consequence, their actions can reduce the effectiveness of policies and actions taken by the monetary and credit agency or even restrain that agency from adopting policies or taking actions which it would consider to be desirable in pursuit of the objectives enumerated in section I above.

During periods of deflation and business decline, monetary policy would ordinarily call for easing action. As economic uncertainties develop, holders of investment securities attempt to dispose of some of their investments, depressing prices of securities generally. At such times in the past, bank supervisors have sometimes required banks to write down the values of (or to liquidate) assets as market prices have declined. Particularly has this been true of the obligations of concerns which appeared to be more susceptible than others to adverse business developments. This practice, if followed again at some time in the future by bank supervisors, would intensify the pressures for liquidation and would lessen the availability of money at the very time that monetary policy would be attempting to arrest or at least slow down the forces of liquidation and deflation.

It is also possible in periods of inflation for supervisors to adopt policies with respect to the valuation of bank assets which would embarrass or interfere with monetary policy. A monetary policy of restraint to combat a speculative growth in credit and speculative and unwise investments in business might not be adopted or pursued with sufficient vigor if there were reason to believe that the supervisors of banks would require the banks to write down the values of their assets to conform to the lower prices which will result temporarily from the increases in money rates and bond yields accompanying the policy of restraint. A situation could be precipitated in which investors would seek to liquidate their holdings in such large volume as to demoralize the market. The financial repercussions of such actions might compel the substitution for a policy of monetary restraint of one of emergency support of demoralized markets, necessitating large purchases of securities by the Federal Reserve with corresponding increases in bank reserves which, when the market crisis was surmounted, would contribute further to the inflation against which national monetary policy was supposed to be contending.

One conspicuous difference in policy between the Federal Reserve and the FDIC has to do with the question of payment of interest on demand deposits. The Federal Reserve System has ruled that the absorption of exchange charges by a bank constitutes payment of interest in violation of Regulation Q of the Board of Governors of the Federal Reserve System and section 19 of the Federal Reserve Act. The FDIC, on the other hand, contends that the absorption of exchange is not a payment of interest on demand deposits in violation of Regulation IV of the Corporation and of section 12–B of the Federal Reserve Act. These conflicting interpretations have given rise to controversy and confusion.

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Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

In general, bank supervision and bank examination seek to protect the public interest in the banking system as a whole. Primary consideration is given to protecting the customers of the bank, particularly the depositors and the beneficiaries of trusts being administered by the bank. Secondary consideration is given to the preservation and growth of the shareholders' equity.

The accomplishment of these objectives is approached through periodic examinations of banks. An examination includes the verification of assets and a determination of the nature and extent of liabilities; an analysis, appraisal, and classification of all of the bank's assets according to their soundness; an investigation to ascertain whether the bank is complying with applicable Federal and State laws and regulations; consideration of the methods and operating practices in use by the bank, including certain tests designed to detect, forestall, and discourage peculations by officers and employees; and an appraisal of the character and ability of the bank's management.

The Comptroller of the Currency is concerned primarily with the soundness of individual national banks and the competence of their managements. The Federal Deposit Insurance Corporation is concerned primarily with the degree of risk in individual bank assets and in the aggregate of those risks as related to the insurance fund. Under the law the Federal Reserve System is required to be cognizant not only of the soundness of banks, the character of their managements, and the degree of risk in bank assets but also the credit policies of the banking system and their relation to basic monetary and credit conditions.

Out of these differences in basic objectives some differences in policies do develop, but they are currently not regarded as of a critical nature. For example, there are differences in the policies of the three supervisory organizations with respect to the thoroughness and frequency of individual examinations. There are differences in policies with respect to the extent to which examiners enforce compliance with regulations which are not directly concerned with the primary functions of their own agencies. Examples of such regulations are Regulations Q affecting payment of interest on demand deposits, U affecting credit to purchase and carry securities, and W, which affected terms on consumer credits. Finally, and perhaps more basically, the differences in institutional objectives, organizations, and procedures lead the examiners of the Federal Reserve System to be particularly aware of current monetary and credit conditions and policies in their appraisal of bank assets and the management of loans and investments.

> 2 (*a*). To what extent, and by what means have the policies of the Federal Reserve been coordinated with those of the FDIC and the Comptroller of the Currency where the functions of these agencies are closely related?

The System answer

For the most part coordination is achieved at both the top policy levels and at the top technical and administrative levels through conferences and exchanges of viewpoints in Washington. We understand that the Board of Governors of the Federal Reserve System is

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preparing an answer to a somewhat similar question, and we believe that the details of the Washington procedures could more appropriately come from that source.

At the district level, coordination is obtained through informal conferences and through exchange of ideas and information. Each of the supervisory authorities holds conferences of its examiners in each of its districts. It has been the practice of each agency to invite representatives of the other agencies to attend its conferences and to participate in discussions regarding policy and procedures, and in discussions of sample cases illustrating existing policies.

2 (*b*). What changes, if any, would you recommend to increase the extent of coordination?

The System answer

While differences in viewpoint and approach exist, particularly with regard to some of the broader aspects of supervisory policy, and while conflicts are possible, existing policies and procedures are not so badly coordinated in actual practice as to be a matter of serious concern. The necessity for, and problems of, coordination among Government agencies with respect to other matters are of greater concern to the Federal Reserve System and the reply to this question is dictated in considerable measure by considerations raised in the answers to other questions, particularly II–3, IV–4, and IV–6.

A variety of suggestions could be made. Among them are:

Consolidation of all Federal supervisory agencies into one;

Designation of the Comptroller of the Currency as an ex officio member of the Board of Governors of the Federal Reserve System, and a member of that Board as an ex officio member of the Board of Directors of the FDIC; or

Creation of a national credit advisory council.

These alternatives are discussed more fully below.

On logical grounds the consolidation of all Federal bank supervisory agencies would appear to be the best solution, and if one were to start with a clean sheet this might be recommended. However, we have an existing system with three Federal agencies which has developed out of the experience and traditions of the country. The problem, therefore, is not what would be done if a fresh start were to be made, but what is to be done with what we now have.

The advantages of consolidation would be: Policy determination would rest in a single source. Consolidation in the Federal Reserve System would provide unified administrative control which could compel coordination not only with regard to bank supervision but also with regard to monetary and credit policy. Consolidation in an independent agency other than the Federal Reserve System would provide administrative control which could compel coordination in bank supervision. Coordination with monetary policy would not be assured but its achievement presumably would not be made more difficult and might be made easier. Some reduction in cost of administering the examination function would probably result from elimination of overlapping supervisory offices. There is little actual duplication, however, among the three Federal agencies.

The disadvantage of consolidation is: A single agency would be supervising three groups of banks to which it would stand in different

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sets of legal relationships—national banks, chartered by the Federal Government, State member banks, and State nonmember insured banks. Suggestions and recommendations made in other answers, if put into effect, would lessen the significance of these differences without lessening in any way the independence of the State banking systems, except on those matters of broad national monetary and credit policy which are properly the concern of the Federal establishment, to be dealt with in such manner as the Congress might direct.

The proposal for designation of ex officio members of the Federal Reserve and FDIC Boards is more fully discussed in the answer to question VI–3 below. As indicated in that answer, it is by no means clear that use of this device in the past has resulted in improved coordination. It is doubtful that future experience would be materially different.

Increased coordination might also be secured through the creation of a national credit advisory council, such as is discussed in the answer to question VI–6. In any case, consideration might be given to amendment of the provisions of the Federal Reserve Act dealing with bank examinations by the three Federal bank supervisory agencies to require regular consultation between these agencies. (See also answer to question VII–1.)

2 (*c*). To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks?

The System answer

As indicated in the answers above, the need for changes in the division among Federal agencies of the authority to supervise and examine banks does not appear to be vital.

Consideration might be given to the desirability of transferring from the Office of the Comptroller of the Currency to the Federal Reserve Board responsibility for determining eligibility of securities for investment by member banks of the Federal Reserve System (both National and State). As indicated earlier, use of this authority has repercussions on the money markets which could reduce the effectiveness of monetary and credit policy.

Consideration might also be given to the transfer from the Federal Reserve Board to the Office of the Comptroller of the Currency of the authority to grant trust powers to national banks. This authority would appear more appropriately to belong with that now possessed by the Comptroller of the Currency.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

While differences in viewpoint and approach exist, particularly with regard to some of the broader aspects of supervisory policy, and while conflicts are possible, existing policies and procedures are so coordinated in actual practice as not to represent a matter of serious concern. However, it is believed that coordination would be facilitated if the FDIC districts were made to coincide with those of the Federal Reserve districts and the headquarters of the supervising examiners were located in Reserve cities. At the present that portion of the Third Federal Reserve District represented by New Jersey and Delaware is in the Second FDIC District with headquarters at New York City, and all of Pennsylvania is included in the Third

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FDIC District with headquarters at Columbus, Ohio. As a result, our contacts with either of the two FDIC supervising examiners are infrequent and the free discussion of our mutual problems is complicated. (See also answer to question 3 (*a*).

3 (*a*). What would be the advantages and disadvantages of providing that a member of the Federal Reserve Board should be a member of the Board of Directors of the Federal Deposit Insurance Corporation?

The System answer

Advantages.—The chief advantage would lie in the possibility of greater coordination of policy.

FDIC could have a better knowledge of and insight into monetary and credit policies of the Federal Reserve System.

The Board of Governors of the Federal Reserve System could have a better understanding of policies and practices of the FDIC.

Channels for the exchange of information would exist as a matter of law and administrative routine rather than, as at present, through personal relationships and cooperative good will.

Disadvantages.—Experience has shown that ex officio members of boards frequently do not give proper attention to affairs of the board or organization of which they are ex officio members.

It has also shown that hopes for increased coordination are not necessarily realized by use of ex officio members.

3 (*b*). Would you recommend that this be done?

The System answer

We have no recommendation to make. Members of the Board of Governors of the Federal Reserve System who would be most concerned with the problem of serving in a dual capacity are probably better able than we to answer this question. From the viewpoint of a Federal Reserve bank the problem is one of coordination of policies and practices. As indicated in the answer to question 2 of this section, a substantial degree of practical coordination now obtains. Should greater coordination be sought, there would appear to be as good a chance of achieving it through the device discussed in the answer to question VI–6 as through any other means short of actual consolidation.

3 (*c*). Should the Comptroller of the Currency be a member of the Federal Reserve Board?

The System answer

We consider this matter to be relatively unimportant and have no recommendation to make. Historical precedents do not support the proposal. The Comptroller of the Currency was an ex officio member of the Federal Reserve Board from 1913 to 1935, at which time he was removed from the Board by the Banking Act of 1935 along with the Secretary of the Treasury of whom the Comptroller of the Currency is a subordinate.

The Comptroller of the Currency is concerned with the task of chartering national banks and supervising the approximately 5,000 national banks now in existence. It is doubtful that he would give the time necessary to the consideration of those broad problems of

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national monetary and credit policy to which the Board members devote their major attention and that he would contribute any more in the future to the establishment of Federal Reserve policy than he did prior to 1935.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

Unquestionably the presence of multiple monetary and banking agencies has created some overlapping of jurisdictions, duplications of function, and, therefore, waste. How sweeping would be the changes required to correct this situation is perhaps debatable. Consideration might be given to the following lines of action:

(*a*) The various bank supervisory agencies might set up a single examination agency jointly operated by all and with all agencies having access to the examination reports.

(*b*) The FDIC would then become more strictly an insurance organization.

(*c*) A more extreme suggestion would be to give the Federal Reserve power to charter and supervise national banks.

(*d*) The various suggestions contained in the Hoover report on these matters should be studied very carefully.

4. In what cases, if any, have the policies of other Government agencies that lend and insure loans to private borrowers not been appropriately coordinated with general monetary and credit policies?

The System answer

Appropriate coordination between the policies of Government lending (or loan-insuring) agencies and general monetary and credit policies would consist in frequent consultation between these agencies and the Federal Reserve System. Coordination would not necessarily imply uniformity of action, since an agency might well find at any particular time, upon reviewing the prevailing national monetary policy, that its own actions should be governed instead by other special considerations. Coordination would mean, however, that decisions would be made by the agencies with full awareness that they conformed to (or deviated from) the general credit policies being applied nationally to the banking system. It would imply that a decision to differ, or to take action which might appear to differ, from general monetary and credit policy should be reached after the factors influencing the determination of general policy had been carefully reviewed.

Such coordination through consultation has not been achieved. Policies of the Government lending (or loan-insuring) agencies have commonly been consistent with over-all credit policy, but this result has been more or less accidental. At times, particularly during the postwar period, there has been an apparent inconsistency, especially in the rapid growth of real-estate credit. It might have proved, if thorough studies had been undertaken, that unusual considerations required a discrepancy between general policy and that aspect of Government loan policy directed to the stimulation of housing construction. But the national interest presumably would have been better served if such a decision had been reached after deliberative review of all relevant considerations by the several agencies engaged in housing finance, in consultation with the Federal Reserve System.

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Moreover, there has not been comparable coordination among the various Government lending (or loan-insuring) agencies themselves. It has appeared during the recent postwar period, for example, that several of the agencies engaged in agricultural finance were engaged in a policy of mild restraint, while some of the other agricultural agencies were encouraging credit expansion. Similarly, at least one of the housing agencies has at times imposed relatively strict standards when inflationary pressures were mounting, while another Government program for insuring the mortgage loans of home purchasers was offering considerably easier terms.

In the aggregate, home-mortgage debt experienced an increase of unprecedented rapidity in the years 1945–48, rising by about $13,000,000,000 to a record total of $33,000,000,000. The amount of Government-guaranteed mortgage debt rose from $4,000,000,000 to $12,000,000,000, not counting debt indirectly encouraged or underwritten by the Federal Government because of the existence of such facilities as the Federal home-loan banks and the secondary market for mortgages provided by the Federal National Mortgage Association (a division of the Reconstruction Finance Corporation). A large proportion of loans was made on an installment basis at 4 percent for periods of 20 and 25 years. Many were made at a high percentage of current sale prices which were greatly inflated.

Agricultural credit supplied by Federal agencies or by those under Government sponsorship in some instances was made available in large amounts at relatively low rates and on easy terms. Loans made by the Commodity Credit Corporation increased sharply in 1948. Likewise short-term production loans to farmers, made principally by production credit associations and banks for cooperatives and financed through the Federal Intermediate Credit Banks, increased substantially in 1948.

Not all of the credit expansion provided by the several Government agencies was inflationary. Much of it was necessary. It is probable, however, that some part was excessive for a period when Government programs were generally oriented toward an anti-inflationary policy. The Government agencies concerned have not in any instance willfully disregarded this over-all policy, but have considered themselves bound (by the mandate setting up their special activity) to pursue their own programs vigorously. No doubt if Congress were to direct each agency to vary its program in accordance with the objectives of the Employment Act of 1946, any future recurrence of such apparent inconsistencies between particular loan programs and general policy could be either avoided, or explicitly reconciled through consultation among the various affected agencies.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

This hiatus in monetary and credit policy was particularly serious in the immediate postwar inflation and is apt to be increasingly critical in the future whenever a stiff monetary policy is presumably desirable. During the immediate postwar period boom conditions called for a policy of monetary restraint which the Federal Reserve was trying to pursue. In view of the serious limitations to a policy of restraint imposed by the bond-support policy, the results were on the whole fairly effective.

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Unfortunately during the time when public opinion was calling for something to be done about high prices, Congress was also voting a very liberal GI loan program and substantially liberalized mortgage credit, at the same time that the RFC and others were making Federal funds available on relatively easy terms to private borrowers. The results were, on the whole, impressive. Government guaranteed mortgages jumped from $4,000,000,000 to $12,000,000,000 in the first three postwar years. During the same period home-mortgage debt jumped from $20,000,000,000 to $33,000,000,000, a rise of 65 percent. Thus the effect was to encourage credit expansion in a substantial way at the same time Federal Reserve policy was rightly trying to discourage it.

If monetary policy is to serve the social interest, such divergencies and conflicts must be minimized. In view of the inflationary biases increasingly prevalent in the economy this might well become an increasingly serious matter.

Reply of Alfred H. Williams Federal Reserve bank, Philadelphia

The rapid and substantial expansion of credit extended by Government agencies directly or through guaranties in the 3-year period of inflationary developments following the war did not appear to be coordinated with the national monetary and credit policy as reflected in Federal Reserve statements and actions seeking to restrain excessive use of private credit in the face of continued limitations on supplies of goods.

It is recognized that special considerations govern the extension of various types of Government credit and that these may be compelling in many cases when the policies run counter to the national monetary and credit policy. Appraisal of these considerations is not believed to be within the purview of this inquiry.

The importance of credit extensions by Government agencies in relation to national credit policy is not only in the amount of the funds added to the flow of private credit even though this is substantial in the case of home-mortgage credit and to a lesser extent farm credit. The principal feature of concern to monetary authorities is the impact of Government credit agency policies on the grantors of private credit.

In this Federal Reserve district, in each of the 4 years since the war, the officers and staff have held from 25 to 40 meetings throughout the district with representatives of all the commercial banks, including a director as well as the principal officer in each bank. During most of this period the discussion at these meetings centered around the desirability of restraint in the granting of private credit and explanation of Federal Reserve policies which sought to produce such restraint. Almost without exception the expansive credit policies of "the Government"—without distinguishing one part of the Government from another—have been cited in each of these meetings as (1) evidence of divided counsel within the Government, and (2) reason for continuing expansive lending policies in the private banks. This, of course, seriously complicated the task of the Federal Reserve authorities.

Without commenting on the individual cases or the special considerations underlying these policies, attention was called principally to rapidly expanding credit and reportedly liberal policies in ap-

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praisals and granting of credit or guaranties by the Federal Housing Administration, the Veterans' Administration, and savings and loan associations operating under the Federal Home Loan Bank Board. In certain agricultural communities the aggressive lending programs of production-credit associations were cited. In the field of industrial and commercial credit the so-called blanket-participation agreement, promulgated by the Reconstruction Finance Corporation and since discontinued, was referred to as a stimulant to lowered credit standards and loose credit practices. Similarly, the price-support program carried out through Commodity Credit Corporation loans was often referred to as evidence that the left hand of the Government was expanding credit aggressively while the right hand sought to restrain such expansion as an anti-inflationary measure.

It would appear from this experience that much of the difficulty could have been eliminated even though many of the policies were unchanged had there been clear evidence that the credit policies of the agencies were adopted in the light of and reconciled with accepted national monetary and credit policy.

5 (*a*). What changes, if any, should be made in the powers of the Federal Reserve to lend and guarantee loans to nonbank borrowers?

The System answer

In the light of over 15 years' experience in making and servicing industrial loans, it now appears that the law granting this authority should be revised because it is unduly complex and in part outmoded. Only two basic provisions of the law, however, materially impede operations.

(1) The limitation requiring proceeds of industrial loans to be used only for working-capital purposes should be eliminated. Extensive technological changes in many instances require concerns to purchase new equipment to strengthen or maintain competitive positions. At the same time, there is an active need for funds to pay high costs, operate at high price levels, and sustain profits through large volumes, while the tax structure tends to restrict the acquisition or accumulation of surplus. In meeting these needs many concerns must frequently borrow for mixed purposes which cannot always be correctly classified as wholly "working capital" requirements.

(2) Full consideration of the basic nature of current requirements for funds growing out of changed financial, technological, and competitive conditions may indicate the desirability of extending the maximum maturity from the present 5-year limit to, perhaps, 10 years, in order to provide for longer-term needs if they should become apparent.

Another (minor) suggested change relates to the industrial advisory committees. These committees have contributed valuably to the development of the work of the Reserve banks in this field, but are no longer required. The directors of the Reserve banks represent broad segments of industry and finance and provide informed judgment on loan applications. In addition, the wide acquaintance of the directors, officers, and staffs of the banks in their respective districts provides direct access to specialized information when it is needed. It would be sufficient to provide that such committees could be formed by the individual Reserve banks whenever needed.

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It would seem desirable to retain the authority to guarantee credits through a commitment procedure, as provided in the present Federal Reserve Act. By means of commitments and participations, the Federal Reserve banks are enabled to assist banks in developing new credit techniques, in appraising particularly complex loan applications, and in carrying loans that exceed the statutory limits of smaller banks (and for which these banks have been unable to obtain the assistance of their correspondent banks). Such a program also provides for the possibility that in the unforeseeable future another period of credit stringency and excessive caution among lenders might lead to cumulative liquidation pressure which might be alleviated by extensive guaranties of local business loans.

It should be noted, however, that the guaranty principle has possible undersirable aspects when applied to the area of commercial or industrial loans, where credit factors are highly individualized and frequently complex. The opportunity to pass credit risks to another institution may be conducive to loose or unduly expansive lending practices, principally because of the desire to receive interest income on amounts which (in the absence of guaranty) would be in excess of legal or prudent limits. For these reasons, the responsibility for a guaranty (commitment or participation) program in commercial or industrial loans should probably be placed in the Federal Reserve System, which has staffs trained both in bank supervision and in loan techniques and appraisals.

5 (*b*). Should either or both of these powers be possessed by both the Federal Reserve and the Reconstruction Finance Corporation? If so, why? If not, why not?

The System answer

There is an appropriate place in the economy for a Government lending agency such as the Reconstruction Finance Corporation, in addition to the industrial loan operations of the Federal Reserve banks. A Government agency should make loans to promote public policies which by nature and, in some cases because of large volume, would be inappropriate assets for a central bank holding the reserves of the banking system. Loans of this nature include:

Home mortgage financing;

Loans to public utilities where the services are necessary to the communities but the credits have subsidy aspects (example—railroads);

Loans to industries whose prospects are peculiarly dependent upon administrative regulation and action by the Government (examples—air lines subject to CAB and aircraft production dependent upon military purchase allocations);

Loans to industries subsidized in accordance with public policy (examples—prefabricated housing, synthetic rubber production, tin smelting and refining);

Loans to municipal instrumentalities;

Loans to stock pile strategic materials; and

Disaster loans.

It is probably unwise, however, for the Reconstruction Finance Corporation and the Federal Reserve banks to be engaged in making or guaranteeing loans of essentially the same character. The Re-

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construction Finance Corporation should undoubtedly have full jurisdiction over any loans (or guaranties) included in the above list that are not specifically delegated to other Government lending agencies. As to business loans, however, such as provided by section 5d of the Reconstruction Finance Corporation statute, and by section 13b of the Federal Reserve Act, there is need for a clear separation of functions.

As noted earlier, a loan-guaranty program for commercial or industrial loans is subject to particular hazards, requiring for effective administration a combination of close operating relations with the banks and the skills of highly developed credit analysis (and experience with marginal cases). The Federal Reserve banks do possess both of these qualifications, while the Reconstruction Finance Corporation possesses only the latter. Moreover, the Federal Reserve banks gained extensive experience with the procedures of loan guaranties when they were charged with administration of the program for guaranteeing war production loans (regulation V loans). For these reasons, it would appear desirable to place full responsibility in the Federal Reserve for any loan guaranties that are to be extended to the banking system for industrial or commercial loans (except for those related to foreign trade, which are handled by the Export-Import Bank).

So far as direct business loans are concerned the appropriate choice of agency is not as clear, nor is the need to eliminate duplication as great. Perhaps a dividing line can be drawn between industrial or commercial loans arising in the normal course of business, and those arising for developmental purposes which have been designated by Congress for special assistance in the public interest. The latter would obviously be handled by the Reconstruction Finance Corporation; the former might better be delegated to the Federal Reserve banks.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

There is an appropriate place in the economy for a Government lending agency such as the Reconstruction Finance Corporation in addition to the industrial loan operations of the Federal Reserve banks. When the Congress decides, as a matter of public policy and not simply to promote sound competition in the regular course of business, that certain areas should be stimulated by loans, credit guaranties, or agreements to purchase loans, it seems proper that the stimulus be administered through a public credit agency. A central banking system does not seem to be the proper agency to administer these credits involving special policies. The credits might include guaranties of home mortgage loans; loans to public utilities where the services are necessary to the communities but the credits have subsidy aspects (example—certain railroads); loans to activities whose prospects are peculiarly dependent upon administrative regulation and action by the Government (example—air lines subject to CAB); loans to activities subsidized in accordance with public policy (examples—synthetic rubber production, wartime tin smelting and refining); loans to municipal instrumentalities; loans to stock-pile strategic materials; and disaster loans.

The Federal Reserve banks are peculiarly well adapted to participating with banks or extending commitments or guaranties to them on commercial or industrial loans arising through the banking sys-

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tem in the ordinary course of business, when banks seek such assistance because of the unusual character or degree of risk in the loans requested. The Federal Reserve banks are an integral part of the banking system, working closely with banks in their daily operations. In the course of 35 years the boards of directors, officers, and staffs have become closely associated with local commerce and industry, its credit requirements, the quality of management, and economic forces affecting them. In addition to carrying on the industrial loan program since 1934, the System gained valuable experience in financing Government contracts during the war through its administration of the guaranteed war production loan program. This experience has proved particularly helpful in serving recent credit needs.

The effective operation of the industrial loan program of the Federal Reserve banks is of mutual benefit to the Reserve banks, the local banks, and the borrowers. Active day-to-day contacts in credits keep the Reserve banks in intimate association with the basic operations of their members and establish a common ground promoting mutual understanding which is vital to effective banking and credit policies. The local banks are provided assistance in meeting the requirements of their borrowers and their communities through a noncompetitive source familiar with such requirements and actively interested in promoting sound bank credit policies and practices.

For borrowers, in times of general economic stress the industrial loan program provides a source of funds to prevent cumulative and destructive credit liquidation. In the regular course of business it makes funds available with a minimum of procedural difficulty to individual applicants having a justified need for credit, which credit for a wide variety of reasons experience has shown is not always supplied through regular channels.

Providing credit by means of guaranties or agreements to purchase is particularly applicable to loans which can most effectively be made and serviced by local institutions. Such loans would include those which are made in large numbers over wide geographic areas, or for other reasons cannot effectively be serviced by the guarantor, and those in which there is a substantial degree of uniformity as to credit standards and procedures. Home-mortgage loans, for example, or other loans of an essentially collateral nature would fall into these categories.

In the case of commercial and industrial loans, where credit factors are highly individualized and frequently complex, the guaranty principle has undesirable aspects. Special problems require special analysis, borrowing conditions, and servicing often not available at local institutions. At the same time, the opportunity to pass credit risks to another institution while retaining most of the interest income is conducive to loose or unduly expansive lending practices.

Accordingly, it is believed that the activities of Government agencies, such as the RFC, in making, guaranteeing, or agreeing to purchase loans, should be confined to those credits extended primarily as an instrument of public policy. The area of commercial and industrial credits arising in the ordinary course through the banking system should be served by the Federal Reserve banks which work closely with their members and seek to promote sound credits as one aspect to credit policy.

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Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I am in disagreement with the position taken in the draft reply to the first question. I do not believe that our present authority to lend, or, in effect, guarantee loans to nonbank borrowers needs change at this time. At the Federal Reserve Bank of Cleveland we have been able to operate effectively under the provisions of the act and do not feel that it is unduly restrictive. Rather, we feel that the restrictions now in section 13b of the Federal Reserve Act are wise and desirable.

6 (*a*). What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission?

The System answer

The principle of orderly consultation among the Federal agencies engaged in direct lending or loan guaranty programs within the United States, as suggested by the Hoover Commission in Recommendation No. 9 of its report on the Treasury Department, is a desirable extension of the cooperation now attained, through the National Advisory Council on International Monetary and Financial Problems, by Federal agencies engaged in extending foreign credits. The present NAC, moreover, in addition to its studies of the factors relevant to particular loan (or guaranty) applications, also attempts to attain consistency by mutual agreement on all principal aspects of United States international financial policy. Although the specific intention of the Commission's recommendation is not clear, it would seem desirable to interpret the proposal as favoring a comparable scope for the domestic agency, including not only the analysis of problems related to Federal granting or guaranteeing of domestic credits, but also the relations among Federal loan policy, the Treasury's fiscal and debt management policy, and the over-all monetary and credit policy of the Federal Reserve System. Consequently the following discussion of advantages and disadvantages, and of suggestions as to the composition of a national advisory council on domestic financial policy, will relate to a recommendation of this broad type.

The major advantage of the recommendation lies in the fact that some coordination of policy objectives is desirable to minimize inconsistencies among the influences exerted upon the economy by the many agencies now engaged in financial (i. e., monetary or credit) activities. First, as indicated in the reply to question VI–4 above, there is a great need for closer coordination among the lending, and loan guarantee activities themselves. Second, with greater consistency among these various agencies achieved, there still remains a need to coordinate the broad policy aspects of any unified loan program with the objectives of the Employment Act of 1946, and with the policies pursued by the Treasury and the Federal Reserve System in conformity with those objectives. Third, it would be desirable to provide for regular periodic consultations among the Treasury, the Federal Reserve, and other affected agencies concerning the underlying principles common to debt management, fiscal affairs, and national monetary and credit policy. It should not be expected that such a council would be a policy-making body; its function would be to promote understanding and cooperation between the agencies represented.

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Administratively, and in terms of the fundamental safeguards of democratic government, there is also great advantage in providing for consultation on an equal plane among agencies experienced in each phase of these common problems, rather than attempting to achieve an apparent but deceptive efficiency by concentrating all directing authority in one of the agencies.

There is the further advantage, in an advisory or consultative relationship, that responsibility for all administration, and for formulating specific regulations interpreting policy, will reside solely in the hands of the agency experienced in the intimate operating details of each field—whether lending, or over-all credit control, or debt management—and will not be subject to mandatory over-ruling by a body composed largely, in each specific instance, of persons representing other fields. Full reliance will thus be placed on the "separation of power," while each agency will benefit from the experience of the others in reaching those fundamental policy decisions which may now, oftentimes, be reached without conscious recognition of their full implications. A forum will also have been created to which inconsistencies arising in the field may be referred for review, while at present only unusually outstanding differences reach the top levels for discussion, and then only through unsatisfactory ad hoc arrangements.

The disadvantages of the Hoover Commission recommendation all arise from the danger that such a council, once established, might not function in the manner just described. Should the Council take upon itself de facto status as the source of all policy, the degree of independence necessary for the formulation, particularly, of over-all monetary and credit policy by the Federal Reserve might be jeopardized. There is the associated risk that the Treasury might tend to dominate the group out of concern for the day-to-day requirements of fiscal and debt-management operations, to the detriment of broader policy objectives. Perhaps, too, if the Council attempted to consider the detailed application of broad policy, it might become an undesirable superimposed administration, hampering the decisive action frequently needed in swift response to changing economic conditions.

The Hoover Commission also mentioned the possibility of combining both foreign and domestic policy formation in one group. At least in the early stages, this might involve the difficulty that studies would be spread too thin over a wider range of subjects than most of the participants could handle effectively. The result might be a haphazard, rather than thorough, analysis of the relatively few deeper, fundamental issues which should occupy such an advisory body. No doubt the question of amalgamating the international and domestic councils could be deferred for several years, while the domestic agency was establishing its procedures and reaching agreement on initial guiding principles.

6 (*b*). On balance, do you favor the establishment of such a body?

The System answer

For the purposes outlined above, and subject to the qualifications expressed below concerning the organization and composition of such a body, it would seem highly desirable to provide for a consultative council of the principal Federal agencies engaged in domestic financial affairs.

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6 (c). If so, what should be its composition?

The System answer

For the broader purposes suggested above, the Secretary of the Treasury and the chairman of the Federal open market committee, or in their absence the Under Secretary and vice chairman, respectively, are two obvious members of such a group. Presumably the Secretary of the Treasury should serve as Chairman of the Council; the chairman of the Federal open market committee, as vice chairman. Since the duties of the secretariat for the present National Advisory Council on International Financial Policy are undertaken by the Treasury staff, comparable duties for the domestic advisory council should be carried out by the staff of the Board of Governors of the Federal Reserve System, serving under the direction of the Board Chairman (who is also chairman of the Federal open market committee, and would be vice chairman of the Advisory Council).

To avoid a large unwieldy membership and unduly heavy representation of the diverse agencies engaged in domestic lending or loan guaranty activities, and to give emphasis to the need for administrative consolidation among these latter agencies, they should be represented in rotation by the chief official of each of the three principal agencies, i. e., the Reconstruction Finance Corporation, the Federal Housing and Home Finance Agency, and the Farm Credit Administration. (It would not be a matter of grave consequence, however, if all three were to sit regularly on the council; this matter can be decided either way without disturbing the major conclusions of the present suggestion.) The chief policy officer of all other lending, loan guaranty, and related agencies (including the two not currently serving on the council under the rotation arrangement) should be permitted to attend all meetings of the council, and should be specifically invited to attend and participate in meetings of direct concern to their own agencies. The staffs of all such agencies should also be invited to participate in the staff working groups, at the discretion of the council. The rotating membership, if accepted as a workable arrangement, might be changed each year, to assure a close and continuous relationship of all three of the principal loan agencies with the work of the council. The list of other agencies permitted to attend might be specified by Congress, and might include the following: The Securities and Exchange Commission; the Federal Deposit Insurance Corporation; the Comptroller of the Currency; the Veterans' Administration, presumably the Administrator or the deputy charged with responsibility for the loan insurance program; the Farmers' Home Administration; the Commodity Credit Corporation; and the Rural Electrification Administration. Others might also be invited by the council itself. The basis for omitting these listed agencies from direct membership on the council, apart from the desire to limit membership in the interest of efficiency, would be that their duties are either primarily administrative or relatively small in volume, or that they do not relate as intimately to the current implementation of monetary or credit policy.

In keeping with the over-all principle that domestic financial activities should be conducted in conformity with the objectives of the Employment Act of 1946, the Chairman of the President's Council of Economic Advisors should also serve as a regular member of the

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Council. If it should be desirable for the Council to prepare regular reports on its deliberations (summarizing activities and perhaps pointing out needs for legislation) these could be sent to Congress through the Joint Committee on the Economic Report.

Owing to the desirability of limiting the Council to an advisory and consultative capacity, formal votes would presumably only be taken on procedural matters, such as invitations to attend, the composition of staff committees or study groups, and so on. The Council could work out its own voting procedure for such cases. The important achievement of such a council would lie in providing a regular meeting place for an exchange of views among the leading officials charged with formulating and carrying out the many different aspects of the domestic financial policies of the United States.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

If stability is to be achieved, it is imperative that all agencies pursue it as a common purpose. It is the concern of the Congress that this be the common purpose. The law can make a substantive contribution by directing each agency to direct its policies and activities to that objective. If all agencies are motivated by a real unity of purpose, they will devise effective procedures—whether through formal or informal organizations or without organization—to achieve that purpose. On the other hand, if the agencies are motivated by diverse and conflicting purposes, statutory organizations and procedures, no matter how effective they may be made to appear on paper, will not reconcile those differences.

The proposal to establish a National Monetary and Credit Council appears to be based on the assumption that coordination can be achieved by establishing a legal organization and procedure. While agreeing thoroughly with the purpose to be achieved by creation of such a council, experience does not afford convincing evidence that the method will be effective.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The problem mentioned in No. 4 primarily requires consistency of policy. This may be secured by a revised organizational set-up, but it is by no means automatic. The most forthright method of assuring consistency of policy would be for the Federal Reserve to assume direct charge of these Government credit programs through some sort of an appropriate extension (e. g. sec. 13b) of Federal Reserve powers to take over the lending agencies' operations. If this suggestion seems to clutter the Federal Reserve System with activities of a somewhat remote or political character, and there are substantial reasons for thinking it may, then the credit agencies themselves should perhaps continue to be the operating organizations through which the credit is extended. In this case some top level monetary policy council such as recommended by the Hoover Commission should be formed to develop the general monetary and credit policy within which all money and credit agencies will operate.

Even this poses questions. Should the council be merely advisory, or should its recommendations be mandatory? If the former, how much of a real contribution to consistency of policy would be made? Is the latter feasible?

This council should presumably be composed of representatives for the Federal Reserve, the Treasury, the Comptroller of the Currency,

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the FDIC, and some representation from the lending agencies themselves.

The Hoover Commission recommendation on this matter should receive particularly serious consideration.

Comments of Allan Sproul, Federal Reserve Bank, New York, on VI as a whole

The first three questions in this section concern Federal Reserve relations with the two other Federal agencies which perform bank examinations. The examination function is important as an audit of the operations of commercial banks, helping to protect depositors and the deposit insurance fund against the risks of unwise or improper conduct of banking operations. The supervision extended to the banks through the examination process may also at times exert some influence on the loan or investment policies of the banks. But, by and large, bank examination and supervision is not an important aspect of the credit control functions vested in the Federal Reserve System.

Insofar as the existence of three different supervisory agencies permits the banking community to attempt to "play one off against the other," there is some danger that a uniform and effective system of examinations may be weakened, particularly in critical periods. There may also be a loss of efficiency, and certainly an additional expense, involved in maintaining three overlapping jurisdictions for bank examination and supervision, even though duplication of supervisory activities has been largely avoided. But these are problems which have not been significant in recent years. Consequently, although it might be a more satisfactory administrative arrangement to place all responsibilities for bank examination in one agency, there is no pressing need to do so. What is important is that a full degree of cooperation among the three agencies be attained.

Question VI (3) mentions two possibilities for making this integration somewhat closer: To place a member of the Board of Governors on the Board of the Federal Deposit Insurance Corporation, and to place the Comptroller of the Currency on the Board of Governors. One other possibility, not specifically mentioned in the questionnaire (but suggested in one of the Hoover Commission task force reports), would be to place the Federal Deposit Insurance Corporation within the Federal Reserve System, providing for administration of the insurance fund as a trust, under regulations to be formulated by the Board of Governors or the Federal open market committee. I think this proposal deserves further study.

I would favor, now, the intermediate step of placing a member of the Board of Governors on the Board of the Federal Deposit Insurance Corporation. Certainly the fact that the Comptroller of the Currency already serves as one of the three members of the Federal Deposit Insurance Corporation Board makes this a logical proposal. If the Board member charged with special responsibility for the examination functions exercised by the Federal Reserve System were to occupy the dual position, it would not be open to the usual difficulties of ex officio membership. That member of the Board of Governors could undoubtedly serve as an active responsible director of the Federal Deposit Insurance Corporation, since many of his duties at both agencies would cover the same ground.

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So far as coordination with the Comptroller of the Currency is concerned, I would oppose making him a member of the Board of Governors of the Federal Reserve System. His responsibilities are largely of a supervisory nature, and he is not primarily concerned with the broad matters of credit policy which should mainly occupy the attention of the Board of Governors. The Comptroller is, of course, a subordinate official of the Treasury, even though the Office has independent status, and I should think any necessary extension of coordination between the national bank examiners and the examination staff of the Federal Reserve System could be accomplished through arrangement between the Secretary of the Treasury and the Chairman of the Board of Governors.

With respect to question VI (6), I am favorably disposed, in general, toward the idea of a National Credit Council. Such a council, if established, however, should confine itself to the broad policy problems of common interest to the Treasury, the Federal Reserve, and the Federal agencies engaged in making credit available to various types of borrowers through loan insurance or direct lending. The council should not be expected or permitted to assume the function of making and enforcing policy decisions. It should serve as a clearing house for the different points of view inherently associated with the three types of agencies. Any attempt to make the council into a superstructure for final policy determination would result in placing responsibility over the affairs of one type of agency in a group composed largely of individuals who are not experienced in the detailed problems peculiar to that agency.

No doubt the deliberations of such a council would be simplified if there were better administrative integration of the many Federal lending agencies now in existence. There would be fewer instances of apparently divergent policies among these agencies; and the membership of the council could be smaller. (The possibilities for merger and unified direction of the lending and loan guaranteeing activities is discussed in the report of the task force on lending agencies of the Hoover Commission.) Meanwhile, I would favor representation of all three of the principal lending agencies in regular membership on any national credit council which might be created, that is the Reconstruction Finance Corporation, the Federal Housing and Home Finance Agency, and the Farm Credit Administration. Until there is some form of coordination between these three principal lending agencies and the many others which are not now affiliated with them, the chief officers of these other agencies could be invited to attend meetings of the national credit council whenever topics of concern to them are included on the agenda for discussion.

I do not think that the chairman of the President's Council of Economic Advisers would be a suitable member of such a council. He is not charged with the administration of policy, and serves solely as an adviser to the President on general economic questions, without any direct responsibility to Congress. All of the other agencies suggested for membership on such a council actually have a relationship both with Congress and the Executive.

Reply of Ray M. Gidney, Federal Reserve Bank, Cleveland

I have reservations about the value, effectiveness or desirability of such a council and, on the whole, would be inclined to oppose its crea-

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tion. Should one be established, however, I believe it should be purely advisory and reportorial. For this reason its membership should be inclusive of all Federal lending and supervisory agencies and not restricted to just a few as suggested in the draft reply.

VII. Deposit Insurance

1. What changes, if any, in the laws and policies relating to Federal insurance of bank deposits would contribute to the effectiveness of general monetary and credit policies?

The System answer

The crisis of the thirties demonstrated that the powers of the Federal Reserve System to provide a flexible currency and to introduce, through its lending powers, greater liquidity into the banking system were not sufficient in a period of serious depression and deflation to provide full assurance of the safe and continuous operations of the banking system. Efforts to correct this situation included the establishment of emergency lending institutions such as the National Credit Corporation and the Reconstruction Finance Corporation, and the broadening of the lending authority of the Federal Reserve banks to permit them to make advances to member banks against any sound assets, regardless of whether or not they met previous eligibility rules. Another major step was the creation of the Federal Deposit Insurance Corporation with a view to strengthening the confidence of depositors in the banking system and thus removing an immediate cause of banking crises. From the viewpoint of the Federal Reserve System, the insurance of deposits affects monetary and credit policies in three ways:

(1) By contributing toward a feeling of general confidence in the banking system;

(2) By contributing to the liquidity of bank assets and to the stability and availability of bank deposits for monetary purposes; and

(3) By contributing to orderly markets and stable values for bank assets through reducing the likelihood of large-scale liquidation.

Although deposit insurance on the basis of the experience thus far has been very successful, there are several ways in which the laws and policies relating to Federal insurance of deposits could be strengthened to contribute further toward the effectiveness of general monetary and credit policies. Since the primary objective of general monetary and credit policies is to promote economic stability at optimum levels, any changes in the arrangements concerning deposit insurance that will contribute to the effectiveness of monetary and credit policies will also contribute to the success of Federal insurance of deposits by reducing the incidence of failures.

General confidence in the banking system.—Confidence in the banking system is aided by Federal insurance of deposits primarily through guaranteeing depositors against loss (up to a specified amount), and through widening the scope of Federal supervision of banks to provide increased general protection for all depositors in insured banks.

As to the guaranty against loss, there would seem now to be good reasons for broadening the scope of insurance coverage. No doubt con-

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fidence would be ideally served by a 100 percent guaranty of all deposits, but several possible disadvantages in a major change of this character have been suggested: full coverage might remove the incentive for large depositors to keep informed as to the soundness of the banking institutions in which their accounts are kept; the feeling that, since all deposits were guaranteed, there would be no threat of transfers of large accounts to other institutions might be conducive to less conservative banking practices; and such an extension of insurance coverage might unduly increase the risks and costs of the FDIC. On the other hand, the self-interest of bankers and bank stockholders themselves may well provide a strong inducement to sound and conservative banking practices and greater costs may be justified if confidence is increased and the likelihood of failures is correspondingly reduced. The debatability of these considerations suggests, however, that the question of full coverage be deferred, and that Congress give immediate consideration instead to raising the limit of insured deposits at least to $10,000. A change of this magnitude would be in keeping with the substantial growth in the total volume of deposits and in the average size of accounts since 1935, and with the decline in the purchasing power of the dollar.

A second major FDIC contribution toward confidence in the banking system is provided by the widening of the range of Federal supervision of banks. Previously such supervision was limited to national banks and to the State chartered banks that chose voluntarily to become members of the Federal Reserve System. It has now been extended to most of the banks throughout the Nation through Federal supervision of insured nonmember State banks. The fact that the legal provisions concerning the examination functions of the Comptroller, the FDIC, and the Federal Reserve are included in the Federal Reserve Act apparently indicates congressional recognition of the close relationship among their operations. But there is not, at the present time, any express legal requirement for consultation among these agencies, nor any implied legal basis for any one of the agencies to bring its problems to the others; the law probably should contain specific provision for consultation among the three agencies.

Liquidity of bank assets and stability of the monetary system.—Federal deposit insurance has contributed to the liquidity of the banking system and to the stability of the money supply by providing liquid funds against unliquid assets in cases where individual banks have gotten into difficulties and their closing either became necessary, or was averted only by action of the FDIC in arranging bank mergers with its support. As was pointed out in the answer to question 1 of section V of the questionnaire, however, the effectiveness of Federal Reserve monetary and credit policies is reduced by the presence of nonmember banks because such banks are not subject to the responsibilities of membership in the Federal Reserve System (especially that of maintaining reserve requirements equal to those that member banks are required to maintain) and because nonmember banks do not have full access to the lending facilities of the Federal Reserve banks. Consequently, further measures to increase the liquidity of the banking system and to promote a more effective control over the money supply would appear to be desirable. Presumably it was with a view to these considerations that the original FDIC legislation in 1933 provided

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for the insurance of deposits of nonmember banks only for a limited period. In effect, this would have required all banks desiring to obtain the benefits of deposit insurance to become members of the Federal Reserve System, and thus to obtain access to its lending facilities and become subject directly to national monetary and credit policy within a few years after the establishment of the FDIC. This provision was omitted from the permanent FDIC legislation of 1935, and the result has been an element of weakness in the banking system and in the implementation of monetary and credit policies.

As was suggested in the reply to question 2 of part V, modifications of the present capital requirements for membership in the Federal Reserve System would make it possible for many more nonmember banks to become members. But in all probability many nonmember banks would still choose to remain outside the Federal Reserve System for one reason or another. Membership of all insured banks in the Federal Reserve System would serve both (1) to increase the liquidity of the banking system by making available to all such banks the lending facilities of the Federal Reserve banks, and (2) to strengthen the effectiveness of Federal Reserve monetary and credit policies by bringing all such banks within the responsibilities as well as the privileges of membership. An alternative would be to require the Federal Reserve banks to offer the same lending facilities to nonmember banks as to member banks on the condition that nonmember banks be required to maintain the same reserve requirements as those in force for member banks. A change in the character of reserve requirements of the sort suggested in the answer to the first part of question IV–1 might go far toward making an adjustment to member bank reserve requirements somewhat less difficult for the nonmember banks.

As a further measure to assure that bank deposits will be as fully available as possible for monetary purposes, consideration might be given to a broadening of the powers of the FDIC to determine the appropriate course of action with respect to banks on the verge of insolvency, and to make deposits in closed banks more quickly available to the depositors. At present only the State banking supervisors and the Comptroller of the Currency can place, respectively, State and National banks in receivership. The FDIC only has powers to facilitate a merger, and these powers are useless if there is not another sound bank in the community which is willing to cooperate. In addition, consideration might be given to authorizing the Federal Reserve banks to lend to the FDIC against the assets of closed banks if, in emergencies, its available resources for releasing deposits in such banks should be inadequate.

So far as the size of the insurance fund is concerned, no attempt should be made to provide a fund large enough to assure liquidity to the entire banking system in the event of a catastrophic situation such as occurred in the early thirties; to a large extent reliance would have to be placed on the Federal Reserve System to supply such liquidity if a similar situation should ever again occur. The fund, however, should be large enough to cover all probable losses over the business cycle. The aggregate amount of the insurance fund should be related to the total volume of deposits and the Corporation should be given the power to vary assessment rates within prescribed limits, once an appropriate relationship between the fund and total deposits

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had been achieved. The Corporation could thus maintain the fund at the desired level, while limiting as far as possible any disturbing cyclical effects of insurance assessments on the banks.

Orderly markets and stable values for bank assets.—Another aspect of Federal insurance of deposits of concern to the Federal Reserve System is the extent to which operations of the insurance system affect the orderliness and stability of markets and values for bank assets. To the extent that deposit insurance promotes public confidence in the banking system and prevents unusual withdrawals of deposits, the danger of forced liquidation of assets to meet such withdrawals is eliminated and with it the depressing influence on the values of all similar assets held by the banking system. To the extent that deposit insurance does not prevent silent runs or mass transfers of funds, however, banks may be compelled to liquidate large blocks of assets under adverse conditions. To the extent that banks can borrow against these assets at the Federal Reserve banks, pending their orderly liquidation, the disruptive effects upon market values and upon the affairs of debtors can be minimized. Even under the most favorable circumstances, however, mass conversion of assets creates serious problems and hazards and has an upsetting effect on markets and also on the attitudes of managers of banks. It is desirable, therefore, that the banking system and the deposit insurance structure be strengthened so as to reduce the possibility of such a development.

The orderliness and stability of markets are affected also by the manner in which the FDIC handles assets in the liquidation of closed banks. To date the method of handling such assets by the FDIC has contributed to stability, and the experience and tradition of the Corporation suggest that its policies and practices will continue to do so in the future. However, the volume of operations involved thus far has been small. Should the volume of assets required to be assumed by the FDIC become significantly large at any time, the Corporation might find itself under some pressure to liquidate large blocks of bank assets. The pressures thus generated would in all probability reduce the effectiveness of monetary and credit policy which would be seeking to reduce pressures on markets during such periods.

The law should provide a basis for resolving such an apparent conflict between public policies at any time in the future. One method would be to permit emergency borrowing by the FDIC, at the Federal Reserve banks, against assets that are to be liquidated, subject to Federal Reserve regulations and approval. In all likelihood a bunching of liquidations could thereby be avoided; and the decision upon when liquidation should be attempted could be determined in consultation with the Federal Reserve System. Any possible conflict between asset liquidation and credit policy could thereby be avoided.

In summary, the measures needed to increase the contribution of Federal insurance of bank deposits toward effective monetary and credit policies are all extensions of principles which have, at one time or another, been included in the banking laws. Primarily, the need is to strengthen the banking system further against the impact of economic crises. As a corollary, any measures answering this need will protect the dual-system characteristic of American banking. Pursuance of these objectives leads necessarily to consideration of the following suggestions. Should these suggestions be accepted in prin-

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ciple, precise details can be worked out in subsequent consultation with the FDIC and the Federal Reserve System.

(1) The coverage of deposit insurance should be widened.

(2) Provision should be made for increased consultation among the three Federal agencies charged with bank examination and supervision.

(3) The lending facilities of the Federal Reserve banks should be extended to banks now outside the Federal Reserve System, concomitantly requiring all such banks to become members, or to hold reserve balances comparable to those of member banks.

(4) The FDIC should be given broader powers with respect to receivership, the appointment of conservators, and borrowing at the Reserve banks against the assets of closed banks in emergencies.

(5) General criteria should be established for determining the adequacy of the insurance fund; and the FDIC should be permitted to vary assessment rates within prescribed limits.

Reply of Allan Sproul, Federal Reserve Bank, New York

I have very little to add to the accompanying statement on this question, but would like to emphasize again that deposit insurance alone cannot assure the uninterrupted availability of deposits for meeting the monetary requirements of the economy. The insurance fund provides protection against ultimate loss, but liquidity in the event of a serious crisis can only be provided through cash reserves supplied the banks (or the Federal Deposit Insurance Corporation) by the Federal Reserve System.

I would agree that the Federal Deposit Insurance Corporation should have a wider range of powers over alternative methods of protecting the depositors in failing banks. The power to facilitate mergers with open institutions is not enough. I would also recommend consideration of legislative provision for permitting the Federal Deposit Insurance Corporation, in emergencies, to borrow directly at the Federal Reserve banks for the account of insured banks in distress, subject to the regulations of the Federal Reserve banks. Both of these suggestions bring attention again to the fact that nonmember banks constitute a peculiar problem for the banking system. Of course, under paragraph 13 of section 13 of the Federal Reserve Act, the Federal Reserve banks may make advances secured by direct obligations of the United States, for periods not exceeding 90 days, to any individual, partnership, or corporation. As interpreted by the Board of Governors, this paragraph permits such advances to nonmember banks, but an even greater access to the facilities of the Federal Reserve banks might be necessary if full assurance of liquidity is to be provided through any period of grave crisis.

Two other aspects of Federal Deposit Insurance Corporation operations deserve mention, although they are not intimately related to the effectiveness of general monetary and credit policies. One is the extent of deposit coverage under the insurance plan; the other is the assessment rate at which insured banks contribute to the fund. In my view an increase in insurance coverage can be justified at this time, as an adjustment to the changes which have occurred in the volume of deposits and the price level since 1933, when deposit insurance was inaugurated. I do not believe, however, that the limit should be

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raised above $10,000. The assessment rate was set at a time when it was necessary to provide for the rapid accumulation of a substantial reserve fund. That fund now exceeds a billion dollars, and I believe criteria should be devised and put into effect promptly for setting some limit on the accumulation of reserves, and for providing flexibility in assessment rates.

Once the criteria for determining adequacy have been devised satisfactorily, consideration can also be given to the development of an assessment formula. While that formula must bear a relation to the liabilities incurred by the Federal Deposit Insurance Corporation year by year, it should be so constructed, or so subject to administrative discretion, as to avoid the possibility of a sharp rise in rates at time of depression and heavy losses to banks. It is at just such periods that the banks which remain open can least afford to bear the burden of insurance assessments.

Reply of Alfred H. Williams, Federal Reserve Bank, Philadelphia

The insurance of bank deposits primarily affects monetary and credit policies by contributing to a feeling of public confidence in the banking system. We see no changes in the law or policies with respect to the insurance itself which would contribute substantially to more effective monetary and credit policy. Changes might be appropriate in connection with the administration of deposit insurance, such as the method of calculating the assessment base and the rate of assessment, but these do not seem to be within the scope of the question.

A change in the law which would increase the effectiveness of monetary and credit policies would be to require that all insured banks be members of the Federal Reserve System as essentially provided in the original legislation. As an alternative, the law might be amended so that insured banks would be required to observe the same reserve requirements as those in force for member banks.

Reply of Hugh Leach, Federal Reserve Bank, Richmond

While there has been no widespread demand for 100 percent insurance of all deposits, many think the limit of insured deposits should be increased from $5,000 to at least $10,000. It appears doubtful, however, that such a change would materially enhance public confidence and the stability of the money supply. It has been argued that an increase in coverage would not in practice cause an increase in liability because when trouble materializes, the Federal Deposit Insurance Corporation customarily protects all deposits through purchase of assets, but this overlooks the possibility that in the future the Corporation may find it advisable to elect to liquidate banks and pay off deposits only to the extent insured.

Reply of J. N. Peyton, Federal Reserve Bank, Minneapolis

The current laws and policies relating to insurance of bank deposits as such do not constitute any great deterrent to the effectiveness of general monetary and credit policy. Accordingly no change seems to be necessary for these reasons.

Reply of C. S. Young, Federal Reserve Bank, Chicago

The present limit of insured deposits of $5,000 covers the great majority of depositors and should not be increased at this time.

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Reply of Chester Davis, Federal Reserve Bank, St. Louis

Insurance of bank deposits has aided general monetary and credit policy by contributing to (1) greater confidence in the banking system, (2) greater liquidity of bank assets and greater stability of bank deposits, and (3) more orderly markets and more stable values.

At the same time, changes in banking law have permitted more flexible monetary and credit policies to deal with problems in an economic downswing. This has resulted in less exposure of the banking system to distress liquidation of assets to meet large-scale withdrawals of funds.

A study of the record of bank failures in the past demonstrates that large depositors, who are relatively better informed than small depositors, have withdrawn funds from banks as they seemed to weaken, and thus have precipitated liquidations of assets. In many cases this action may have made the difference between the continuation of the bank and its failure.

Because of this past history it would seem desirable to increase the coverage of deposit insurance. Since the banks have more liquidity by reason of greater freedom of central bank action, and by reason of other institutional changes, exposure to failure resulting from distress liquidations is not as great as it was prior to 1935.

Theoretically, if the major purpose of deposit insurance is viewed as maintaining confidence and preventing withdrawals of deposits leading to forced liquidations, full coverage insurance would seem to be logical. This question should be given extensive study. For the present, however, I believe that more limited extension of coverage, perhaps to as high a figure as $25,000, would be a desirable step toward greater stability of deposits and consequently a greater contribution toward effective monetary and credit policy.

Some formula should be devised for relating the total amount of the insurance fund to the total amount of deposits, and permission should be granted to the FDIC to vary the assessment rate so as to keep a fund of proportionate size.

Finally, it would seem desirable to require that all insured banks be members of the Federal Reserve System. In addition to the considerations which have been advanced in answers to previous questions with respect to membership in the Federal Reserve System, membership of all insured banks in the System would provide for equal access of such banks to Federal Reserve credit and thus reduce the potential amount of liquidation facing the FDIC in case of adverse economic conditions.

VIII. Earnings of the Federal Reserve Banks and Their Utilization

1 (*a*). What changes, if any, should be made in the ownership of the Federal Reserve banks?

The System answer

It is assumed that this question refers to the ownership of the stock of the Federal Reserve banks. No change in the ownership of the stock is suggested. It may be appropriate to point out that the required holding of Federal Reserve bank stock by member banks in proportion to their own capital and surplus does not mean ownership by member banks of the Federal Reserve banks in the usual meaning of

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the term "ownership." Member banks are more in the position of owners of preferred stock with limited voting rights. They are entitled to a cumulative dividend at a specified rate on the Reserve bank stock they hold, but most of the net earnings of the Reserve banks, after payment of the fixed dividend, are paid to the United States Treasury. In the event of liquidation of the Reserve banks, the residual assets remaining after payment of all obligations and the par value of the stock are payable to the United States. The stock is not transferable; it cannot be sold or assigned. The stockholding member banks may elect six of the nine directors of a Federal Reserve bank, but only three directors may be bankers, and each member bank has only one vote, regardless of the number of shares it holds. Three directors, including the Chairman, are appointed by the Board of Governors of the Federal Reserve System, a Government body. The stockholding member banks have only a very limited—and, in general, remote—voice in the determination of the policies of the Federal Reserve System.

The Federal Reserve System has achieved much of its effectiveness because of its regional organization and of its internal freedom from domination by any particular group. The individual banks are operated by men trained in banking and, to an increasing extent, by men with long years of central banking experience. In each bank, a board of directors oversees the administration by the bank's officers. The directors are generally well known and highly regarded in their communities and represent banking, business, agriculture, and the public. They are elected or appointed because of qualities which have been evidenced by success in their respective fields. Besides providing direction of the operations of the Reserve banks, these men furnish valuable sources of information as to the economic conditions within each district, help to widen public understanding of the policies and operations of the Reserve System, and provide local support for the Federal Reserve banks through their connection with them.

The directors administer the affairs of the Reserve banks, subject to the general supervision and regulations of the Board of Governors of the Federal Reserve System. Expenses, including salaries, are subject to the Board's approval, as are appointments of the two chief executive officers of each bank by its board of directors. Thus, in the actual administration of the 12 banks, a unique combination is obtained through the positive contributions of able directors and experienced officers combined with the safeguard of effective supervision by a public body.

The System has been able to secure men of ability to serve as officers and directors only because operations have been directed to the public interest and have not served the objectives of special groups. Directors are willing to serve because they feel that they are elected or appointed on the basis of ability and reputation; officers who have made a career of central banking have done so because they are attracted to a public-service institution and feel that advancement for merit and security from arbitrary selection are available in the Federal Reserve banks.

The present organization of the Federal Reserve System exemplifies the principle of checks and balances traditional in American Government. Some powers have been given to the central agency, the Board of Governors; some to the regional banks; and some to a com-

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bination of the two. Group judgments provide variation in emphasis, and this is a source of strength. Member-bank ownership of the stock of the Reserve banks was not intended to place control of the System's policies in the hands of the member banks, and has not in fact done so.

1 (*b*). What changes, if any, should be made in the dividend rates on Federal Reserve stock?

The System answer

Dividends are paid on Federal Reserve bank stock at the rate of 6 percent per annum as required by section 7, paragraph 1, of the Federal Reserve Act. This rate was set during a period when interest rates were substantially above their present levels, and the proposal is sometimes made that it should now be reduced to conform to present low rates.

There are several possible considerations involved; the most important one is the question of equity as regards the member banks. The stock of the Reserve banks is noncallable; holdings of the individual member bank are redemable only to the extent that they must be surrendered in the event of a reduction in the capital and surplus of the member bank or in the event of the liquidation of the member bank or its withdrawal from membership. The stock of a Reserve bank, as a whole, is redeemable only in the event of the liquidation of the Reserve bank. Member banks have been required to hold stock of the Reserve banks through periods when the prospects for Reserve-bank earnings were uncertain and through periods when prevailing open-market interest rates were higher than the dividend rate on the stock, as well as in periods when open-market rates were lower.

The payment of dividends has never presented any serious problem to the Federal Reserve banks, nor has it influenced Federal Reserve policies with a view to increasing or maintaining Reserve-bank earnings. Since 1925, there have been only 3 years in which dividends were not fully paid out of current earnings.

There is no apparent necessity of a reduction of the dividend rate, and there is a good reason, in equity, for maintaining the present rate on outstanding stock. Furthermore, the current rate, in present circumstances, offers a minor attraction to membership in the Federal Reserve System. It is recommended that the present dividend rate be maintained.

2. What changes, if any, should be made in the legislative provisions relative to the disposal of Federal Reserve earnings in excess of expenses?

The System answer

It is recommended that no action be taken with respect to the disposition of the earnings of the Federal Reserve banks.

The original Federal Reserve Act contained provision (sec. 7) for the payment by the Federal Reserve banks of a franchise tax based upon earnings after dividends. Although this provision was modified in 1919 to provide for the accumulation of larger surplus funds by the banks, the principle remained in force until 1933, when the Banking Act of 1933 removed all requirement of franchise-tax payments becaues the Reserve banks were required to place amounts equal to one-half of their surplus accounts in subscriptions to the capital stock of the Federal Deposit Insurance Corporation.

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From 1933 through 1942, earnings were not large enough to present any problems about their disposition. Net additions to surplus amounted to $37,000,000, only a fraction of the $139,000,000 which had been utilized in 1933 for the purchase of FDIC stock.

Beginning in 1943, however, earnings after dividends were substantial in amount. In that year $40,000,000 was carried to surplus, followed by $48,000,000 in 1944, $82,000,000 in 1945, and $81,000,000 in 1946. By the end of 1946, the capital accounts of all Reserve banks were equal to or exceeded the total of their subscribed capital, the level set in the act prior to 1933 as the point at which the payment of the franchise tax should begin.

In view of this fact and because earnings of the banks were expected to continue at high levels, the Board of Governors invoked the authority granted them by section 16, paragraph 4, of the Federal Reserve Act to impose an interest charge upon the Federal Reserve notes of each bank. As stated in the Board's announcement of April 24, 1947, "The purpose of this interest charge is to pay into the Treasury approximately 90 percent of the net earnings of the Federal Reserve banks for 1947."

So long as the franchise tax was in effect, there was little reason for imposing the interest charge, since excess earnings of the banks were transferred to the Treasury through the tax mechanism. Similarly, following the removal of the franchise tax in 1933, no interest charge was called for, since it had been the obvious intent of the Banking Act of 1933 that earnings should be used to restore surplus funds depleted by the subscription to the capital stock of the FDIC.

The imposition of the charge upon Federal Reserve notes was thus in accord with the original intent of the Federal Reserve Act: that excess earnings of the Reserve banks, after provision for the building up of adequate surplus accounts, be paid to the Government. This action, in a positive sense, recognizes the public character of the Reserve banks. This device is at present transferring the excess earnings of the Reserve banks to the Treasury just as effectively as the earlier franchise tax.

Reply of Allan Sproul, Federal Reserve Bank, New York

I do not believe that any change should be made in the ownership of the Federal Reserve banks. Stock ownership by the member banks is an important, if intangible, link between the Reserve banks charged with the execution of over-all monetary policy and the member banks which experience the direct effects of that policy. The stock does not, of course, carry the powers of control normally associated with stock ownership in private corporations. However, through their election of six of the nine directors, the member banks do have an opportunity to gain some sense of participation in the chain of responsibilities through which over-all credit policy is evolved.

It is also significant that the member banks do not have a right to share proportionately in the earnings of the Federal Reserve banks. These earnings, over and above all operating expenses, and the payment of a fixed cumulative dividend on stock shares, are now returned to the Treasury, with the exception that some allowance may be made for further additions to the surplus accounts of the individual Reserve banks. The device now used for accomplishing the payment to the Treasury is a self-imposed tax related to the volume of Federal

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Reserve notes outstanding and uncovered by gold-certificate reserves. I regard this as an inappropriate method, because it involves distortion of the purpose of the tax. The original purpose of placing an interest charge on such Federal Reserve notes was to prevent any tendency for the Federal Reserve banks to overissue their notes. That danger has never arisen, as the Federal Reserve banks have never made any effort to keep more of their notes in circulation than have been required to meet the demands of the public. It seems to me quite anomalous, therefore, to use techniques intended for an altogether unrelated purpose to accomplish the transfer of Federal Reserve bank earnings to the Treasury.

To accomplish the purpose and overcome the objection, I would favor reimposition of the franchise tax on Federal Reserve banks provided for in section 7 of the original Federal Reserve Act as amended March 1919. This tax implicitly recognized the mixed status of Federal Reserve banks, and the fact that their "profits" arise from the earning assets acquired in carrying out over-all credit policy. The earnings subject to the tax should be determined by the Federal Reserve banks in accordance with regulations of the Board of Governors.

Appendix to Chapter III

August 1949.

QUESTIONNAIRE ADDRESSED TO THE PRESIDENTS OF THE FEDERAL RESERVE BANKS

I. Objectives of Federal Reserve policy

1. What do you consider to be the more important purposes and functions of the Federal monetary and credit agencies? Which of these should be performed by the Federal Reserve?

2. What have been the guiding objectives of Federal Reserve credit policies since 1935? Are they in any way inconsistent with the objectives set forth in the Employment Act of 1946?

3. Cite the more important occasions when the powers and policies of the System have been inadequate or inappropriate to accomplish the purposes of the System.

4. Would it be desirable for the Congress to provide more specific legislative guides as to the objectives of Federal Reserve policy? If so, what should the nature of these guides be?

II. Relation of Federal Reserve policies to fiscal policies and debt management

1. Would a monetary and debt-management policy which would have produced higher interest rates during the period from January 1946 to late 1948 have lessened inflationary pressures?

2. In what way might Treasury policies with respect to debt management seriously interfere with Federal Reserve policies directed toward the latter's broad objectives?

3. What, if anything, should be done to increase the degree of coordination of Federal Reserve and Treasury objectives and policies in the field of money, credit, and debt management? What would be

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the advantages and disadvantages of providing that the Secretary of the Treasury should be a member of the Federal Reserve Board? Would you favor such a provision?

4. What changes in the objectives and policies relating to the management of the Federal debt would contribute to the effectiveness of Federal Reserve policies in maintaining general economic stability?

5. On what occasions, if any, since 1929 have the Government's fiscal policies militated against the success of the Federal Reserve in attaining its objectives? What type of fiscal policy would best supplement monetary policies in promoting the purposes of the Employment Act?

III. International payments, gold, silver

1. What effect do Federal Reserve policies have on the international position of the country? To what extent is the effectiveness of Federal Reserve policy influenced by the international financial position and policies of this country? What role does the Federal Reserve play in determining these policies? In what respects, if any, should this role be changed?

2. Under what conditions and for what purposes should the price of gold be altered? What consideration should be given to the volume of gold production and the profits of gold mining? What effect would an increase in the price of gold have on the effectiveness of Federal Reserve policy and on the division of power over monetary and credit conditions between the Federal Reserve and the Treasury?

3. What would be the principal advantages and disadvantages of restoring circulation of gold coin in this country? Do you believe this should be done?

4. What changes, if any, should be made in our monetary policy relative to silver? What would be the advantages of any such changes?

IV. Instruments of Federal Reserve policy

1. What changes, if any, should be made in the reserve requirements of member banks? In the authority of the Federal Reserve to alter member-bank reserve requirements? Under what conditions and for what purposes should the Federal Reserve use this power? What power, if any, should the Federal Reserve have relative to the reserve requirements of nonmember banks?

2. Should the Federal Reserve have the permanent power to regulate consumer credit? If so, for what purposes and under what conditions should this power be used? What is the relationship between this instrument and the other Federal Reserve instruments of control?

3. What, if any, changes should be made in the power of the Federal Reserve to regulate margin requirements on security loans?

4. Should selective control be applied to any other type or types of credit? If so, what principles should determine the types of credit to be brought under selective control?

5. In what respects does the Federal Reserve lack the legal power needed to accomplish its objectives?

6. What legislative changes would you recommend to correct any such deficiencies?

V. Organization and structure of the Federal Reserve System

1. In what respects, if at all, is the effectiveness of Federal Reserve policies reduced by the presence of nonmember banks?

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2. What changes, if any, should be made in the standards that banks must meet in order to qualify for membership in the Federal Reserve System? What would be the advantage of such changes?

3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies? In the size, terms, and method of selection of the Board of Governors? In the Open Market Committee? In the boards of directors and officers of the Federal Reserve banks ? What would be the advantages and disadvantages of the changes that you suggest?

VI. Relation of the Federal Reserve to other banking and credit agencies

1. What are the principal differences, if any, between the bank-examination policies of the Federal Reserve and those of the FDIC and the Comptroller of the Currency?

2. To what extent and by what means have the policies of the Federal Reserve been coordinated with those of the FDIC and the Comptroller of the Currency where the functions of these agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination? To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks?

3. What would be the advantages and disadvantages of providing that a member of the Federal Reserve Board should be a member of the Board of Directors of the Federal Deposit Insurance Corporation? Would you recommend that this be done? Should the Comptroller of the Currency be a member of the Federal Reserve Board?

4. In what cases, if any, have the policies of other Government agencies that lend and insure loans to private borrowers not been appropriately coordinated with general monetary and credit policies?

5. What changes, if any, should be made in the powers of the Federal Reserve to lend and guarantee loans to nonbank borrowers? Should either or both of these powers be possessed by both the Federal Reserve and the Reconstruction Finance Corporation? If so, why? If not, why not?

6. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

VII. Deposit insurance

1. What changes, if any, in the laws and policies relating to Federal insurance of bank deposits would contribute to the effectiveness of general monetary and credit policies?

VIII. Earnings of the Federal Reserve banks and their utilization, 1940–

1. What changes, if any, should be made in the ownership of the Federal Reserve banks? In the dividend rates on Federal Reserve stock?

2. What changes, if any, should be made in the legislative provisions relative to the disposal of Federal Reserve earnings in excess of expenses?

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CHAPTER IV

REPLY BY PRESTON DELANO, COMPTROLLER OF THE CURRENCY

1. Under what conditions and for what purposes are requests for national bank charters denied?

The Comptroller of the Currency for many years has used certain criteria as guides in the approval or disapproval of applications for national bank charters. In his instructions No. 4, promulgated in 1927, national bank examiners making preliminary investigations for that purpose were instructed:

In making this investigation, the examiner is instructed to give full consideration to all factors entering into the proposition. Among other matters to be considered are, first, the general character and experience of the organizers and of the proposed officers of the new bank; second, the adequacy of existing banking facilities and the need of further banking capital; third, the outlook for the growth and development of the town or city in which the bank is to be located; fourth, the methods and banking practices of the existing bank or banks, the interest rates which they charge to customers, and the character of the service whch as quasi public institutions they are rendering to their community: fifth, the reasonable prospects for success of the new bank if efficiently managed.

This instruction is judicially noticed with approval by the Court of Appeals of the District of Columbia in *Apfel* v. *Mellon* ((1929) 33 F. (2d) 805).

Similar criteria have been crystallized into law by Congress (title 12, U. S. C., sec 264 (e) (2)), wherein it is provided that before being admitted to deposit insurance by the Federal Deposit Insurance Corporation each national bank newly organized shall be certified to that Corporation by the Comptroller of the Currency, whose certificate shall show that consideration has been given to the following factors: The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this section.

The procedure followed at the present time by the Comptroller of the Currency in the consideration of applications for charters still follows the broad principles indicated above, although the present instructions to examiners are considerably more detailed. This procedure is briefly as follows:

A field examiner is designated in each case to visit the town or city in which the proposed bank is to be situated to inquire into the several factors enumerated above. In the course of this inquiry, he sounds out the local demand for banking facilities; he investigates the competitive aspects of the proposed bank; he reviews the local sources of income and wealth to determine whether the bank could be supported and would be successful; he interviews and inquires into the qualifi-

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cations and the financial responsibility of the proposed management, the proposed board of directors, and the principal stockholders.

At the same time, notice of the pending application is given to the appropriate Federal Reserve bank and also to the Federal Deposit Insurance Corporation. It is customary for each of these agencies to send an examiner to the town or city involved and to give the Comptroller the benefit of its views after such investigation.

The Comptroller may therefore take adverse action upon an application for charter if he finds any substantial deficiency in any of the factors enumerated. In practice, adverse action is taken with respect to a considerable proportion of applications received, as follows:

Year	Applications received	Applications denied	Percent	Year	Applications received	Applications denied	Percent
1943	22	6	27	1947	49	20	41
1944	38	5	13	1948	48	17	35
1945	63	12	19	1949 [1]	23	[2] 12	
1946	71	21	30				

[1] To Sept. 15.
[2] 9 pending.

The Comptroller of the Currency desires that the national banking system be maintained in a position to furnish banking service wherever there is a demand for a national bank and the circumstances appear to justify its establishment. The increase of wealth, the spread of industry, and the shifts of population afford the national banking system opportunities for growth. Long experience in bank supervision has demonstrated that the establishment of numerous weak banks, or banks that by their competition weaken existing banks, is no source of advantage to the communities in which they exist. A careful screening of new applications, not to perpetuate an existing monopoly or to restrict the legitimate banking service rendered to any community, but to ensure so far as possible at inception the organization of strong, well-managed, soundly conceived, and favorably situated banks is deemed in the interests of the industry, commerce, and citizenry of this country.

2. What changes, if any, in the legislation relating to the chartering and operation of national banks would improve their usefulness to the economy and contribute to economic stability?

At the present time, the Comptroller of the Currency has no changes of this nature to suggest, with the exception of the recommendations set forth hereinafter regarding (*a*) local branch banking, and (*b*) statutory capital requirements with respect to branch banking.

Defects of operation which at one time were troublesome, such as the unsatisfactory organization of reserves, the inelasticity of the note issue, and the collection of out-of-town checks, were corrected through the organization of the Federal Reserve System.

The national banking system, operating in the 48 States, the District of Columbia, and the Territories, has more than one-half of the total assets of commercial banks. It is maintaining its position in competition with the several State bank systems. It is believed the present laws governing the operation of national banks are sufficiently comprehensive to permit them to meet all legitimate demands for bank credit in their respective communities and to furnish modern, efficient

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banking service to industry, commerce, and to the public. Fundamentally the national banks are sound. Quality of management, in general, is on an exceptionally high level. Sufficient bank credit has been generated by all banking systems to sustain the Government and the business of the Nation. No change is suggested as a contribution to economic stability.

The Office of the Comptroller of the Currency is opposed to undue development of either branch banking or group banking on a Nation-wide basis or on a widespread sectional basis. The branch banking privileges now enjoyed by national banks were granted only to the extent granted to State banks by State law and were designed generally to bring about competitive parity within the dual banking system. However, our experience has indicated that branch banking within a single large city offers great advantages to both the banking public of such city and the bank itself, and is not subject to the several powerful objections which can be made to more widespread branch banking. Furthermore, there are sections and communities in many cities where unit banks cannot be established without creating an over-banked condition or without resulting in uneconomic or unsafe banking facilities. In some cities neither State nor National banks can have branches by virtue of the limitations of State laws, even though a sound local bank, if permitted to do so, could establish one or more branches in such a community, to its own profit and the benefit of the public, without in any manner endangering the banking system as a whole.

Therefore, in order to provide better and more easily available banking services, and to keep national banks abreast of present-day economic development in the cities, so necessary to the public under present conditions, it is recommended that national banks be authorized to establish branches, with the approval of the Comptroller of the Currency, within the limits of the municipality in which the bank is situated, regardless of whether State law authorizes the establishment of similar branches by State banks situated therein. Such a privilege would substantially improve the usefulness of national banks to the economy, and would not violate the principle of competitive equality between State and National banks, since the State legislatures could confer the same privilege upon State banks, if deemed advisable.

At the present time, section 5155 of the Revised Statutes (12 U. S. C. 36) contains two sets of capital requirements with respect to establishment and maintenance of branches by national banks. Section 5155 (d) requires that a national bank with branches must have capital at least equal to "the aggregate minimum capital required by law for the establishment of an equal number of national banking associations situated in the various places where such association and its branches are situated." This requirement is not unreasonable, and has not caused any substantial difficulty or injustice in actual operation.

Section 5155 (c), as it applies to national banks in most of the States, forbids a bank to have any branches outside of its own town or city unless its capital is at least $500,000. This requirement seems to have little justification, and actually has prevented national banks in smaller towns from establishing a branch or branches in nearby towns or villages, even though such branches would be of considerable benefit to the communities concerned, and the proposed banking structure actually did not call for capital of $500,000 or more. This excessive capital requirement has also had the effect, in some cases,

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of preventing banks from organizing as, or converting into national banks, or becoming members of the Federal Reserve System.

In view of the foregoing, we recommend elimination, or at least amendment, of the last sentence of section 5155 (c). In our opinion, the requirement of section 5155 (d) is a sufficient capital requirement in this connection, since it is simply a statutory minimum, and the Comptroller of the Currency is authorized to require such greater capital as he deems appropriate before permitting establishment of national bank branches.

> 3. What changes, if any, should be made in the standards that banks, including State-chartered banks, must meet in order to qualify for membership in the Federal Reserve System?

National banks are automatically eligible for membership in the Federal Reserve System by virtue of being chartered by the Comptroller of the Currency. With respect to national banks, therefore, this question, to a considerable extent, is equivalent to that presented in question 2 of the questionnaire.

With respect to standards and requirements for State bank membership in the Federal Reserve System, it is believed that this is a matter as to which the Board of Governors of the Federal Reserve System is peculiarly qualified to judge and make recommendations, because of its decades of experience in that field and its knowledge of the factors to be taken into consideration. However, the Office of the Comptroller of the Currency strongly recommends that the standards for membership in the Federal Reserve System, and for the operations of member banks, and the comparable standards with respect to national banks, be maintained on a parity, so far as possible in order to continue the existing beneficial equality of opportunity and competition among national banks and State member banks.

> 4. What are the principal differences, if any, between the bank-examination policies of the Comptroller of the Currency and those of the FDIC and the Federal Reserve? Please describe any such differences in some detail, giving the reasons for them.

The primary differences between the approach to the bank supervision of the Office of the Comptroller of the Currency, the Federal Reserve System, and the FDIC, result from the somewhat different functions of the three agencies. With respect to all national banks and other banks under his supervision, the Comptroller of the Currency is charged with primary supervisory responsibility. State member banks and nonmember insured banks are creatures of the law of the several States, operated under the banking laws thereof, and are subject to the primary supervisory authority of the State superintendent of banks or comparable official or board. The Federal Reserve System examines State member banks to ascertain whether they are operating in accordance with the laws, regulations, and conditions of membership to which they are subject by reason of Federal Reserve membership; and the examination functions of the FDIC are comparable, with chief emphasis derived from the Corporation's status as insurer of bank deposits. Accordingly, the examination activities of the Federal Reserve System and of

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the FDIC ordinarily are performed in cooperation with State banking authorities, rather than separately.

Despite these important differences in function and approach, the objectives of the three Federal bank supervisory agencies are the same. Each bank is examined to determine solvency, to ascertain that it is being operated in accordance with applicable laws, and to determine the soundness of the policies (particularly credit policies) of management. In connection with these objectives, there are few, if any, differences in policy among the three agencies. This desirable uniformity in policy is achieved through the practices and procedures outlined in question 5.

5. To what extent and by what means have the policies of the Comptroller of the Currency been coordinated with those of the Federal Reserve and the FDIC where the functions of those agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination? To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks? Please give reasons for your answer.

The policies of the three agencies are closely coordinated, to the extent that their functions are related. This coordination is achieved through frequent conferences and consultations, both among the top officials of the agencies and the members of their staffs, for the purpose of developing tentative programs and policies with respect to new subjects and problems, and changes in policies and procedures to meet changed conditions calling for either major or minor modifications.

As an important example, it is to be noted that the forms for examination reports, reports of condition, and reports of earnings, expenses, and dividends have been substantially standardized for the three agencies, and major changes therein are made only after thorough interagency study and exchange of views. In addition, all reports of examination of national banks are made available to the Federal Reserve System and to the FDIC, since national banks, as members of the Federal Reserve System and the FDIC, are subject to the requirements of such memberships and therefore must be taken into account by those agencies in the formulation of Federal Reserve and Federal deposit-insurance policies and practices. By such interchange of information and opinions there is achieved a higher degree of coordination among Federal bank supervisory agencies than is generally realized.

We feel that it would be undesirable to alter the division of the authority to supervise and examine banks. As indicated in our answer to question 4, they occupy quite different positions with respect to the banks which they examine. The chief function of the Office of the Comptroller of the Currency is to exercise general supervision over national banks, since these are chartered by the Federal Government and operate under a Federal code of laws. The primary function of the FDIC is that of an insurer of bank deposits, and State banking authorities are primarily responsible for general supervision of the nonmember insured banks which the FDIC examines. The

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Federal Reserve System is concerned chiefly with credit and monetary matters; its examination and supervision of State member banks is relatively a less important function. Nevertheless, the suggestion recently has been made from a semiofficial source that all Federal bank supervision be unified within the Federal Reserve System, apparently for the purpose of subordinating bank supervision to national credit policy.

In our opinion such a development would be inimical to the well-being of American banking and its effective performance of its important role in American economic life. Furthermore, it would tend to undermine the confidence of bankers in the Federal supervisors, who they now know to be concerned solely with the soundness of each individual unit of the banking system and its ability to furnish the fullest possible service to its community and the Nation. This valuable relationship would be lost to the extent that Federal bank supervision became merely one means for putting into effect current economic policies of the Federal Government. For these and related reasons, this office firmly believes that any such unification would be inadvisable, and that contentions to the contrary are based upon a superficial understanding of the different functions of the Federal supervisory agencies and the coordinated and efficient manner in which they are performed.

> 6. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

Despite its designation as a National Monetary and Credit Council, it appears that the body recommended by the Commission on Organization of the Executive Branch of the Government would have as its purpose the coordination of the policies and operations of the lending, insuring, and guaranteeing functions of Federal Government agencies, in the domestic field. (Report on Treasury Department (March 1949) pp. 19–21, 32–33.)[1]

In the course of its frequent examination of 5,000 commercial banks throughout the country, the Office of the Comptroller of the Currency has encountered relatively little conflict, inconsistency or lack of coordination in the operations of the numerous Government agencies engaged in lending, insuring, and guaranteeing loans, and the like. It is believed that, to a considerable extent, there is at the present time a practice of exchange of information regarding policies and operations among those agencies. However, the agencies actually engaged in such work are unquestionably in a better position to express opinions regarding the need for a Council of the nature described.

Subject to the foregoing limitations, it is our opinion that a Council of this type would accomplish relatively little in addition to what is now accomplished through voluntary coordination and exchange of views by the departments and agencies concerned. If this is cor-

[1] The functions of the National Monetary and Credit Council recommended by the Hoover Commission, as outlined above, would be entirely different from the functions of the National Monetary Commission proposed by S. 1559, 81st Cong. Our comments refer solely to a body of the nature recommended by the Hoover Commission, to which the questionnaire refers.

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rect, the existence of such a Council might tend to formalize and complicate the process of coordination, and to that extent might actually impede the process. On balance, therefore, this office does not affirmatively favor the establishment of such a body, although it has no basis for strong opposition thereto.

> 7. What would be the advantage and disadvantages of providing that the Board of Directors of the FDIC should be composed of the Comptroller of the Currency, the Chairman of the Federal Reserve Board, and an appointed Chairman? Would you recommend that this be done?

The banking system of the United States is often described as a dual banking system, made up of some 5,000 national banks holding more than half of the total deposits, and somewhat less than 10,000 State banks (including mutual savings banks) holding the remainder. Examiners of the FDIC examine insured nonmember banks once each year, ordinarily in cooperation with the State banking authorities. National banks are examined only by the Comptroller of the Currency the reports of examination being made available to the FDIC.

The present composition of the Board of Directors of the FDIC provides direct contact with the primary supervisory authorities with respect to all insured banks. The ex officio directorship of the Comptroller of the Currency makes for easy coordination, so far as desirable, of the insurance functions and policies of FDIC, and the general supervisory functions and policies of the Comptroller. Likewise, the fact that joint examinations of the majority of insured State banks are made by the FDIC and the State banking authorities gives an opportunity for similar cooperation between the FDIC and the State authorities. Consequently, the present composition of the Board of Directors of the FDIC provides the highly desirable feature of closed and continuous contact with the authorities, State and Federal, having primary supervisory responsibility with respect to every part of the dual banking system. This is perhaps the most important reason for including the Comptroller of the Currency as one of the three directors of the FDIC.

It is true that the presence on the FDIC Board of the Chairman of the Board of Governors of the Federal Reserve System would furnish the advantage of direct contact with the body charged with Federal supervision of State member banks. To this extent the FDIC (and to a lesser degree, the Federal Reserve System) might receive some benefit from the suggested change in the composition of the Board of Directors of the FDIC.

However, if the FDIC had a three-man Board of Directors composed of the Comptroller of the Currency, the Chairman of the Federal Reserve Board, and an appointed Chairman, a majority of the Board would consist of directors with dual responsibilities. We regard this as undesirable, for we believe that the FDIC should be directed by a board of whom a majority are concerned solely with the most effective performance of deposit-insurance functions.

Although a decision in this matter is difficult to make, we are inclined to believe that neither the change outlined in the questionnaire nor the alternative outlined above is desirable. The present three-man Board of the FDIC has great advantages of flexibility and convenience. In addition, the factors mentioned in the preceding

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paragraphs indicate that the relatively limited advantages of a Federal Reserve directorship on the FDIC Board would be outweighed by the potential disadvantages. We therefore recommend against a change of this nature in the composition of the Board of Directors of the FDIC.

> 8. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished?

This office is not in a position to discuss this question adequately. Our duties (other than ministerial) are restricted to bank examination and supervision, and do not call for determinations or activities involving economic questions of this nature. For this reason, the bureau does not employ professional economists, within whose field these subjects would fall.

Within the Treasury Department, problems of this character would be dealt with by the Office of the Secretary.

Appendix to Chapter IV

August 1949.

QUESTIONNAIRE ADDRESSED TO THE COMPTROLLER OF THE CURRENCY

1. Under what conditions and for what purposes are requests for national bank charters denied?

2. What changes, if any, in the legislation relating to the chartering and operation of national banks would improve their usefulness to the economy and contribute to economic stability?

3. What changes, if any, should be made in the standards that banks, including State-chartered banks, must meet in order to qualify for membership in the Federal Reserve System?

4. What are the principal differences, if any, between the bank-examination policies of the Comptroller of the Currency and those of the FDIC and the Federal Reserve? Please describe any such differences in some detail, giving the reasons for them.

5. That what extent and by what means have the policies of the Comptroller of the Currency been coordinated with those of the Federal Reserve and the FDIC where the functions of those agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination? To what extent would you alter the division among the Federal agencies of the authority to supervise and examine banks? Please give reasons for your answer.

6. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

7. What would be the advantages and disadvantages of providing that the Board of Directors of the FDIC should be composed of the Comptroller of the Currency, the Chairman of the Federal Reserve Board, and an appointed Chairman? Would you recommend that this be done?

8. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished?

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CHAPTER V

REPLY BY MAPLE T. HARL, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

1. How broad do you consider the purposes of deposit insurance to be? Merely to protect small depositors? To prevent losses of reserves by the banking system, or by large portions of the system, through preventing fear-inspired withdrawals of currency and shifts of deposit balances within the system? To maintain the availability of credit at banks by creating confidence among bankers that they will not be subjected to runs by their depositors? Other purposes?

We consider deposit insurance as having the following principal purposes: The chief purpose is to protect small depositors. Another major purpose is to maintain the confidence of depositors in the banks.

An additional function of deposit insurance is to improve the standards of bank management and increase the soundness of the banking system through examination and supervision of individual banks by the Federal Deposit Insurance Corporation.

A further objective of deposit insurance is to restore to a community, in the event of a bank failure, a portion of the deposits used in the community as a circulating medium.

Considering reserves in a broad sense, the losses of reserves by the banking system through fear-inspired withdrawals of currency and shifts of deposit balances within the system will be largely prevented to the extent that deposit insurance maintains the confidence of the mass of depositors in the banks. The legal reserves of banks which are members of the Federal Reserve System, of course, are controlled by the policies and operations of the Federal Reserve System and, therefore, we do not believe that deposit insurance was intended to exert any direct influence on such reserves.

Depositors' confidence creates confidence among bankers that they will not be subjected to runs by their depositors, and this in turn exerts a favorable influence in maintaining the availability of credit at banks.

2. In the cases of banks that have fallen into such serious financial difficulties that the FDIC had to take them over, have you found that there are often large withdrawals of deposits during the period before actual failure? If so, have these withdrawals included deposit accounts in excess of $5,000? Please supply revelant statistics if these are available.

In several cases of insured banks merged with aid from this Corporation or placed in receivership, it is known that unusual withdrawal activity occurred during the period shortly before the closing of the bank. However, these withdrawals were not limited to ac-

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counts exceeding $5,000. Some depositors withdrew the entire amount of the deposit; others withdrew only the amount in excess of $5,000. In adition, some depositors with accounts below $5,000 withdrew their entire deposit balances. For the most part, these cases involving unusual withdrawals occurred in the early stages of Federal deposit insurance. In recent years this type of depositor behavior has almost entirely disappeared and in some cases, deposits have actually increased in the period just prior to the receivership or merger.

The period during which Federal deposit insurance has been in operation has been comparatively free from serious banking troubles. In recent years the number of insured banks requiring financial aid from this Corporation for the protection of depositors has declined to almost negligible proportions. The activity in deposit accounts in this period would furnish little basis for ascertaining the situation likely to be encountered in times of great financal stress. Accordingly, we have not made and do not have available detailed statistical studies of the activity in deposit accounts in banks receiving Federal deposit insurance aid.

3. Does the information at your disposal indicate that bank runs have often been initiated or reinforced at an early stage by withdrawals of large deposit accounts?

No bank runs of any consequence have occurred since the Federal Deposit Insurance Corporation has been in operation. Hence, this Corporation has no direct information to—

indicate that bank runs have often been initiated or reinforced at an early stage by withdrawals of large deposit accounts.

Several years ago a study was made by a project of the Works Progress Administration of the behavior of deposits prior to suspension in a selected group of banks. The study covered 67 banks which suspended during the period from November 1930 to March 1933. These banks were considered representative of suspensions involving banks with total deposits from $1,000,000 to $25,000,000 located in urban areas. The results of the investigation were summarized as follows:

1. From the time that serious deposit withdrawals began until the date on which they suspended, the banks included in the survey experienced an average reduction of almost 40 percent in their deposits.

2. In most of the banks demand deposits showed somewhat larger percentage reductions than time deposits, and interbank deposits showed much sharper reductions than either demand or time.

3. A decrease of 70 percent took place in the balances of demand deposit accounts of $100,000 and over. The magnitude of the percentage decline in balances tended to decrease in each successively smaller size class, and became negligible in accounts of less than $200. Large demand deposits were a very important factor in withdrawals of deposits both because of their proportionate magnitude and because they were reduced much more sharply than smaller deposits. In the sample group of banks as a whole, reductions in the balances of accounts of $25,000 and over accounted for 43 percent of the total decrease in demand deposits, although demand deposits of this size accounted for only 28 percent of the total demand deposits on the date from which decreases were measured. Accounts of this size were reduced 64 percent, as contrasted with a reduction of 40 percent in total demand deposits, and a reduction of 6 percent in the balances of accounts of less than $500.

4. The most important factor in explaining differences in the variability of demand deposit balances in time of stress is apparently the size of the balance. The influence of other factors, such as type of deposit (demand or time), residence

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of holder (local or nonlocal), or type of holder (business or personal), seems to be of comparatively minor importance.[1]

4. What changes, if any, in the coverage of deposit insurance are desirable to further the purposes of the Employment Act? What would be the advantages and disadvantages of providing full insurance coverage of all deposits in insured banks? On balance, would you favor such a policy? Please give reasons for your answer.

The purpose of the Employment Act of 1946 is stated as follows:

The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.

As we have stated in the answer to question No. 1, the principal purposes of Federal Deposit Insurance are to protect small depositors, to maintain the confidence of depositors in banks, to raise standards of bank management and increase the soundness of the banking system, and to aid in protecting the circulating medium. The accomplishment of these purposes would contribute to economic and financial stability and thus serve to further the purposes of the Employment Act.

During the period of its operation, Federal Deposit Insurance has accomplished its primary purpose of protecting depositors. As a result, the confidence of the depositors has been restored and maintained. That the third stated purpose of deposit insurance has been fulfilled is attested by the fact that during the entire period of the Corporation's operations, the condition of insured banks has steadily improved and banks generally are in the best condition in our banking history. Insofar as its function of protecting the circulating medium is concerned, deposit insurance has effectively discharged this responsibility, and in this connection it should be noted that in more than 5 years there has not been any loss of circulating medium in any community due to the closing of an insured bank.

Therefore, we are of the view that the Corporation, under the present insurance coverage, is making a maximum contribution to furthering the purposes of the Employment Act and in this respect there would be no benefit to be gained in changing the coverage of deposit insurance.

Those who favor changing the law to provide full insurance coverage for deposits have advanced the following arguments:

1. Approximately 50 percent of dollar amount of deposits are insured under present statutory limitations. If deposit insurance covering 50 percent of deposits is desirable and necessary, 100 percent insurance would be more effective and would result in a more complete fulfillment of the purposes of deposit insurance.

2. The present deposit insurance limit of $5,000 results in most

[1] Federal Reserve Bulletin, March 1939, p. 178.

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of the larger deposits going to the big banks. Full insurance coverage would result in smaller banks getting more of deposits in excess of $5,000.

3. Due to the preponderance of large accounts in big banks, the proportion of insured deposits is relatively low. Since assessments are based on total deposits, it is claimed that the big banks carry more than a proportionate share of the costs of deposit insurance. The redistribution of deposits resulting from 100 percent insurance would shift some of the burden of deposit insurance protection from the big to the small banks.

4. In most cases of insured banks in difficulty, the Federal Deposit Insurance Corporation, under its merger procedure, protects all depositors in full, so why not require insurance protection in full by law and thus take full advantage of the psychological benefits of 100 percent insurance.

Those who do not favor changing the law to provide for full insurance for deposits give the following reasons in support of their view:

1. Full insurance coverage would necessitate the imposition of greater controls over the banking industry which would narrow the area of managerial decision by individual banks. It is questionable just how much more control can be imposed on the present free-enterprise system of banking without stifling it. Somewhere in the process of increasing controls, the point would be reached where the controls would do death to the system. Since this point cannot be ascertained by hypothetical means, this hazard to the free-enterprise system of banking must be taken into account when considering full deposit insurance coverage.

2. Full insurance coverage would destroy the influence for sound banking which is now exerted upon bank management by large depositors. This result, commonly called placing a premium on bad banking, would have a decidedly unfavorable effect upon banking practices in that it would break down bank-management standards developed to their present high quality over the past 15 years.

3. There is no satisfactory assurance that the insurance fund is adequate to provide full insurance protection.

4. Deposit insurance has achieved in full the objectives established for it and has functioned effectively during its entire existence. It is true that the Corporation has not faced a period of serious trouble in the banking system. However, deposit insurance was designed to aid in preventing severe financial crises and its effective functioning and the improvements and reforms in the banking and monetary system made in 1933–35 have greatly lessened the possibility of recurrence of such conditions. In view of the 15 years of successful deposit-insurance operations, it would be illogical to make such a drastic change based purely on speculation as to the necessity for and the results of such a change.

On balance, we do not favor amending the deposit-insurance law to provide full insurance for deposits as the disadvantages, in our opinion, substantially outweigh the advantages.

5. What changes, if any, should be made in the basis and rates of deposit-insurance premiums?

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The Corporation has been conducting an extensive study in conjunction with representatives of the American Bankers Association regarding the changes, if any, which should be made in the basis and rates of deposit-insurance assessments. This study has not yet been completed and, therefore, we are unable to state our recommendations on that subject at this time.

6. What changes, if any, should be made in the commitments of the Government to provide financial assistance at any time that the resources of the FDIC might prove to be inadequate?

We do not at this time recommend any change in the commitment of the Federal Government to provide financial assistance to the Federal Deposit Insurance Corporation.

7. How do the percentage losses to the Corporation in those cases in which the FDIC itself acts as receiver for insured banks compare with its percentage losses in those cases where others act as receivers for insured banks?

The Corporation has acted as receiver for 77 insured banks which had deposits of $34,000,000. The Corporation was not appointed receiver in the case of 168 closed insured banks with $76,000,000 deposits.

In the banks for which the Corporation has acted as receiver the Corporation disbursed 25.7 million dollars. The Corporation's loss was 3.7 million dollars or 14.4 percent of disbursements. This loss was 11.0 percent of the total deposits of the banks.

In the banks for which others have acted as receiver the Corporation disbursed 61.3 million dollars. Its loss was 10.8 million dollars or 17.7 percent of its disbursement. The loss was 14.3 percent of the total deposits of the banks.

8. What would be the advantages and disadvantages of requiring all commercial banks to become members of the FDIC? Would you recommend that this be done?

An advantage in requiring all commercial banks to become insured banks would be extension of the benefits and protection of deposit insurance to depositors of approximately 1,100 noninsured commercial banks.

A disadvantage would be that such compulsory insurance requirement would disturb the relations between the Corporation and the State supervising authorities. Under the present law, the Corporation operates as a unifying link between the State and Federal banking systems. It is concerned equally with both classes of banks, State and National. By establishing deposit insurance on an optional basis for State nonmember banks, the authority of the States to charter and supervise banks was preserved. Compulsory insurance for all commercial banks would result in either the State authorities controlling the admission of banks to insurance or the Corporation dominating the chartering of commercial banks by the State. Obviously, it would be unsound to require the Corporation automatically to insure all commercial banks chartered by the State authorities. Likewise, it would be an usurpation of a prerogative of the States to require that no State commercial bank could operate without insurance by the Corporation. This requirement would, in effect, transfer the chartering powers of the States to this Corporation.

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We believe the friction and pressures of compulsion would outweight any advantage that would ensue from requiring all commercial banks to be insured. Therefore, we recommend against such a proposal.

9. In your review of the examinations made by the Federal Reserve and the Comptroller of the Currency, what have you found to be the principal differences, if any, between the bank-examination policies of the FDIC and those of the Federal Reserve and the Comptroller of the Currency?

There are no important differences between the bank-examination policies of this Corporation and those of the Federal Reserve or the Comptroller of the Currency. The existing differences are unimportant and are attributable mainly to the difference in the functions and purposes of the three agencies. Complete cooperation exists between all three agencies. Uniformity of examination policy is gradually being achieved and close liaison now obtains with respect to a uniform approach to corrective programs.

10. What changes, if any, should be made in the division among the Federal agencies of the authority to supervise and examine banks? What would be the advantages of such changes?

We do not at this time recommend any changes in the division among Federal agencies of the authority to supervise and examine banks.

11. What would be the advantages and disadvantages of adopting the Hoover Commission proposal that supervision of the operations of the FDIC be vested in the Secretary of the Treasury?

There would be no advantages in adopting this Hoover Commission proposal. A review of causative conditions existing at the time of creation of the Federal Deposit Insurance Corporation is necessary to examine in proper perspective the disadvantages of the proposal.

At the time of the establishment of this Corporation in 1933, the banking system was prostrate, confidence of depositors had vanished, and the effectiveness of supervisory authorities to remedy the situation was at an all time low.

The condition of the banking system at that time and the part played by the Corporation in restoring soundness and confidence was most eloquently stated by the Honorable Arthur H. Vandenberg on the floor of the Senate on July 25, 1947:

* * * I ask Senators to remember back 15 years, to the days of the bank holidays. I ask them to remember the utter paralysis in America as the result of the bank holidays. I ask them to remember that those bank holidays did not flow so much from insolvent banks as from the general lack of confidence in American banks. The banks themselves, when they finally went through the wringer, in 9 cases out of 10 proved that they had been solvent. It was not their lack of solvency which ruined the country for a decade; it was the lack of public confidence in them, regardless of the nature and character of their assets.

It was under those circumstances that Congress created the Federal Deposit Insurance Corporation, and from the moment it was created and from the moment it opened its doors there has never been a succeeding moment in the life of the Nation when there has been the slightest lack of public confidence in our banking system. As a result we went all through those perilous holidays when everything else was collapsing on all sides. We went all through them without a single bank faiure in the land. If it had not been for the contribution which the

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Federal Deposit Insurance made to the life of the Nation at that time, I dread to think what the outcome might have been.

The law creating the Federal Deposit Insurance Corporation was not hastily considered and passed by the Congress under stress of the emergency existing in 1933. Numerous proposals for Federal deposit insurance had been carefully studied by the Banking and Currency Committees of both the Senate and House for more than a year before adoption of the first deposit insurance law. During this period and in the time between the date of enactment of the first law and the date of enactment of the permanent law in 1935 much debate took place on some of the very same proposals that have been made by the Hoover Commission.

Serious consideration was devoted to the question of whether Federal deposit insurance was to be a government guarantee of deposits or a mutual trust established and sponsored by the Government and maintained by the banks. The present system, a mutual trust arrangement, was adopted in preference to a direct governmental guarantee. Thus, control of the Corporation by any of the executive departments, including the Treasury, was automatically excluded as being inconsistent with the mutual character of the Federal deposit insurance system and a bipartisan board of directors was given authority for the management of the Corporation as a means of assuring independent and impartial administration.

Extended argument was had on the question whether the Federal Reserve Board should have any direct or indirect control over the Corporation. Fear was freely expressed, especially by the small banks, that if the Federal Reserve System should control the Federal Deposit Insurance Corporation, deposit insurance would be used as a means of forcing State banks into the Federal Reserve System, which during its 20 years of existence prior to that time had been notably unsuccessful in inducing State banks to become members. To allay these fears the Corporation was established as an independent agency thus assuring national banks, State member and State nonmember banks of nondiscriminatory treatment and a proposal for Federal Reserve representation on the Board of Directors of the Corporation was rejected.

The Federal Deposit Insurance Corporation thus was intended as became the unifying link between the State banking and National banking systems. Consistent with this concept of Federal deposit insurance as conceived by the Congress, the Corporation's policy has always been one of strong advocacy and support of the dual system.

There are, therefore, fundamental reasons why the Federal Deposit Insurance Corporation should remain an independent agency, free from the control or interference of any other agency or department. Its independence and the dual banking system are interdependent and are inextricably bound together. To the extent that the independence of the Corporation is impaired the dual banking system is endangered. The independence of the Corporation is fundamental to the continuance of Federal deposit insurance as now consituted. Its independence cannot be destroyed or whittled away without changing the basic character of the Federal deposit insurance system and impairing the dual banking system. Federal deposit insurance cannot function successfully as a mutual insurance fund while subjected or subordinated

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to the fiscal policies of the Treasury Department or the policies of any other agency or department of the Federal Government.

12. What would be the advantages and disadvantages of providing that the Board of Directors of the FDIC should be composed of the Comptroller of the Currency, the Chairman of the Federal Reserve Board, and an appointed chairman? Would you recommend that this be done?

There would be no advantage in replacing one of the present appointive members of the Board of the Federal Deposit Insurance Corporation with the Chairman of the Board of Governors of the Federal Reserve System.

There would be a number of disadvantages, viz:

A Board of Directors composed of two ex officio members and an appointive member would result in a situation in which it would be possible for the heads of the two other Federal banking agencies to dominate and control the policies and operations of the Corporation. This would be contrary to one of the fundamentals of Federal Deposit Insurance as it is now constituted, viz, that it be administered by a bipartisan board as an independent agency. At the time of creation of the Corporation, the Congress considered and rejected proposals for representation of the Federal Reserve on the Board of the Federal Deposit Insurance Corporation as being totally unacceptable. The functions and the purposes of the Federal Reserve System are different from those of the Federal Deposit Insurance Corporation, and although cooperation between both is desirable, the subordination of one to the other would be destructive of the effectiveness of the agency dominated by the other. We recommend against such a proposal.

13. To what extent and by what means have the policies of the FDIC been coordinated with those of the Federal Reserve and the Comptroller of the Currency where the functions of these agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination?

Those functions of the Federal Deposit Insurance Corporation, the Federal Reserve System, and the Comptroller of the Currency, which are related to each other pertain principally to the examination of banks, the collection of reports from banks, and the publication of banking statistics. Coordination of policies and work in these fields has been achieved through consultation among the heads, officials, and staff members of the three agencies.

The degree of coordination which has been achieved through consultation includes a uniform method of appraising the value and quality of bank assets and adequacy of bank capital by bank examiners; close staff liaison in respect to uniform corrective measures; closely similar forms for the reports of examinations; uniform report forms for information collected from banks with respect to their assets and liabilities, and their earnings, expenses, and dividends; and preparation of a single set of tabulations covering all operating commercial and mutual savings banks.

Coordination has also been achieved in the field of regulation. The Corporation and the Board of Governors of the Federal Reserve System have promulgated uniform regulations governing the payment of interest on deposits. In addition, the Corporation has cooperated

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with the Federal Reserve in policing the latter's regulations T and U and former regulation W in the insured nonmember State banks.

As to the changes, if any, which should be made to increase the extent of coordination, we have no recommendation to make at this time.

> 14. What would be the advantages and disadvantages of establishing a national monetary and credit council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

The principal advantage which we see in the establishment of a national monetary and credit council as proposed by the Hoover Commission would be to provide a regular opportunity for the expression of views of all interested agencies on various types of problems in the field of monetary and lending policy. However, we understand that this result is largely accomplished now through the coordinating efforts of the Treasury Department. Hence, the establishment of the council probably would not have a vital impact on any fundamental problem. Although we are not opposed to the establishment of the council, we do not believe any great purpose will be served by its creation. If the council is established, in our opinion it should be composed of representatives of all monetary, banking, financial, and credit agencies of the Government.

> 15. What change, if any, should be made in the standards that banks must meet to qualify for membership in the Federal Reserve System? What would be the advantages of such changes?

We do not propose any changes in the standards that banks must meet to qualify for membership in the Federal Reserve System.

> 16. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished? Please give the reasons for your answer.

We would prefer not to state our views on this question, leaving the answer to those agencies having a more direct interest in the problem.

> 17. What changes, if any, in the existing powers of the FDIC would facilitate its operations and contribute to the purposes of the Employment Act?

We have no changes to propose in the existing powers of the Federal Deposit Insurance Corporation at this time.

Appendix to Chapter V

August 1949.

QUESTIONNAIRE ADDRESSED TO THE FEDERAL DEPOSIT INSURANCE CORPORATION

1. How broad do you consider the purposes of deposit insurance to be? Merely to protect small depositors? To prevent losses of reserves by the banking system, or by large portions of the system,

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through preventing fear-inspired withdrawals of currency and shifts of deposit balances within the system? To maintain the availability of credit at banks by creating confidence among bankers that they will not be subjected to runs by their depositors? Other purposes?

2. In the cases of banks that have fallen into such serious financial difficulties that the FDIC had to take them over, have you found that there are often large withdrawals of deposits during the period before actual failure? If so, have these withdrawals included deposit accounts in excess of $5,000? Please supply relevant statistics if these are available.

3. Does the information at your disposal indicate that bank runs have often been initiated or reinforced at an early stage by withdrawals of large deposit accounts?

4. What changes, if any, in the coverage of deposit insurance are desirable to further the purposes of the Employment Act? What would be the advantages and disadvantages of providing full insurance coverage of all deposits in insured banks? On balance, would you favor such a policy? Please give reasons for your answer.

5. What changes, if any, should be made in the basis and rates of deposit insurance premiums?

6. What changes, if any, should be made in the commitments of the Government to provide financial assistance at any time that the resources of the FDIC might prove to be inadequate?

7. How do the percentage losses to the Corporation in those cases in which the FDIC itself acts as receiver for insured banks compare with its percentage losses in those cases where others act as receivers for insured banks?

8. What would be the advantages and disadvantages of requiring all commercial banks to become members of the FDIC? Would you recommend that this be done?

9. In your review of the examinations made by the Federal Reserve and the Comptroller of the Currency, what have you found to be the principal differences, if any, between the bank examination policies of the FDIC and those of the Federal Reserve and the Comptroller of the Currency?

10. What changes, if any, should be made in the division among the Federal agencies of the authority to supervise and examine banks? What would be the advantages of such changes?

11. What would be the advantages and disadvantages of adopting the Hoover Commission proposal that supervision of the operations of the FDIC be vested in the Secretary of the Treasury?

12. What would be the advantages and disadvantages of providing that the Board of Directors of the FDIC should be composed of the Comptroller of the Currency, the Chairman of the Federal Reserve Board, and an appointed chairman? Would you recommend that this be done?

13. To what extent and by what means have the policies of the FDIC been coordinated with those of the Federal Reserve and the Comptroller of the Currency where the functions of these agencies are closely related? What changes, if any, would you recommend to increase the extent of coordination?

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14. What would be the advantages and disadvantages of establishing a national monetary and credit council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

15. What changes, if any, should be made in the standards that banks must meet to qualify for membership in the Federal Reserve System? What would be the advantages of such changes?

16. What would be the principal advantages and disadvantages of reestablishing a gold-coin standard in this country? Do you believe that such a standard should be reestablished? Please give the reasons for your answer.

17. What changes, if any, in the existing powers of the FDIC would facilitate its operations and contribute to the purposes of the Employment Act?

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CHAPTER VI

REPLY BY HARLEY HISE, CHAIRMAN, BOARD OF DIRECTORS, RECONSTRUCTION FINANCE CORPORATION

1. What do you consider to be the major purposes and objectives of RFC loans and guaranties of loans to private borrowers?

In authorizing RFC to make loans to private borrowers directly or in participation with banks or other lending institutions, the Congress stated the purposes and objectives to be: To aid in financing agriculture, commerce and industry; to encourage small business; to help in maintaining the economic stability of the country; and to assist in promoting maximum employment and production. The major purposes of RFC loans are to help finance new or established business enterprises engaged in the production, distribution, and sale of goods or the furnishing of services in which has developed a need for working capital, and for funds to finance new construction and expansion of existing plant facilities, the credit for which it not otherwise available on reasonable terms.

2. Do you believe that the RFC should operate continuously as a lender and guarantor of loans to private borrowers, or that it should operate in this field only in emergency periods? If you favor continuous operation, what are your principal reasons for this?

In our opinion RFC should continuously be in a position to lend to private borrowers, but its activities should be curtailed or expanded as required by changes in general economic conditions. This presupposes, of course, that such continuance would be subject to existing or similar statutory limitations which now restrict the Corporation's lending activity to loans that cannot be obtained from private sources on reasonable terms yet which offer reasonable assurance of repayment.

It has been the Corporation's experience that even though employment and production may be at a high level, availability of private credit is not present in many cases, particularly in the field of small business. Not having access to equity capital sufficient for its needs, small business is forced to look to credit sources for much of its financing. Long-term credit is the primary need, but, according to our experience, is not generally available from private sources, notwithstanding that prospects of the companies indicate reasonable assurance of repayment. For worthy small concerns not to have any source of such credit would be handicapping seriously an important segment of the country's industry.

Demand also exists and to an increasing degree from large enterprises for long-term credit to be used for working capital, for refinancing of distressed indebtedness, and for plant modernization and

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expansion. Of primary importance in numerous such cases are the long establishment of the business, the character of the products or the service rendered, the employment feature and the fact that because of regulations and other reasons lending banks can continue adequate lines of credit with many of their borrowers only with the type of assistance to be had from RFC.

The RFC's lending power constitutes a reservoir of credit which can be tapped at any time by any adversely affected segment of the economy or area of the country whenever and wherever needed. This is a necessary safeguard in emergency periods, the beginning of which cannot be easily identified. Emergency periods and depressions do not occur at the same time in all industries. Different industries and different areas do not have their recessions at the same time. Continuous need for RFC financing also exists because of the incapacity or unwillingness of private sources to supply credit to various segments of the national economy when the need arises in other than periods of emergency. RFC should remain in position to carry out congressional policies in time of cyclical business decline whose severity might be alleviated by timely RFC aid. It has operated during depressions, defense arming, war, reconversion, and recovery. Congress has used the RFC as a vehicle for carrying out its policies during each of these periods.

3. (*a*) What, if any, are the gaps or inadequacies in the private financial system that justify Federal loans and guaranties of loans to private borrowers?

(*b*) What feasible changes, if any, in the structure, powers, and policies of private financing institutions and in Government laws and regulations applying to these institutions would lessen the need for Federal loans and guaranties of loans to private borrowers?

(*a*) The gaps or inadequacies in the private financial system that justify Federal loans and guarantees of loans to private borrowers are due to the following:

(i) The risk involved in making certain types of loans. Since measurement of this risk is not reducible to a formula or yardstick basis the human factor of judgment and changing economic conditions automatically will continue to develop the so-called gaps, and for these there can be no constructive remedy in legislation or regulation. Each case has to be judged on its merits. These gaps or inadequacies occur whenever the private financial system is unable or unwilling to supply long-term financial aid to worthy applicants, especially small-business enterprises.

(ii) Private lenders do not have unlimited funds. While the availability of loans from private sources would obviously be restricted in periods of financial or economic distress, there are many instances in which financial assistance is not available to potential borrowers through private channels in so-called normal times. The fact that the vast majority of funds available for lending purposes by commercial banks are represented by deposits subject to immediate withdrawal or withdrawal on short notice has a tendency to deter the making of a substantial number of long-term loans.

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(iii) Private lenders will not make loans that they believe are slow or cumbersome or unduly expensive to administer. Small banks do not have ability to develop technique for successfully handling borderline loans. Most small-business loans require time and patience to make and administer.

(iv) Private lenders fail to meet the need for certain types of long-term credit. This lack of availability of long-term credit, and particularly for small business is due not only to the fact that the risk is greater, but that the cost of making and servicing a small loan is proportionately greater than a large loan. The smaller businesses face serious difficulty of obtaining long-term financing. Accordingly, it is essential that smaller businesses have some assured source of long-term credit. As a matter of fact we have found that there is insufficient long-term private credit available to some large businesses. While there may be ample potential credit for all business, it does not always reach the economic area when and where it is needed.

Some of the reasons heretofore advanced by banks for declining loans, which were subsequently presented to RFC are: Maturity requested too long; amount of loan too large; type of loan not acceptable by the bank; enterprise located too far from bank; bank furnishing short-term credit to applicant and unwilling to grant long-term credit; collateral considered inadequate; bank unwilling to make capital loan; applicant engaged in new enterprise or recently moved to community. In many cases the soundness of the requested credit was not questioned but for the foregoing or other reasons, loans were declined.

(*b*) While it is not the function of RFC to suggest changes in the desirable ratios of sound capital to deposits or of loans to capital, many and various suggestions for the alleviation of this condition have been made, among them are: The extension of the ability of the insurance companies to buy common stocks; the efforts on the part of SEC to make small registrations for capital easier; the granting of the right of fiduciary funds to invest more liberally; and the relaxation of taxes on new businesses. There have been many more such suggestions made. Many of these changes might endanger our banking structure and in the long run prove to be more expensive than if a credit reservoir is maintained by a Government agency.

4. (*a*) What are the relative advantages and disadvantages of RFC loans and guaranties of loans in achieving the purposes indicated in (1) above?

(*b*) What considerations guide the RFC in determining when it will extend its aid by lending and when it will extend its aid by guaranteeing loans?

(*a*) The advantages of RFC loans and guaranties of loans have been discussed in the answers to questions 2 and 3. Advantages include longer maturities than are available through other channels of credit, regular amortization in relation to earning capacity, no legal limitations as to the amount or type of security, relatively reasonable interest rates, availability to borrowers of services of RFC credit and engineering staff for consultation.

(*b*) RFC policy is that (1) if at all possible a bank should make the entire loan; (2) if the bank cannot make the entire loan, the RFC will

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take a participation; (3) if the bank cannot make the loan on a participation basis, the RFC will consider making a direct loan.

The RFC has consistently expressed the desire for local bank participation wherever possible and preferably on a basis enabling the bank to make and administer the loan, thus assuring continued loan relationship between the borrower and his banker.

5. (*a*) With respect to the provisions that the RFC shall not lend or guarantee loans unless the applicant is unable to secure credit from normal sources on reasonable terms, what are the RFC interpretations of "normal sources" and "reasonable terms"?

(*b*) What steps are taken by the RFC to ascertain whether an applicant is able to secure credit from normal sources on reasonable terms?

(*a*) "Normal sources" are considered those to which a particular applicant might be expected to go and from which in the ordinary conduct of his business he might be expected to receive loans. These would normally include banks and private lending agencies in or adjacent to his business area. Other sources are reputable factoring concerns supplying specialized services in the handling of receivables and inventory, finance and insurance companies, and dealers in investment securities. In connection with financing of public agencies both dealers and investment firms handling municipal bonds are considered normal sources of credit.

"Reasonable terms" is construed to mean that the conditions under which credit may be available from private sources are clearly not unreasonable as to maturity, interest rate, and other applicable provisions.

(*b*) As a general rule, an applicant is expected to show that his efforts to secure credit from local banks have been unsuccessful. Satisfactory evidence of such efforts must be presented to RFC. In those instances where a factoring service would normally be utilized or where new construction is to be undertaken of a type in which an insurance company might be interested, the possibiltiy of obtaining the desired credit from these sources must be fully explored and evidence submitted as to the outcome. As to public agency applicants they also are required to submit copies of correspondence from investment firms or other banking institutions that financial assistance is not available on reasonable terms. Frequently the RFC is able to work out a sound basis for a loan which banks have initially declined but which they are then willing to make.

6. What principles guide the RFC in determining interest rates on its loans and charges for its guaranty of loans?

(*a*) Are these rates and charges uniform for all borrowers and all types of loans? If not, what is the basis for their differentiation?

(*b*) What would be the advantages and disadvantages of providing that the interest charges by the RFC should be the same as those generally prevailing on that type of loan in the area where the borrower is located?

The interest rate charged upon loans to business enterprises is fixed at such amount as is determined to be reasonable and calculated to

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permit RFC's lending operations to be maintained on an over-all sustaining basis.

(*a*) Interest rates and charges by RFC are uniform as applied to loans and investments according to type. That is, there is a uniform rate of interest in connection with loans to business enterprises; the same applies to public agency loans and catastrophe loans.

(*b*) Interest rates vary so greatly within communities and sections of the country that it would be impractical and almost impossible to function on a basis other than one rate for one kind of loan. Thus any claim of discrimination is avoided. There would be no advantage in differing rates and competition is prevented by RFC's refusal to make a loan if the money is obtainable privately at a reasonable rate.

7. Should the power to lend and guarantee loans to private borrowers be possessed by both the RFC and the Federal Reserve? If so, why? If not, why not?

One source of Federal assistance in a particular loan field appears sufficient in the interest of consistent policies and procedure.

8. To what extent and by what means have the policies of the RFC been coordinated with the general monetary and credit policies of the Federal Reserve and the Treasury? Describe the degree and methods of coordination since the end of the war.

The RFC has always worked in close cooperation with the Federal Reserve and Treasury to the extent that loans of a type which were not conducive to sound national economy have not been encouraged. The RFC has endeavored to keep abreast of general monetary and credit policies of both the Federal Reserve Board and the Treasury Department by having representatives present at conferences and otherwise through official channels. In those instances where policies established have application to the lending functions of the Corporation, appropriate action has been taken by the RFC Board.

9. (*a*) What do you consider to be the major purposes and objectives of the Federal National Mortgage Association?

(*b*) Outline briefly the activities and policies of this Association since the end of the war.

(*a*) The major purposes and objectives of the Federal National Mortgage Association are generally to assist the housing program by encouraging the construction of housing accommodations and investments in mortgages on homes and rental housing projects insured by FHA, and homes guaranteed to by the Veterans' Administration. As a means of accomplishing this objective, the Association established and maintains a secondary market for the purchase of such mortgages at par and accrued interest. This secondary market is used only where private financing is unavailable.

(*b*) Since the war, the Association has provided a secondary market for FHA and VA mortgages.

Under this program, RFC and FNMA presently hold 54,640 FHA insured mortgages aggregating $389,957,000, and 41,473 VA guaranteed mortgages in the total amount of $247,474,000, which have been acquired by purchase pursuant to the provisions of the secondary market program, and these mortgages have been offered for sale to eligible purchasers within the past month at prices ranging from

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$100\frac{1}{2}$ to $102\frac{1}{4}$. Furthermore, the Association also has outstanding contracts to acquire additional mortgages as follows:

18,248 FHA mortgages	$345,935,000
52,172 VA mortgages	375,924,000

10. Do you favor the Hoover Commission recommendations:

(*a*) The operations of the RFC should be placed under the supervision of the Secretary of the Treasury?

(*b*) The Federal National Mortgage Association should be transferred to the Housing and Home Finance Agency?

(*a*) The fact that in the performance of its duties, the RFC makes direct loans to private individuals and institutions and is a moneyed corporation, is in itself insufficient reason to put it in the Treasury Department. The making of loans is but one of several techniques by which the Corporation aids in financing various segments of the economy. The functions of the Treasury Department in collecting revenues, acting as custodian of public funds, managing the public debt, etc., differ substantially from RFC's broad economic purposes.

(*b*) The Federal National Mortgage Association is a financial and not a housing agency. As such, it properly belongs with RFC. As heretofore stated, its primary objective and purpose is to provide a secondary market for FHA insured or VA guaranteed home mortgages. RFC has operated the FNMA activity as an integral part of its operations for many years and can do so as economically and efficiently as it is possible to conduct a business of this nature. The operation of this secondary market for such mortgages does not involve any responsibility on the part of FNMA to determine questions pertaining to the necessity for the housing, the soundness of its financing, or the adequacy or quality of its construction, as these matters are for the consideration of the Federal Housing Administration or the Veterans' Administration. We do not agree with the recommendation that the Federal National Mortgage Association should be transferred to the Housing and Home Finance Agency.

11. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

The advantages of the establishment of a National Monetary and Credit Council of the type proposed by the Hoover Commission would appear to be that such a body could represent an excellent forum for the exchange of information and ideas as well as discussions pertaining to the various lending and kindred functions of the several governmental agencies so involved. Doubtless within such a body there would be developed constructive suggestions which might better coordinate their activities from the viewpoint of purposes, functions, and results attained. If the powers to be exercised by such a council are intended to be more than advisory in nature, then the possible advantages mentioned above would probably be nullified by resulting diffusion of authority. As a matter of practical administration some of these elements would exist even in a council that was purely advisory. Each agency at interest should be accorded the privilege of having a representative in attendance at the meetings.

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Appendix to Chapter VI

QUESTIONNAIRE ADDRESSED TO THE RECONSTRUCTION FINANCE CORPORATION

1. What do you consider to be the major purposes and objectives of RFC loans and guaranties of loans to private borrowers?

2. Do you believe that the RFC should operate continuously as a lender and grantor of loans to private borrowers, or that it should operate in this field only in emergency periods? If you favor continuous operation, what are your principal reasons for this?

3. (*a*) What, if any, are the gaps or inadequacies in the private financial system that justify Federal loans and guaranties of loans to private borrowers?

(*b*) What feasible changes, if any, in the structure, powers, and policies of private financing institutions and in Government laws and regulations applying to these institutions would lessen the need for Federal loans and guaranties of loans to private borrowers?

4. (*a*) What are the relative advantages and disadvantages of RFC loans and guaranties of loans in achieving the purposes indicated in (1) above?

(*b*) What considerations guide the RFC in determining when it will extend its aid by lending and when it will extend its aid by guaranteeing loans?

5. (*a*) With respect to the provision that the RFC shall not lend or guarantee loans unless the applicant is unable to secure credit from normal sources on reasonable terms, what are the RFC interpretations of "normal sources" and "reasonable terms"?

(*b*) What steps are taken by the RFC to ascertain whether an applicant is able to secure credit from normal sources on reasonable terms?

6. What principles guide the RFC in determining interest rates on its loans and charges for its guaranty of loans?

(*a*) Are these rates and charges uniform for all borrowers and all types of loans? If not, what is the basis for their differentiation?

(*b*) What would be the advantages and disadvantages of providing that the interest charges by the RFC should be the same as those generally prevailing on that type of loan in the area where the borrower is located?

7. Should the power to lend and guarantee loans to private borrowers be possessed by both the RFC and the Federal Reserve System? If so, why? If not, why not?

8. To what extent and by what means have the policies of the RFC been coordinated with the general monetary and credit policies of the Federal Reserve and the Treasury? Describe the degree and methods of coordination since the end of the war.

9. (*a*) What do you consider to be the major purposes and objectives of the Federal National Mortgage Association?

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(*b*) Outline briefly the activities and policies of this Association since the end of the war.

10. Do you favor the Hoover Commission recommendations that—

(*a*) The operations of the RFC should be placed under the supervision of the Secretary of the Treasury?

(*b*) The Federal National Mortgage Association should be transferred to the Housing and Home Finance Agency?

11. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

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CHAPTER VII

REPLY BY RAYMOND G. FOLEY, ADMINISTRATOR, THE HOUSING AND HOME FINANCE AGENCY

I. Questions Relative to the Federal Savings and Loan Insurance Corporation

1. How broad do you consider the purposes of this insurance to be? Merely to protect the owners of small accounts at insured savings and loan associations? To promote the willingness of people to entrust funds to these associations, thereby enhancing the availability of housing credit? To prevent fear-inspired withdrawals of funds from these associations, thereby preventing curtailment of the supply of housing credit in disturbed periods? To maintain the availability of credit at these associations by creating confidence among their managers that they will not be subjected to runs by those who supply funds?

Answer, question 1

It is our opinion that this insurance program was designed and established to meet very broad objectives and in recognition of the fact that major economic disturbances may be the accumulative result of scattered individual hardships. For this reason insurance is considered to have all of the purposes which are indicated by the specific questions raised above. In terms of economic functions, it is probable that the assurance of a continuous supply of housing credit and the prevention of fear-inspired withdrawals are among the major objectives of the Insurance Corporation. It should also be emphasized that insurance of savings in the savings and loan field will probably operate to prevent panics which might spread to savings banks, commercial banks, and other financial institutions. From this point of view, the insurance program of the Federal Savings and Loan Insurance Corporation and the Federal Deposit Insurance Corporation are complementary.

2. In what respects, if at all, do the present provisions relative to the form of payment, to holders of insured accounts in defaulted institutions prevent the FSLIC from making its maximum contribution to the purposes of the Employment Act? What changes, if any, would you recommend in the methods of payment? What would be the advantages and disadvantages of providing that a holder might, at his option, receive from the FSLIC in cash the full amount of his insured account immediately after default by an association? Would such a provision be likely to increase or decrease the total cost to the FSLIC?

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Answer, question 2

Two forms of insurance settlement up to $5,000 are available to savers with funds in insured savings and loan associations in default. First, the savers may demand the entire amount in savings accounts in normally operating insured institutions. Second, payment may be taken, at the option of the insured account holder, in the form of 10 percent cash, 45 percent in debentures due within 1 year, and 45 percent in debentures due within 3 years. The results in terms of contribution to the purposes of the Employment Act will obviously depend upon which form of payment is chosen by the shareholder.

With respect to the cash-debenture form of settlement, it is obvious that the availability of the total funds is deferred and that the prompt restoration of purchasing power is accordingly limited. Undoubtedly investors themselves have recognized this deficiency since only six, with savings amounting to $13,200, have demanded payment in this manner. The almost universal demand for settlement by means of new accounts suggests, in turn, its favor by the public, which action also is probably motivated by measurement of the purchasing power effects. Indeed, the newly acquired accounts would have the same availability for spending as savings accounts in institutions not affected by default.

After careful study of past experience, it is recommended that the Insurance Corporation be given the option to pay insurance claims in cash. Not only would such a provision permit more economical administration of the payment of insurance, but, in addition, it would obviously serve to stimulate economic activity by reason of the addition to the purchasing power of a community.

The above question also raises the point as to whether or not the right of selection of settlement in cash, if statutory provision were made for cash settlement, should be held by the owner of the insured account. It is believed that more orderly direction of the payment of insurance could be effected if the right were placed in the Insurance Corporation. As indicated previously, such action would, in our opinion, decrease the total cost to the FSLIC. Under the present arrangement, a considerable amount of administrative detail is involved in selecting paying agents and drawing up the necessary forms to close out the shares in the defaulted institution and to issue the shares by the appointed agents.

The question of cash payment in the settlement of insurance claims has been the subject of considerable debate for the past several years. The proposal has been criticized by some as an attempt to simulate liquidity and demand payments in the operations of savings and loan associations. The point is made by certain opponents to this proposal that savings and loan associations are for the most part mutual institutions operating on a share-capital basis and that investments in such shares are not comparable to demand deposits in commercial banking institutions. This being the case, it is argued, the payment of insurance settlements in cash would lead account holders in savings and loan associations into the belief that their share investments are tantamount to demand deposits. This agency has taken the position that the payment of insured accounts in cash, in the event an institution is closed, in no way changes the share investment nature of accounts in savings and loan associations, and that it would be considerably more economical than the present somewhat cumbersome method of

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purchasing shares, with cash, in another institution for the account of investors in a defaulted institution.

> 3. Have you found that there are often large withdrawals of funds before the actual default of an insured institution? If so, have these included accounts in excess of $5,000? Have they tended to be concentrated in the accounts in excess of $5,000?

Answer, question 3

In connection with the associations which the Insurance Corporation has liquidated as receiver, we have found no evidence that there were any large or unusual withdrawals during the 60-day period prior to the appointment of the receiver, either of accounts in excess of $5,000 or accounts of $5,000 and under. However, it should be remembered that in practically all of our receiverships the cause for action has been that of impairment, and runs were not a complicating factor, probably because the public was unaware of the true condition of the associations. Attention is also called to the fact that we have had only a total of seven receiverships to date and our observation is obviously limited in scope accordingly.

> 4. What changes, if any, in the coverage of this insurance are desirable to further the purposes of the Employment Act? What would be the advantages and disadvantages of providing full coverage of all accounts at insured institutions? On balance, would you favor such a policy? Please give reasons for your answer.

Answer, question 4

The purposes of the Employment Act naturally meet their severest test under economic distress. Consequently, the avoidance of such a condition is in the interest of the public welfare and suggests the use of every sound financial means of preventing or eliminating trouble. Probably the most important suggested change in the insurance program which is pointed in this direction is that of giving the Insurance Corporation the right to pay insurance claims in cash, as suggested in the answer to question 2.

With respect to the specific inquiry about full insurance coverage, it must be admitted that such a plan would have the merit of buttressing public confidence to the limit. At the same time, it is believed that complete coverage may be injurious to the long-term purpose of the Employment Act. Among the more important reasons against total insurance are the following:

(*a*) Private management may lose its sense of primary responsibility and contribute to unsound operation.

(b) There is an equalization of management which may destroy the incentive for efficiency.

(*c*) Private funds with full insurance may compete unduly with the direct obligations of Government.

We would favor a policy of continued limitation of amount, but may make the suggestion that the insurance limit could be wisely increased to $10,000. The present insurance coverage of insured savings and loan associations is now about 93 percent of their savings accounts, and the increase to $10,000 would approach full coverage. At the same time, by not covering extremely large investments, institutions will not

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be faced with the unnecessary hazards of importune withdrawal of large amounts.

5. What changes, if any, should be made in the commitments of the Government to provide financial assistance at any time that the resources of the FSLIC might prove to be inadequate? Please give reasons for your answer.

Answer, question 5

Currently the Government itself has no mandatory legal commitment in the way of providing financial assistance in the event the resources of the FSLIC might prove to be inadequate. At the same time it is obvious that the supreme test of the insurance program will depend upon the Corporation's ability to meet its obligations. On various occasions many officials have indicated the moral responsibility of the Government, and it would seem that much could be gained by providing the certainty which is made possible only by legal provision. Not only should this add to public confidence and thereby further the purposes of the Employment Act, but, in addition, it could be a means of saving loss to the Government. It should be remembered that the payment of insurance is not the measure of loss because the latter is determined only by the later liquidation of the assets of institutions in default.

It is recommended that an initial appropriate action to take in this respect would be to authorize the Federal Savings and Loan Insurance Corporation to borrow, in case of need, directly from the United States Treasury. Legislation has heretofore been recommended by the Agency which would have the effect of confining the borrowing of the Insurance Corporation to Treasury loans and which would fix the maximum of such loans which might be outstanding at any one time to $750,000,000. Such an action, if taken now by the Congress, would make adequate provision for any foreseeable contingencies and would certainly authorize an adequate source of borrowing to meet any except the most drastic emergency situation. Attention is called to the fact that a similar arrangement for acknowledged Government support has already been authorized in the case of the Federal Deposit Insurance Corporation.

6. What changes, if any, should be made in the basis and rates of insurance premiums?

Answer, question 6

It is believed that any insurance premium should be fixed at a rate which will make the operation self-sustaining. For this reason, the premium rate should be under constant scrutiny for the purpose of maintaining a just charge. Such an evaluation is by no means easy because, in view of the long-term nature of the real-estate cycle, the risks in mortgage lending are not easily measured.

During the 15 years of operation, the Corporation has incurred net losses of only $5,213,000, or slightly less than 5 percent of the accumulated net income to June 30, 1949. Such favorable experience would at first glance suggest reduction in the rate, but, at the same time, this must be weighed against such qualitative features as the large volume of mortage loans made in the past 2 or 3 years and

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the fact that the reserves of insured institutions have not increased percentagewise in any pronounced manner during this period of time. Because virtually all of the experience of the Insurance Corporation has occurred in a rising real-estate market, it is our opinion that additional experience is needed before any decision is made on a reduction in the premium rate. In short, a reduction in rate at this point could not be based on sound actuarial experience, and it is, therefore, recommended that action be postponed.

II. Questions Relative to the Federal Housing Administration

1. Do you believe that Congress intended the FHA to use its powers in an anticyclical way to inhibit inflationary booms and to combat recession and depression? What legislative provisions would have to be changed to enable the FHA to make a greater contribution to economic stability?

Answer, question 1

In approving the original National Housing Act on June 27, 1934, the intent of the Congress was to combat the depression of the early thirties and to make a lasting contribution to the Nation's economic stability. The provisions of the act by which these objectives were to be achieved included the vehicles of loan insurance and the secondary market. These vehicles provided the Government with leadership and direction in the two key branches of private enterprise; namely, construction and financing. Through their operation the Congress provided effective incentives to the construction and financing industries to mobilize the economic resources of the Nation necessary to build new housing and improve existing housing for moderate- and lower-income families and to make their demands effective through more liberal but sounder financing terms. The insurance vehicle under titles I and II of the act was intended to encourage the release of funds for the improvement and construction of housing and to encourage the demand for these goods. By encouraging investment, employment in the building trades and production in the durable-goods industries would be stimulated and a greater degree of stability in residential construction would be realized. The secondary-market vehicle under title III of the act was intended to give wider marketability to mortgage securities. By promoting the freer flow of mortgage funds into and out of securities based on residential properties, a greater degree of stability in residential construction and mortgage markets would be realized.

The economic conditions prevailing in the early thirties which were emphasized in the hearings before the Senate and House Committees on Banking and Currency clearly indicated the concern of the Congress with combating the depression and making a lasting contribution to greater economic stability in the residential construction and mortgage markets by preventing the recurrence of these conditions on a scale of similar magnitude in the future. Some of these conditions were as follows:

(*a*) Unemployment in the building trades was very great. It was estimated that more than 6,000,000 persons identified with the building and allied trades were receiving public assistance.

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(*b*) Because of the neglect of repair work and the almost complete stoppage of new construction, a rapid and accelerating deterioration was taking place in housing standards.

(*c*) Despite the accumulation of reserves for investment by lending institutions, it was almost impossible to secure advances of credit for the purpose either of modernization and rehabilitation or the construction of new dwellings.

(*d*) Notwithstanding the gigantic effort made by the Home Owners' Loan Corporation to stem the tide of mortgage foreclosures, these foreclosures continued in appalling numbers, and financial institutions almost universally refused to advance funds to meet maturing mortgages, to facilitate the acquisition of homes, or to enable the construction of new homes.

(*e*) The disastrous collapse of real estate and home values, and the consequent loss of equities and accumulation of real estate in the assets of lending institutions were pointed out as the results of unrealistic and antiquated mortgage lending practices which were widely prevalent during the decade of the twenties. Some of the more harmful of these practices were:

(1) Nonuniform and inflated appraisals.

(2) Restriction of first-mortgage loans to a minimum portion of the appraised value of the property, with consequent loans on second or junior liens at exorbitant interest rates and other finance charges.

(3) Failure to adopt or enforce any standards with respect to construction of new homes on the security of which credit was extended.

(4) The widespread use of short-term instruments of credit to secure advances of funds which necessarily represented long-time credits.

(5) The failure of any market machinery or market practices to give to mortgages the marketability essential to the realization of funds when necessary because of local conditions or stringencies that developed in the money market.

(6) The neglect of careful examination of the relationship between the rate of building and the probable market, which led to excessive building in price ranges in which the houses could not be absorbed.

In the subsequent amendments to the National Housing Act, the intent of the Congress was, chronologically, for the Federal Housing Administration (*a*) to promote further recovery, (*b*) to combat the recession beginning in the fall of 1937, (*c*) to meet emergency housing needs during the defense, war, and immediate postwar periods on a basis consistent with the price, priority, and allocation controls in operation during this period, and (*d*) in the recent postwar years when controls were terminated to increase the supply of housing for veterans and at the same time inhibit the inflationary developments in construction and land costs.

In the original act, the provision for the insurance of home improvement loans under title I expired on January 1, 1936. The success of the insurance program under this title prompted the Congress to extend this title periodically in order to promote further employment

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recovery in the building trades and in the manufacture of building materials and supplies.

The first major amendments to the National Housing Act, approved February 3, 1938, indicate that the Congress intended the Federal Housing Administration to combat the recession which developed suddenly in the fall of 1937. As early as November 30, 1937, the Committee on Banking and Currency of the House of Representatives began hearings on amendments to the National Housing Act. The Senate's committee also began hearings the following day. The objectives of the amendments were to stimulate the purchase of durable goods and to stimulate the employment of labor in the construction industry and in the building materials industry. Both objectives were brought out forcefully in these hearings. To achieve these objectives the amendments, as approved, provided for the renewal of the title I home improvement program and mortgage insurance for the construction of rental housing for moderate and lower income families and of small homes in the lower price ranges on more liberal financing terms.

In the defense, war, and immediate postwar periods, the amendments to the National Housing Act were designed to meet the emergency housing needs of the Nation. The inflationary impact on the Nation in filling these needs was to be met by price, priority, and allocation controls. The first of these amendments, known as title VI, defense housing insurance, was approved March 28, 1941, and the intent of the Congress here was to use the mortgage-insurance vehicle to stimulate the financing and construction of small homes for defense workers in established communities. Although the financing terms for mortgage insurance were more liberal than for the regular small home mortgage-insurance program under title II, it is noteworthy that the Congress provided for the same basis of valuation. In this respect, the intent of the Congress may be interpreted as recognizing the need for dampening the incipient inflationary forces in residential construction and land costs.

On May 26, 1942, title VI was amended to provide (*a*) for higher insurable principal amounts and longer terms for small home mortgages and (*b*) for rental housing mortgage insurance on more liberal terms than for the regular rental housing mortgage insurance program under title II. With respect to the latter, the Congress provided for a more liberal valuation basis in "reasonable replacement cost" than for the regular rental housing insurance program under title II which provides for the Administrator's estimate of value. The intent of the Congress in introducing this difference in valuation and in liberalizing the financing terms for small homes may be interpreted as giving greater recognition to the urgency in meeting the housing shortage in war production centers.

During this defense and war period, the title I home improvement program was also extended in order to provide financing for additional housing accommodations in existing structures and such extensions on the part of the Congress may also be interpreted as giving greater recognition to meeting the housing shortage.

The first postwar amendments to the National Housing Act, known as the Veteran's Emergency Housing Act of 1946, were approved May 26, 1946. The act amended title VI and further liberalized the

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financing terms of both small home and rental housing mortgage insurance and adopted "necessary current cost" as the valuation basis. These amendments were designed—

to assist in relieving the acute shortage of housing which now exists and to increase the supply of housing accommodations available to veterans of World War II at prices within their reasonable ability to pay.

Although the Congress liberalized the financing terms to achieve the objective of relieving the housing shortage, the intent of the Congress in inhibiting inflationary forces is indicated in the preamble to the act which reads as follows:

To expedite the availability of housing for veterans of World War II by expediting the production and allocation of materials for housing purposes and by curbing excessive pricing of new housing, and for other purposes.

The second major postwar amendment to title VI provided for the insurance of loans to manufacturers of prefabricated houses. This amendment was approved June 30, 1947, and its objective also was—

to assist in relieving the acute shortage of housing which now exists and to promote the production of housing for veterans of World War II at moderate prices or rentals within their reasonable ability to pay, through the application of modern industrial processes * * *.

This amendment was followed by three amendments, approved August 5, 1947, December 27, 1947, and March 31, 1948, all of which increased the authorization for insurance under title VI.

In the last of these three amendments, approved March 31, 1948, and in subsequent amendments, the intent of the Congress may be interpreted as being clearly in the direction of inhibiting inflationary developments. This amendment provided for a single month's extension to the small home mortgage insurance program under title VI to April 30, 1948, and authority for new insurance under this provision of the National Housing Act has not been renewed. In place of "necessary current cost" as the valuation basis, this amendment provided for "value (as of the date the mortgage is accepted for insurance) * * *". The objective of this change was to dampen the inflationary pressures on construction and land costs by reducing the appraisal base. In providing for only 1 month's extension for this emergency small home mortgage insurance program, the intent of the Congress was clear that henceforth small home mortgage insurance should be subject to the less liberal appraisal and financing terms of the regular insurance program under title II. In effect, the Congress by this amendment of March 31, 1948, intended to provide a transition from the veterans' emergency insurance program of more liberal appraisal and financing terms for meeting the veterans' housing shortage back to the stabilizing influence of the long-term insurance program.

In the Housing Act of 1948 approved August 10, 1948, the intent of the Congress may be interpreted as giving fuller recognition to the need for a transition from the emergency mortgage insurance programs to the regular insurance programs. Under title I, FHA title VI and transitional period amendments of this act, one of these amendments to the emergency rental housing provision under title VI is in line with the small home mortgage insurance amendment of March 31, 1948. It provided for an appraisal basis which would have the effect of stabilizing costs of rental housing by limiting the maximum mort-

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gage amount eligible for insurance to a percentage of replacement cost or cost prevailing on December 31, 1947, whichever is lower. This appraisal basis was substituted for necessary current cost. This same amendment also provided for a short-term extension of this veterans' emergency rental housing program under title VI and the several short-term extensions since then indicate the intent of the Congress to provide for a transition to the stabilizing influence of the regular long-term rental housing insurance program under title II.

Two other amendments, approved August 10, 1948, dealing with insured financing of small home construction, also reflect the intent of the Congress to encourage low-cost housing. One of these two amendments provides for more liberal financing terms to operative builders and home purchasers of new single-family home mortgages of $6,000 or less. The other amendment is designed to assist and encourage the application of cost-reduction techniques through large-scale modernized site construction methods and the erection of houses by modern industrial processes by providing insurance of construction advances on houses with mortgage amounts of $6,000 or less.

With respect to the question on the legislative provisions which would have to be changed to enable the Federal Housing Administration to make a greater contribution to economic stability, I should like to list the following legislative proposals:

(*a*) The extension at least to June 1, 1952, of the insurance program for the modernization and repair of existing homes under title I. This title expires March 1, 1950.

(*b*) The extension of the insurance program under title I to insure small home mortgages for families of low and moderate income particularly in suburban and outlying areas where it is not practicable to obtain conformity for properties so located with many of the requirements essential to insurance of mortgages on housing in built-up urban areas. The maximum amount of insurance outstanding should not exceed $500,000,000. The maximum amount of mortgage should not exceed $4,750, or 95 percent, of the appraised value for single-family, owner-occupied homes, and $4,250, and 85 percent, of appraised value for operative builders. The maximum term should be 30 years and the maximum interest rate should be 5 percent with a maximum insurance premium of 1 percent. The present program expires March 1, 1950, and provides for a maximum mortgage of $4,500.

(*c*) Liberalization of the maximum loan terms for new home mortgage insurance under title II on lower priced homes by increasing the maximum loan from $6,000 to $6,650, and an additional $950 for each bedroom in excess of two, up to a maximum of four bedrooms.

(*d*) Liberalization of the maximum loan terms for mortgage insurance under title II on cooperative rental housing projects sponsored particularly by veterans.

(*e*) Liberalization of maximum mortgage amount for insurance of construction advances to operative builders using site-fabrication methods. The maximum mortgage loan per dwelling should be raised from $6,000 to $7,650 and the maximum loan percentage from 80 percent to 85 percent.

These legislative proposals are in principle incorporated in S. 2246 which was reported out by the Senate Banking and Currency Committee and in H. R. 6070 which was passed by the House of Representatives.

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In my opinion these changes in the National Housing Act will contribute to economic stability by providing the incentives to fill the housing and home repair needs of the moderate and lower income families and to make their demands effective through liberal financing terms.

2. In practice, how has the FHA used its powers for countercyclical purposes? Its limitations on interest rates? Its charges for insurance of mortgages? Its limitations on the maturity of mortgages? Its appraisal policies? Limitations on the total amount of mortgages insured? Its other powers?

Answer, question 2

Interest rates.—In practice, the Federal Housing Administration has used its authority under the National Housing Act to limit interest rates in order to promote economic recovery, to increase the supply of housing, and to make a lasting contribution to economic stability. Its interest rate policy has been governed by two principal considerations, namely, the availability of funds among institutional lenders for mortgage investments and the effective demand of home purchasers and renters among families with moderate and lower incomes. This policy has in general resulted in interest rates below the statutory limits provided by the National Housing Act and its amendments for the separate insurance programs. One of the most significant economic developments during the last two decades has been the accumulation of institutional funds seeking high-yield and high-grade investments. The insurance vehicle eliminated the major risk element in residential mortgage investments which is the loss in the disposal of the foreclosed mortgage security. This vehicle overcame in large measure the widespread reluctance of financial institutions to advance funds for mortgage investments which prevailed in the early thirties. Moreover, it encouraged institutional lenders to use their accumulated reserves for mortgage investments. However, the mortgage interest rate structure which prevailed in the thirties was regional in character and at levels which made home purchase or rent by families of moderate and lower incomes prohibitive. The Financial Survey of Urban Housing, a Civil Works Administration project, prepared under the supervision of the United States Department of Commerce, disclosed, as of January 1, 1934, a regional structure of urban interest rates on first mortgages which ranged from under 6 percent in middle Atlantic cities to almost 10 percent in mountain cities. For second and third mortgages, interest rates were over 10 percent in west south central cities.

By eliminating the major risk element, and by making the insured mortgage a negotiable instrument with wider marketability, the accumulated reserves of institutional lenders could be used on a Nationwide basis to meet the demands of mortgage investment. To make this demand effective, the interest rates had to be set at levels which home purchasers and renters of limited means could afford. In so doing, the Federal Housing Administration has contributed to the Nation's economic stability.

Insurance charges.—In practice the Federal Housing Administration has not used its powers in limiting the regular insurance premiums for countercyclical purposes. The changes in insurance premiums

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followed changes in the statutory limits and it has been the policy of the Administration to charge only the premium necessary to cover the expenses of administering the separate insurance programs and to provide adequate reserves for insurance losses. However, in response to a letter from the President to the Administrator of the National Housing Agency to cooperate in controlling inflationary developments produced by the war demands upon the Nation's economy, on May 26, 1942, the Federal Housing Administration amended its regulations to eliminate the prepayment premium where insured mortgages on small homes were prepaid in full without refinancing. The objective of this provision in the regulation was to encourage home owners with mortgages insured by the Federal Housing Administration to pay off these mortgages from their growing incomes and savings and thereby reduce inflationary pressures on the prices of consumer goods. Through June 30, 1949, approximately 413,000 home owners with mortgages insured by the Federal Housing Administration made such prepayments of their mortgages without any prepayment charges.

In cooperation with the Federal Reserve Board's efforts to stem the incipient inflationary tide during the postwar years, a cash down payment of at least 10 percent of the cost of each job was written into the regulations governing the home improvement loan insurance program, effective May 10, 1948. Lenders were also encouraged to scrutinize credits very closely to prevent overpricing on jobs, and overburdening of potential borrowers. The amendment to the regulations, requiring a copy of the dealer's contract or description of the proposed job has served to reduce misunderstandings, and to clarify for all parties concerned the contractual responsibilities of the dealers. As the incipient inflationary forces abated and a reversal of trend became observable, the cash down-payment requirement was repealed, effective April 28, 1949.

Maturity of mortgages; mortgage principal amounts; loan-value ratios.—In practice the Federal Housing Administration has not used its powers in limiting these terms of financing for countercyclical purposes for the reason that the governing considerations in these terms of financing are the appraisal policies. The appraisal policies directly affect these terms of financing and they are discussed in the following paragraph. Consequently, the administrative rules and regulations for these terms of financing are identical with the statutory limits provided in the National Housing Act and its amendments.

Appraisal policies.—In practice the Federal Housing Administration has used its appraisal powers within the limits of its statutory authority for countercyclical purposes. For the regular small home and rental housing mortgage insurance programs under title II a determination of appraised value is a prerequisite for establishing the maximum insurable mortgage amounts. The Federal Housing Administration has determined appraised value to represent long-term use. In making this determination, the Federal Housing Administration takes into consideration three basic factors: (1) Replacement cost, (2) available market price, and (3) capitalized amenity or rental income depending on whether the property is intended for owner-occupancy or rental purposes.

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Conditions existing during the years 1934 through 1936 sometimes resulted in values for long-term use in excess of the immediately available market price. These conditions were brought about by the fact that there was an oversupply of residential properties in some areas and such properties were purchased at bargain prices, i. e., a price less than value. The Federal Housing Administration's appraisal policies in effect tended to set a floor for residential property values at that time, thereby contributing to the stability of property values.

Later, beginning generally in the fall of 1940, a diametrically opposite situation was widely encountered, i. e., there was a growing scarcity of properties available to the market, and from that period until recently, in many areas, the market was paying a so-called premium for ownership occupancy. Following its established and widely recognized concept of valuation for long-term use, the Federal Housing Administration refused to recognize during those periods of shortage the so-called premium amounts as value. On appraising new construction the Federal Housing Administration refused to recognize those elements of construction cost which were caused by temporary shortages and materials and labor, such as delays in construction, payments of unusual bonuses, absence of trade discounts, and the lower efficiency of labor. This portion of costs was interpreted as transitory and was disallowed in the valuation of residential properties.

This appraisal policy was also followed in the emergency mortgage insurance programs under title VI during the defense and war periods and during the postwar period until May 26, 1946, when the amendment to title VI substituted "necessary current cost" for appraised value. This basis of valuation remained in effect until March 31, 1948, for the emergency small-home insurance program and until August 10, 1948, for the emergency rental housing mortgage-insurance program. For the former program a 1 month's extension with "necessary current cost" replaced by value was provided for in an amendment. For the latter program a longer extension with "necessary current cost" eliminated in favor of replacement cost or cost prevailing on December 31, 1947, whichever is less, was provided for in an amendment. In administering the emergency housing programs under the statutory provisions of necessary current cost, value, and replacement cost during the postwar period, administrative policy to inhibit inflationary developments was formulated in a series of instructions to field offices and these are as follows:

On June 3, 1946, field offices were instructed that commitments for insurance under the small-home emergency insurance program could be canceled at any time after 30 days from the date of commitment if construction had not started. This was to enable the Federal Housing Administration to reduce the amount of commitments outstanding when transitory construction costs started to drop. On June 6, 1947, field offices were further instructed to invoke a 30-day cancellation clause where construction had not started within the 30-day period in those areas where declining costs and reduced locality adjustments would effect a decrease of 4 percent or more in the commitment amounts.

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On May 23, 1947, field offices were instructed to reduce the amount of commitment for emergency rental housing projects for which requests for extension or reissuance have been received when a decline in the current cost would effect a 4-percent reduction in the amount of commitments on mortgages of $200,000 or less or a reduction of $8,000 or more in the amount of commitments on mortgages of more than $200,000.

On September 17, 1947, field offices were instructed that in processing applications for refinancing small-home mortgages insured under title VI, the new insured mortgage may not exceed the outstanding balance of the old mortgage plus the cost of financing and alterations, and repairs approved by the Commissioner, except in the case of purchases by World War II veterans. These instructions were designed to control inflationary developments in the transfer of small-home properties secured by mortgages insured under the emergency program.

On March 25, 1949, field offices were instructed (1) to determine the extent of the effective demand for housing with reference to rent-paying capacity of families in the rental market and the paying and carrying capacity of families in the home purchase market; and (2) to reject applications for insurance on rental properties with rents above the market, and on homes with prices in excess of the capacity of purchasers. These instructions were followed by two others. The first of these, dated April 4, 1949, ordered market surveys of potential rental housing demand and the determination of maximum rentals in the potential market. The second, dated August 31, 1949, ordered these maximum rentals to be the ceilings for future applications for rental housing mortgage insurance and applications involving higher rentals were to be rejected.

Total amount of mortgages insured.—In practice the Federal Housing Administration has used its powers to increase the aggregate amount of mortgages insured in order to promote recovery and to contribute to the stability of the construction and financing industries. The original National Housing Act provided for a maximum face amount of insurance under title II of $2,000,000,000. In the subsequent amendments to this title, the maximum amount of insurance was based upon the outstanding balances of the mortgages insured and provision was made for an increase in authorization with the approval of the President up to a statutory limit.

Authorization of insurance under title VI is based on the face amount of mortgages insured. The original authorization under title VI provided for a maximum amount of $100,000,000 in mortgage insurance. To meet the emergency housing needs of this insurance program, the Congress authorized eight increases between March 28, 1941, and May 26, 1946, at which time the aggregate amount of all mortgages insured was limited to $2,800,000,000 and an additional billion dollars with the approval of the President. Since that date, the Congress has increased the authorization four times until, at the present time, the authorization stands at $6,150,000,000. All but one of these last four increases provided for increases in authorization with the approval of the President. In all cases where such increases in insurance authorization with the approval of the President were

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provided for in the amendments, the Federal Housing Administration has requested the approval of the President.

3. What legislation would you recommend for the purpose of increasing FHA's contribution to general economic stability?

Answer, question 3

The legislation I would recommend for the purpose of increasing the Federal Housing Administration's contribution to general economic stability is as follows:

(*a*) To place title I, the home improvement loan insurance program, on a permanent basis. Although conceived originally as a temporary recovery measure, its periodic extensions and renewals by the Congress demonstrates a permanent need among lenders and home owners. In meeting this need by permanent legislation, an important contribution to general economic stability can be made. A permanent program of this kind can keep the Nation's homes in a sound state of repair and improvement and thereby maintain and enhance the values of the Nation's homes. The demand for home repairs and improvement can contribute to maintaining employment in the building trades in off-season periods and the level of production of building materials.

(*b*) To provide the President with authority to terminate or reinstate emergency insurance programs on an economically sound basis depending on the economic conditions prevailing in the Nation. Such authority would provide a degree of flexibility in the administration of the insurance programs which would increase the Federal Housing Administration's contribution to general economic stability. The success of the emergency insurance programs during the defense, war, and postwar periods testifies to their effectiveness in meeting the housing needs of the Nation. In meeting the housing needs of the Nation, a significant contribution can be made to general economic stability.

4. What are the advantages and disadvantages of legislative limitations on the height of interest rates and insurance charges on insured mortgages? In what ways, if at all, should the present provisoins be altered?

Answer, question 4

So long as there is the plethora of accumulated institutional funds seeking high-yield and high-grade investments such as the insured mortgage provides, there are several distinct advantages of maintaining the present limits. In the first place, the present limitations have demonstrated their effectiveness in encouraging institutional investors to advance funds for insured mortgages and in stimulating the demands of home purchasers and sponsors of rental housing. To raise the present limits would only result in choking off some of the demand for mortgage money. In the second place, raising the limits would mean a reversion to the regional structure of interest rates prevailing in the early thirties. Interest rates in the East would not be affected substantially, and in the West they would go up again and have a depressing effect on mortgage investment. The disadvantages of raising the present level of insurance charges are identical with those of raising the legislative limits on interest rates. Since the

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insurance charge is paid by the home purchaser and is included in the rent of the renter as a cost, to raise the cost of mortgage money would have a depressing effect on the demand for housing.

III. Question Relative to the Federal Home Loan Banks

1. What changes, if any, in the legislation relative to these banks would you recommend in order to promote the purposes of the Employment Act?

Answer, question 1

The Federal home-loan banks constitute a reserve credit system serving approximately 3,800 member institutions, the bulk of which are savings and loan associations. As presently established under existing legislation, the Federal home-loan banks promote the purposes of the Employment Act since their reservoir of credit which may be drawn on by their member institutions will assist the member institutions, in turn, to meet withdrawals in times of economic stress and thus aid in stabilizing the purchasing power of the public which invests its funds in the member institutions. The investors in member institutions of the Federal home-loan banks comprise approximately 8,500,000 persons. In a broad sense, Federal home-loan banks also assist in stabilizing purchasing power in that their existence as credit reserve institutions enables the member institutions to further encourage thrift on the part of the public, with the knowledge that their savings will not be hopelessly frozen and unavailable when needed.

Indirectly, Federal home loan banks as presently constituted serve to promote employment through their power to advance funds to member institutions which in turn may lend such funds for the financing of homes, including the construction of homes which might not otherwise be built. This would particularly contribute to the purposes of the Employment Act during times when member institutions were not as a whole accumulating sufficient funds in the form of savings from the public to meet the demands for loans, including construction loans, and the credit which could be supplied by the Federal home-loan banks to meet such demand would exist as a stabilizing factor in the economy which contributed toward employment and maintenance of purchasing power. Such member institutions currently hold home mortgages totaling $10,000,000,000 which is 28 percent of the entire nonfarm home mortgage debt in the United States.

In the light of the above discussion, it may be stated in reply to the question that any new legislation which would strengthen the ability of Federal home-loan banks and their member institutions to carry out their functions would in turn promote the purposes of the Employment Act, at least indirectly. Specific proposals for new legislation relative to the Federal home-loan banks which would aid in carrying out the purposes of the Employment Act are the following:

Authority for Treasury to purchase FHL bank obligations.—This proposal which appears in section 5 of H. R. 5596 and section 8 of S. 2325 would authorize the Secretary of the Treasury to purchase obligations of the Federal home-loan banks up to a total principal amount of $1,000,000,000 held at any one time. These purchases would be made upon terms and conditions as determined by the Secretary of the Treasury, including interest at a rate based upon the

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current average rate on outstanding marketable obligations of the United States as of the last day of the month preceding the making of such purchase.

This proposal, if enacted into law, could be considered as promoting the purposes of the Employment Act of 1946. It would not only promote such purposes by generally strengthening the Federal Home Loan Bank System as a stabilizing factor in the economy as indicated above, but it would assure that the banks could obtain funds at times when there might not be a private market for Federal home loan bank obligations, when interest rates on such obligations might be prohibitive, or when sale of such obligations privately might interfere with United States Treasury financing. In this last connection it should be noted that all Federal home loan bank financing is coordinated closely with United States Treasury financing and with operations of the Federal Reserve Board Open Market Committee. This additional source of funds and potential credit for member institutions could operate materially to prevent the forced sale of homes of individuals at sacrifice prices which would damage other factors in the economy. It would also be helpful in preventing, due to scarcity of funds, a cessation of home building, with a consequent adverse effect on employment.

While the Home Loan Bank Board believes that this proposal is basically sound and that there is substantial argument in its favor, it recommends that action on the provision be postponed until its discussions and study with the Federal Reserve Board are completed. The Board is hopeful that these discussions will put it in a better position to carry out recommendations of the President on this matter in his last budget message. At the time the Treasury support proposal was recommended to the Senate Banking and Currency Committee in the Eightieth Congress, legislative proposals on collateral matters were suggested by the Federal Reserve Board. These dealt in the main with the question of liquidity requirements for institutions which are members of Federal home loan banks. There have been extended discussions with other agencies of the Government on the subject with a view to achieving mutual agreement upon a recommendation to Congress on the subject of Treasury support for the Federal home loan banks in the event of certain economic emergencies.

The Bureau of the Budget proposed that the staff of the Home Loan Bank Board continue to work with the staff of the Federal Reserve Board to agree on a recommendation. Substantial progress has been made in reducing the area of disagreement, and it is probable that further discussions will permit a joint recommendation to be made.

Retirement of United States-owned FHL bank stock.—This proposal which appears in section 6 of H. R. 5596 and section 5 of S. 2325 would accelerate the retirement of the Government-owned capital stock in the Federal home loan banks. The capital stock of these banks is owned partly by the Government, and partly by member institutions which are now required to hold such stock equal to at least 1 percent of the unpaid principal of their home mortgage loans, with a minimum of $500. On July 31, 1949, the Government-owned stock totaled $95,818,800, while the members owned $128,940,500.

The proposed amendment would increase members' stock holdings by requiring each member, within 1 year, to hold such stock equal to

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at least 2 percent of the unpaid principal of such member's home mortgage loans, home-purchase contracts, and similar obligations, retaining the present $500 minimum.

Upon the taking effect of this requirement, each Federal home loan bank would be required to retire an amount of its Government-owned stock equal to the amount by which the stock then held by members exceeded the amount required under the old law. Annually thereafter each Federal home loan bank would be required to retire Government-owned stock equal to 50 percent of the net increase in members' stock since the last previous retirement. The existing Government capital could not, at any time, be retired under the new provision, if such retirement would reduce the aggregate capital stock, reserves, surplus, and undivided profits of all the banks under $200,000,000. The amount was $251,492,000 on July 31, 1949. It is estimated that the Government stock would be retired in full by the end of 3 years after the enactment of the above-proposed amendment. The retirement of the Government-owned stock would enable the United States Treasury to use the funds represented thereby for the reduction of the public debt for other purposes.

IV. Questions Relative to the Public Housing Administration

1. How much discretion does this body have relative to the amounts and timing of its loans and insurance of loans to local public housing authorities? As to other devices affecting the amounts and timing of these projects?

Answer, question 1

The United States Housing Act of 1937, as amended by the Housing Act of 1949, provides certain flexibility to the Public Housing Administration in the timing of loans and annual contributions, when authorized by the President.

In terms of money, the act provides that the Public Housing Administration is authorized to enter into contracts for annual contributions on and after July 1, 1949, in the amount of $85,000,000 per annum, which limit shall be increased by further amounts of $55,000,000 on July 1 in each of the years 1950, 1951, and 1952, and $58,000,000 on July 1, 1953. The act further provides that, subject to the total authorization of not more than $308,000,000 for the additional low-rent program, the above amounts may be increased at any time or times by additional amounts aggregating not more than $55,000,000 upon a determination by the President, after receiving advice from the Council of Economic Advisers as to the general effect of such increase upon conditions in the building industry and upon the national economy, that such action is in the public interest.

In terms of number of dwelling units to be started, the act provides that the Public Housing Administration may authorize the commencement of construction of not to exceed 135,000 units per year for the 6 years 1949 through 1954. The President may, under the same conditions stated above, and subject to the total limitation of 810,000 dwelling units, increase the authorization in any year by not more than 65,000 units. He may also decrease the authorization by not more than 85,000 units.

Thus, the United States Housing Act of 1937, as amended, within the limits stated above, does permit expansion or contraction of the

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public-housing program to counteract cyclical fluctuations in the national economy.

2. To what extent, if at all, have these discretionary powers been used for countercyclical purposes?

Answer, question 2

The original United States Housing Act did not specifically provide for expansion and contraction of the program. Moreover, the volume of housing under the original act was so small relatively and the period during which it was built was so short and of the same general economic character, that the United States Housing Authority did not have to exercise whatever discretionary power it may have had to vary the volume of construction.

3. What changes, if any, in the relevant legislation would you recommend in order to promote the purposes of the Employment Act?

Answer, question 3

Within the volume limits of the present law, there is sufficient flexibility to adjust the public housing program to cyclical fluctuations in the economy. We do not recommend any changes at this time.

V. General Questions

1. To what extent and by what means are the policies of your agencies coordinated with those of the RFC in the housing finance field?

Answer, question 1

It is our view, in answering this rather broad question, that a good degree of coordination exists between the policies of the Housing Agency and its constituents with those of the RFC in the housing finance field. The principal means by which this coordination is both achieved and maintained is through the National Housing Council. The Council was established as an integral part of the Housing and Home Finance Agency under the terms of Reorganization Plan No. 3 of July 27, 1947. The Housing and Home Finance Administrator serves as chairman of the council, and membership is now composed of:

(*a*) The Federal Housing Commissioner.
(*b*) The Public Housing Commissioner.
(*c*) The Chairman, Home Loan Bank Board.
(*d*) The Administrator of Veterans' Affairs (or his designee).
(*e*) The Chairman, Board of Directors, Reconstruction Finance Corporation (or his designee).
(*f*) The Secretary of Agriculture (or his designee).
(*g*) The Secretary of Commerce (or his designee).
(*h*) The Secretary of Labor (or his designee).
(*i*) The Administrator, Federal Security Agency (or his designee).

The purpose of the National Housing Council as set forth in Reorganization Plan No. 3 is as follows:

> The National Housing Council shall serve as a medium for promoting, to the fullest extent practicable within revenues, the most effective use of the

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housing functions and activities administered within the Housing and Home Finance Agency and the other departments and agencies represented on said Council in the furtherance of the housing policies and objectives established by law, for facilitating consistency between such housing functions and activities and the general economic and fiscal policies of the Government, and for avoiding duplication or overlapping of such housing functions and activities.

The Council has served as an effective means for keeping all of the agencies which are members thereof advised of one another's programs and basic policy decisions. It has also served as a means of working out problems which may arise from time to time in connection with the administration of the Government's various housing programs. For example, since this question relates to RFC, a specific example in that area is cited. Through Council discussions, it became apparent that both the RFC and the FHA were dealing directly with the same prefabrication firms in connection with the insurance of or actual extension of loans. Responsible staff members of the two agencies immediately developed a working arrangement under the terms of which all information concerning specific applications in the possession of one agency is made available to the other, and there is a full understanding and coordination of effort in the two loan programs.

2. To what extent and by what means are the policies of your agencies coordinated with those of the Federal Reserve?

Answer, question 2

Since the Board of Governors of the Federal Reserve System is not included in the membership of the National Housing Council, there does not exist the same formal means for the coordination of policies of this agency with those of the Federal Reserve. At the same time, there is a constant exchange of views at staff levels, and, wherever necessary, there is consultation between members of the Board of Governors and the appropriate top officials of the Housing and Home Finance Agency. One specific example of the coordination resulting from this normal type of working arrangement relates to the tie-in between an administrative down payment requirement of FHA on its modernization credit program with the Regulation W requirements of Federal Reserve. The FHA down payment requirement was in force during approximately the same period as the reinstituted Regulation W, was designed to accomplish the same general aim, and the termination of the FHA administrative ruling was discussed with appropriate officials of Federal Reserve before the actual rescinding order was issued. It should also be pointed out that in the preparation and submission of legislative proposals, the Bureau of the Budget serves in a clearing and liaison capacity between the Housing and Home Finance Agency and its constituents and the Board of Governors of the Federal Reserve System. This clearance procedure in and of itself means that the major policy considerations of interest to both agencies are continuously under joint discussion and consideration.

3. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

Answer, question 3

In commenting on the Hoover Commission proposals to the Honorable John L. McClellan, chairman, Committee on Expenditures in the

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Executive Departments, United States Senate, on July 15, 1949, our position was fully set forth on the question of establishing a National Monetary and Credit Council. For your further information, our comments on this subject were as follows:

In commenting on this recommendation, I should like to emphasize my agreement with the objective of closer coordination of economic policy within the executive branch. I do not agree, however, that the establishment of a council of the type described by the Commission is the appropriate vehicle for attaining that objective. It would seem more appropriate to recognize that this is a coordinating responsibility which can best be discharged within the executive office of the President and the Bureau of the Budget, where problems of program conflicts can best be resolved in the interests of fundamental governmental policy. In short, I am inclined to share the misgivings expressed by Commissioner Rowe on the specific method suggested by the Commission in this connection.

Appendix to Chapter VII

August 1949.

QUESTIONNAIRE ADDRESSED TO THE ADMINISTRATOR OF THE HOUSING AND HOME FINANCE AGENCY

I. Questions relative to the Federal Savings and Loan Insurance Corporation

1. How broad do you consider the purposes of this insurance to be? Merely to protect the owners of small accounts at insured savings and loan associations? To promote the willingness of people to entrust funds to these associations, thereby enhancing the availability of housing credit? To prevent fear-inspired withdrawals of funds from these associations, thereby preventing curtailment of the supply of housing credit in disturbed periods? To maintain the availability of credit at these associations by creating confidence among their managers that they will not be subjected to runs by those who supply funds?

2. In what respects, if at all, do the present provisions relative to the form of payment to holders of insured accounts in defaulted institutions prevent the FSLIC from making its maximum contribution to the purposes of the Employment Act? What changes, if any, would you recommend in the methods of payment? What would be the advantages and disadvantages of providing that a holder might, at his option, receive from the FSLIC in cash the full amount of his insured account immediately after default by an association? Would such a provision be likely to increase or decrease the total cost to the FSLIC?

3. Have you found that there are often large withdrawals of funds before the actual default of an insured institution? If so, have these included accounts in excess of $5,000? Have they tended to be concentrated in the accounts in excess of $5,000?

4. What changes, if any, in the coverage of this insurance are desirable to further the purposes of the Employment Act? What would be the advantages and disadvantages of providing full coverage of all accounts at insured institutions? On balance, would you favor such a policy? Please give reasons for your answer.

5. What changes, if any, should be made in the commitments of the Government to provide financial assistance at any time that the resources of the FSLIC might prove to be inadequate? Please give reasons for your answer.

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6. What changes, if any, should be made in the basis and rates of insurance premiums?

II. Questions relative to the Federal Housing Administration

1. Do you believe that Congress intended the FHA to use its powers in an anticyclical way to inhibit inflationary booms and to combat recession and depression? What legislative provisions would have to be changed to enable the FHA to make a greater contribution to economic stability?

2. In practice, how has the FHA used its powers for countercyclical purposes? Its limitations on interest rates? Its charges for insurance of mortgages? Its limitations on the maturity of mortgages? Its appraisal policies? Limitations on the total amount of mortgages insured? Its other powers?

3. What legislation would you recommend for the purpose of increasing the FHA's contribution to general economic stability?

4. What are the advantages and disadvantages of legislative limitations on the height of interest rates and insurance charges on insured mortgages? In what ways, if at all, should the present provisions be altered?

III. Question relative to the Federal home-loan banks

1. What changes, if any, in the legislation relative to these banks would you recommend in order to promote the purposes of the Employment Act?

IV. Questions relative to the Public Housing Administration

1. How much discretion does this body have relative to the amounts and timing of its loans and insurance of loans to local public housing authorities? As to other devices affecting the amounts and timing of these projects?

2. To what extent, if at all, have these discretionary powers been used for countercyclical purposes?

3. What changes, if any, in the relevant legislation would you recommend in order to promote the purposes of the Employment Act?

V. General questions

1. To what extent and by what means are the policies of your agencies coordinated with those of the RFC in the housing-finance field?

2. To what extent and by what means are the policies of your agencies coordinated with those of the Federal Reserve?

3. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

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CHAPTER VIII

REPLY BY I. W. DUGGAN, GOVERNOR, FARM CREDIT ADMINISTRATION

1. What do you consider to be the major purposes and objectives of the Farm Credit Administration and of the Farm Credit agencies under its jurisdiction?

The major purposes of the Farm Credit Administration and of the banks, corporations, and associations supervised by it are to provide a dependable source of long-term and short-term credit at all times to farmers and to farmers' cooperative associations on a sound credit basis through coordinated cooperative credit facilities and to obtain loan funds from the investing public without the necessity of the Government guaranteeing the securities issued. A fundamental principle of the Farm Credit Administration is the encouragement and development of agricultural cooperative institutions with farmer ownership the ultimate objective, especially insofar as the institutions it supervises are concerned. A further objective, insofar as those banks, corporations, and associations are concerned, is farmer operation and control to the extent consistent with a federally chartered Nation-wide credit system which is subject to regulation and supervision by the Government.

The system provides a permanent source of credit to farmers who can qualify on a sound basis at the lowest possible cost consistent with maintaining the institutions on a sound financial basis. The charges to the member borrowers are based upon the cost of money, the expenses of operation, and the building of necessary reserves. The purpose from the beginning has been to make available special types of cooperative credit upon terms and conditions suited to the particular needs of agricultural production and marketing.

The basic institutions of the Farm Credit System—the Federal land banks and the national farm-loan associations, the Federal Farm Mortgage Corporation, the production-credit corporations and the production-credit associations, the banks for cooperatives, and the Federal intermediate-credit banks—are instruments for effectuating the general policy of Congress for maintaining a sound and permanent system of cooperative agricultural credit for the purpose of meeting the credit needs of agriculture at minimum cost consistent with sound financial and lending policies. These institutions are either themselves cooperative organizations which finance individual farmers or have the financing of cooperative enterprises among their major functions. Although the intermediate-credit banks and the production-credit corporations are wholly Government-owned, their corporate purposes are such that in actual operation they are important and highly effective agencies to aid the functioning of farmers' cooperative credit organizations.

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Federal land bank system

The Federal land banks and national farm loan associations were established in 1916 as permanent institutions to provide farm mortgage credit for farmers on terms fitted to their needs and at rates of interest adequate to cover the costs of borrowed funds plus a margin sufficient to defray necessary operating expenses and to build reserves. Sound farm mortgage credit on amortization plans and other terms and provisions adapted to the exigencies of the farming business is available to all farmers who can qualify. Since such loans from the Federal land banks have been available, some other lenders have adopted many of these lending practices and have offered loans on similar terms, especially in the better agricultural areas.

The initial capital of $9,000,000 of the Federal land banks, according to law, was to be provided by private subscriptions or, if such subscriptions were insufficient, by the Federal Government. A total of $8,892,130 was subscribed by the Government. Each borrower through a national farm loan association is required to subscribe for stock in his local association in an amount equal to 5 percent of his loan. The association in turn is required to subscribe to a like amount of stock in the Federal land bank. Such stock is held by the bank and the association as additional collateral security for the repayment of the loan. Also, the Federal Farm Loan Act provided a formula whereby borrower capital replaced Government capital, thus providing a means for the banks to become entirely farmer-owned.

Federal Farm Mortgage Corporation

This Corporation created in 1934 has the following authorities: It may finance Land Bank Commissioner loans, may purchase Federal land-bank bonds, may make secured loans to the Federal land bank, may exchange its bonds for Federal land-bank bonds, and may obtain necessary funds through the sale of its own bonds. Through these functions it provides a backlog of strength to the farm mortgage credit structure of the Nation in the event of any emergency serious enough to impair the availability of farm mortgage credit at reasonable rates and terms.

The first of these authorities now is exercised only in connection with the financing and collection of existing Land Bank Commissioner loans. Authority to make new commissioner loans expired at the close of business July 1, 1947. If the authority of the Land Bank Commissioner to make new loans should be renewed at any time in the future, this function of the Corporation again would become important.

Experience has demonstrated that an available source of farm mortgage credit at reasonable rates and terms during all times and under all conditions is vital to the economy of the Nation. The Federal land banks can provide such a source of credit as long as they have access to funds in the money market at reasonable rates. Should conditions again materialize which would cause other lenders to withdraw from the farm mortgage field and general market conditions be such that the Federal land banks would find it impossible to sell their bonds in the open market at reasonable rates, the Federal Farm Mortgage Corporation could purchase such bonds, thereby enabling the banks to continue making new loans. Under such circumstances the authorities of the Corporation would become extremely important.

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The production-credit system

The production-credit corporations and the production-credit associations were established in 1933 to provide a permanent source of short-term production credit for farmers, through local cooperative credit associations designed to become wholly owned by their farmer members. To assist in setting up this permanent cooperative production-credit system, $120,000,000 was appropriated in 1933 to capitalize the 12 production-credit corporations which, in turn, furnished in the form of class A stock most of the original capital of the production-credit associations. As farmers became borrowers, they were required to own class B (voting) stock in the associations to the extent of 5 percent of their loans. An important objective of the system is to accumulate member-owned capital and build adequate reserves in the associations so that they will become sound and constructive lending organizations and be able to gradually repay the capital stock which was furnished by the Government through the production-credit corporations.

Banks for cooperatives

The 12 district banks for cooperatives and the central bank for cooperatives were established in 1933 as permanent institutions to make loans to eligible cooperative associations engaged in marketing agricultural products, purchasing farm supplies, and furnishing farm business services, for the purposes of helping finance the orderly marketing, processing, and distribution of agricultural products, the efficient and economical distribution of farm supplies, and the furnishing of farm business services.

The initial capital for the banks for cooperatives was subscribed by the Governor of the Farm Credit Administration from funds realized from assets of the revolving fund authorized by the Agricultural Marketing Act of 1929. In addition to this capital, each borrower from a bank for cooperatives is required to own capital stock in the bank or make payments into a guaranty fund, if an association is not authorized to purchase stock. The amount of capital which a borrowing association is required to own is equal to $100 for each $2,000 or fraction thereof of the amount of operating capital and facility loans made to it. For commodity loans, the required amount is 1 percent of the amount of the loan with credit given for stock purchased in connection with other loans.

In addition to offering farmers' cooperatives credit service carefully adapted to their needs, an important objective of the Farm Credit Administration is to encourage ownership of the banks for cooperatives by its borrowing associations insofar as practicable. Under the present law, however, there is no effective method for the eventual complete ownership of the banks by the borrowing cooperatives. There is pending before Congress legislation (H. R. 848) which has as its principal objective a reasonable and orderly method of retiring Government capital and replacing it with the capital furnished by the cooperative associations using the facilities of the banks. This proposed legislation has the full support of all the leading farm organizations and of the Department of Agriculture.

Federal intermediate credit banks

The 12 Federal intermediate credit banks, organized in 1923, were created as banks of discount to provide a continuing and dependable

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source from which local agricultural and livestock credit corporations, State and National banks, and other primary lending institutions may obtain funds to finance their short-term and seasonal agricultural paper, consisting of loans for the production and marketing of crops and livestock. The Federal intermediate credit banks are not authorized to make loans directly to individuals. Loanable funds used by the credit banks are obtained principally from the money market through the sale of consolidated collateral trust debentures which are offered monthly. From time to time the banks also borrow money for short terms from commercial banks. They are also authorized to rediscount paper, having a maturity of not to exceed 9 months, with the Federal Reserve banks. The Government assumes no liability for the debentures or other obligations of the intermediate credit banks.

The Federal intermediate credit banks are the only source from which production-credit associations obtain money. In addition, the banks serve approximately 80 other credit organizations, most of which obtain all their borrowed funds from the credit banks. The banks for cooperatives also borrow from and rediscount some of their paper with the intermediate credit banks. One of the principal objectives of the system is to maintain sound credit standards as a basis for maintaining confidence in the quality of its securities in the money markets. The ability of the banks to provide a sustained credit service for agriculture depends upon their adherence to sound practices and policies in all phases of their operations.

> 2. Do you believe that the farm credit agencies under your jurisdiction should operate continuously or that they should operate only in emergency periods? If you favor their continuous operation, what are your principal reasons for this?

The institutions under the supervision of the Farm Credit Administration must operate continuously if they are to reach the objectives set forth above in reply to question 1. The attainment of these objectives requires ready access to the money markets, highly trained personnel, and a volume of business sufficient to permit efficient and low-cost operations. Self-sustaining institutions cannot meet such requirements if they operate only on an emergency and stand-by basis. Furthermore, continuous operation is a fundamental requirement of a cooperative credit system which fulfills a need for a specialized credit service to farmers. The characteristics peculiar to a farmer's business make it essential that he establish a credit home, upon which he can depend for his sound credit needs at all times and which is designed to finance his entire farm business on terms and conditions that are adapted to his particular farm operations. In order to be assured of this credit service, members purchase stock in production credit associations and national farm loan associations, which are cooperative organizations largely controlled by their members.

It should be emphasized that these cooperative lending institutions derive their lending funds through the sale of bonds and debentures and other borrowings not guaranteed by the Government; that they are either owned by their members or are moving in that direction as rapidly as practicable. All of the national farm loan associations are wholly owned by farmer members. These associations and a few direct borrowers, in turn own all of the capital stock of the Federal land banks. Fifty-nine of the five hundred and three production-

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credit associations are wholly owned by the farmer members, and in the entire production credit system over 70 percent of all the capital stock of the associations is owned by members. Thus, the ability of these institutions to attain the objectives mentioned must be considered largely from the standpoint of their capacity as member-owned cooperative credit associations.

The lending of money to farmers and their cooperatives on a sound, constructive basis is a highly technical business operation. Risks must be recognized and evaluated helpful counsel must be given to member borrowers and standards of credit service must be established. Personnel able to meet the special needs of these institutions require thorough training and seasoning. Such personnel can be developed and retained only by permanent institutions offering steady employment and opportunity for advancement in a desirable career.

As stated, a primary aim is to provide continuous credit service at low cost without reliance upon Government guaranty of the securities issued. A prerequisite in this goal is the building of a favorable reputation for the securities in the money markets. This cannot be done if the securities are offered by part-time institutions and if investors associate those securities with emergency or distress lending activities. The building of a ready market for securities at low rates of interest depends upon regular and frequent offerings by fully active, permanent institutions which are in strong financial condition.

A reasonable and continuous volume of business also is necessary, partly to build the financial strength needed to obtain loan funds at low rates of interest, as just referred to, and partly to permit low-cost operations. The cost of administering credit service is greatly affected by the number and dollar amount of loans handled per person and per office. Low-cost service, therefore, is dependent upon the maintenance of an adequate volume of business upon the books at all times. A factor in maintaining this necessary volume is the readiness with which farmers are willing to subscribe to capital stock in the lending institutions. Such investment would not be attractive if the institutions operated only during emergency periods.

The national farm-loan associations, Federal land banks, production-credit associations, and banks for cooperatives thus are designed to serve in the credit field as other farmers' cooperatives provide service in marketing, purchasing farm supplies, and similar activities. Neither marketing, purchasing, credit, nor any other cooperatives can function effectively if operations are limited to periods of emergency.

Except for the Federal Farm Mortgage Corporation, which is on a stand-by basis, the wholly Government-owned corporations under the jurisdiction of the Farm Credit Administration are a necessary part of the cooperative credit system. The Federal intermediate credit banks obtain the funds through the sale of debentures for the purpose of discounting loans made by the production-credit associations and other private credit organizations. The production-credit corporations provide the production-credit associations with capital that is needed in excess of member-owned capital and supervision. Experience has shown that the lack of a dependable source of funds, lack of adequate capital for local lenders, and lack of adequate supervision were the primary weaknesses in short-term agricultural lending prior

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to the establishment of the production-credit system. Therefore, the continuous functioning of these wholly Government-owned corporations is an integral part of the cooperative credit system essential to its success.

This view with respect to the continuity of operations of the institutions comprising the Farm Credit Administration is consistent with the attitude of the Congress when the authorizing legislation was enacted. The history of this legislation does not suggest a stand-by or intermittent role for these institutions. In authorizing the Federal land banks and the production-credit system, for example, it was provided from the start that the Government capital in the Federal land banks and the production-credit associations eventually would be retired and they would become fully member-owned institutions. It seems obvious that the accumulation of member capital and the building of adequate reserves could not be expected to be accomplished by limiting operations to emergency periods.

3. What, if any, are the gaps or inadequacies in the private financial system that justify the operation of the farm credit agencies that are under your jurisdiction?

The fundamental gap or inadequacy in the private financial system that justifies the operation of the cooperative farm credit system is the fact that other financial institutions are not economically adapted to provide a dependable source of credit at all times on terms and conditions that fit the farmers' needs. Furthermore, farmers are not able to group together to pledge their resources to obtain funds from the money markets. A discussion of these inadequacies with respect to the different types of agricultural credit follows:

Long-term farm mortgage credit

Capital turn-over in agriculture is normally a relatively slow process. Therefore, credit to finance farmers' real estate and improvements must necessarily be of a long-term nature. Another characteristic of the farmer's business is that his income is subject to fluctuations from year to year due to weather, insect pests, animal diseases, or to changes in prices for his crops. These variations in income require flexibility at certain times in the servicing of his mortgage contract. It is essential that mortgage credit service that fits the farmer's needs be available to all qualified farmers in all areas and during all periods of the economic cycle.

The Federal land-bank system may offer amortized loans for periods from 5 to 40 years and the terms of the loans are adapted to the farmers' individual situations to the extent feasible. Appraisals are made on the basis of normal agricultural value of farms, and the income of the farm for agricultural purposes is an important factor in determining such value. Loans cannot legally exceed 65 percent of the normal value, and the amount and terms are kept within such limits that annual or semiannual installments can be met out of normal farm income. The future payment fund provides a means whereby a farmer can make advance payments during years of high income which can be used during less favorable years. Worthy members of the national farm loan associations who, for reasons beyond their control, find themselves unable to meet their loan installments usually can have their loan repayments adjusted to fit their particular situation.

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When the characteristics of other farm mortgage lenders are analyzed, it can be seen that several important gaps would exist if it were not for the Federal land banks. Farm mortgage loans by commercial banks, while generally available in most parts of the country, are not generally available on terms entirely suitable to the farming business, especially insofar as the length of term is concerned. The amounts of farm mortgage loans that commercial banks can make and the terms which may be offered are affected by a variety of conditions and laws, the principal governing factor being that these loans are made from funds on deposit which are subject to withdrawal on demand and their loan portfolios must be built with this circumstance constantly in mind. In view of this need for a well balanced loan portfolio banks usually limit the amount they are willing to lend on farm mortgages, and at times individual banks find themselves "loaned up" even in periods of high economic prosperity. National banks may lend up to 50 percent of appraised value for 5 years where the loan is to be repaid in a lump sum. They may lend up to 60 percent for 10 years where the loan is amortized so as to provide for a 40-percent reduction in principal during the period.

The limitations on individual loans affect a large proportion of all banks since they likewise apply to many State banks which are members of the Federal Reserve System. Furthermore, the banking laws of several States have been patterned after the law for national banks.

It has been the general practice of commercial banks to make mortgage loans on an unamortized basis for short terms. In 1934, the average term of these bank loans in the country as a whole was 1.9 years, and it was below 3 years in almost every region. In 1947, the national average was 5.2 years, ranging down to 2.4 years in the east South Central States.

Life-insurance companies, while not affected materially by shortage of loanable funds during depression periods, can withdraw from the agricultural lending field whenever they find it to their advantage to do so. Most of the life-insurance companies suspended their farm mortgage lending activities during the early 1930's, and during the recent postwar period, at least one large company has withdrawn from the farm lending field. Farm mortgage loans for the life-insurance companies taken as a group represent only about 3 percent of their total assets, and this makes it relatively easy for them to expand or withdraw from the field, whichever course is to their advantage.

Another gap in the farm credit service offered by private financial institutions is the fact that they tend to concentrate their farm loan services in areas where agriculture is most stable and prosperous. This is most pronounced in the case of life-insurance companies where, in 1948, two-thirds of the farm mortgages they recorded were in the 10 States of Ohio, Indiana, Illinois, Missouri, Minnesota, Iowa, South Dakota, Nebraska, Kansas, and Texas.

As mortgage lenders, individuals are not subject to restrictions as to the amounts they can lend in relation to appraised values, nor is there any restriction of the terms of the loans they make. However, their inability to take care of farm mortgage credit needs, is clearly shown by the historical record. Individuals as a group have generally extended credit liberally during good times but at relatively high rates and for short terms. In the event of another depression it is

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reasonable to expect that the average individual lender would restrict lending and in many cases would find it necessary to foreclose promptly when borrowers could not meet their payments.

The Federal land-bank system has been a consistent pace-setter in establishing reasonable interest rates and terms for farm mortgage loans. Average contract interest rates on farm mortgages recorded have been consistently lower on land-bank loans than rates on loans by any other major type of lender. There has been a greater reduction in interest rates generally on farm mortgage loans in the high rate areas than in the low rate areas, with the result that there has been a considerable narrowing of the spread between interest rates charged in various parts of the country.

The following tabulation shows the percentages of mortgages recorded by each lender group to the total of all mortgages recorded for the years 1934, 1937–40, and 1948. These three selected periods represent depression, prewar, and prosperity conditions, respectively.

Percentage of amount of mortgages recorded by lender groups to total mortgages recorded

	1934	1937–40	1948
Federal land banks	40	8	10
Land Bank Commissioner	30	4	
Commercial banks	7	29	31
Insurance companies	3	18	18
Individuals	14	32	35
Miscellaneous	6	9	6
Total	100	100	100

During 1934, which was a year of heavy farm foreclosures, the Federal land banks were called upon to furnish 40 percent of all farm mortgage credit to farmers and the Land Bank Commissioner 30 percent, most of which was for the purpose of refinancing mortgages or short-term debt held by other lenders. During the same year, commercial banks and insurance companies furnished only 7 percent and 3 percent, respectively, of the farm mortgage credit required by farmers. Individuals furnished only 14 percent of the total. In sharp contrast to these proportions, the Federal land banks furnished only 10 percent of the total farm mortgage credit to farmers in 1948, while commercial banks, insurance companies, and individuals furnished 31 percent, 18 percent, and 35 percent, respectively.

It is obvious from these facts that agricultural credit from both private institutional and individual sources has been inadequate in the past during periods of depression. This lack of adequate credit during depression periods may be due in part to unwillingness of private sources to take the risks that are inherent in making loans to farmers. However, a more compelling reason, especially in the case of commercial banks, is the fact that during periods when deposits shrink the supply of loanable funds shrinks, thus reducing the ability of these institutions to make loans at times when the demand may be greatest. Also, during such periods banks are not in a position to defer or to extend mortgage payments of individual farmers who may have temporary difficulty in making their payments. Similar factors also affect the ability of individuals to extend credit during depression conditions.

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The period from 1933 has included the worst depression and the greatest period of agricultural prosperity in history. Under these two extreme conditions of economic activity, the Federal land-bank system has served largely as a balance wheel in the farm mortgage field. The adoption of the normal value concept of appraisal in the period of depressed land values not only proved to be sound from the standpoint of the lender but sound from the standpoint of the borrower as well, because it recognizes in effect that a long-term loan is to be paid under average conditions most likely to prevail over the life of the loan rather than the conditions existing at any given time. That is equally true of loans being made during recent years when agriculture is generally more prosperous than ever before.

Such a policy necessarily results in the accumulation of a larger proportion of the total farm mortgage loans during a period of depression and the retention of a smaller proportion of the total in periods of prosperity. Experience during the life of the land-bank system indicates clearly, however, that it is necessary for the land-bank system to obtain an important share of the total farm mortgage financing, if it is to remain an effective stabilizing influence. In order for the system to be an effective yardstick, it is essential that its services be available to every qualified borrower at all times.

Short-term production credit

Farmers also need an adequate and dependable source of short-term production credit which is adapted to their particular requirements. The needs of farmers for short-term production credit are quite different from the needs of other business for commercial loans. Farmers who need credit for production purposes require loans for a full season or until the crops or livestock being financed can be marketed. It is also important that farmers obtain the financing of their entire short-term requirements from one lender, rather than to have several loans from different lenders, each secured by a part of the farmer's crops, livestock, or equipment. When a farmer has scattered debts with several lenders, a plan of repayment is difficult to work out, and he is always subject to the risk of having some part of his chattels foreclosed if he should be unable to meet his payments on one of these debts.

A suitable source of credit to meet the needs peculiar to the agricultural and livestock industries was long a problem receiving consideration by the Congress and by the governmental agencies. These needs became more acute as a result of changes in agriculture growing out of our participation in the First World War. Other developments, such as the trend toward mechanization of farming, increased substantially the demands of farmers for loans adapted to their requirements. Because of the slower turn-over in agriculture as compared with business and industry generally, and the characteristic inability of farmers to shift their production programs quickly, all these developments made the need for a continuing source of dependable credit increasingly important.

The agricultural credit situation in the early 1920's was in a disorganized state. Credit was often impossible to obtain when most needed and substantial losses were incurred when prices of agricultural products declined and many lenders were obliged to collect loans through forced liquidation, thus further depressing prices of farm commodities. In 1921 and 1922 the War Finance Corporation Act of

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1918 was amended to permit that corporation to extend credit for agricultural purposes for a temporary period, while the Congress considered ways and means of providing more adequate, permanent facilities for such financing. The Federal intermediate credit banks then were created in 1923 on a permanent basis, to supersede the War Finance Corporation in the field of discounting agricultural paper for banks and other financing institutions and in making direct loans to farmers' cooperative marketing associations. Thus, the establishment of the intermediate credit banks in 1923 was the first step by the Federal Government in providing for a continuing and dependable source through which local lending institutions and farmers' cooperatives could obtain funds to finance the production and marketing of crops and livestock. To assure sound and stable operations, as well as an ample supply of loanable funds, the Federal intermediate credit banks were capitalized by the Government but required to finance their loan and discount operations principally through the issuance and sale of debentures in the money markets and other borrowings. To provide additional assurance that these banks would be able to meet the demands that might be made upon them, the Federal Reserve Act was amended to authorize them to discount agricultural paper for the Federal intermediate credit banks.

Considerable amounts of credit were extended by this new system for marketing purposes. However, even with these discount facilities private lenders did not make sufficient use of them to meet the needs for short-term agricultural credit on a national basis. The lack of short-term production credit to farmers became extremely acute in the early 1930's. To correct this weakness in the agricultural credit situation, the production-credit corporations and associations were established as a permanent system to provide local cooperative production credit associations with access to the discount facilities of the intermediate-credit banks. Thus, the production-credit system was originally established in 1933 to fill permanently a gap which existed in the agricultural-credit situation. Experience had shown that insufficient capital, inadequate supervision, lack of understanding of the farming and ranching business, and dependence on local resources generally for loanable funds were serious weaknesses in agricultural lending. The structure for the Production Credit System was designed, therefore, to provide safeguards which would minimize these weaknesses.

Commercial banks are the principal source of short-term production credit to farmers. However, there are definite limitations to the credit service that can be offered to farmers by country banks. The most important function of a bank is to act as a depositary for its customers. Therefore, banks are organized in localities where funds for deposit are available to them. Frequently communities with plentiful deposit funds do not require large amounts of agricultural credit, while areas which need such credit in comparatively large amounts too often have only a limited supply of local-deposit funds. It is also characteristic of agricultural sections that cycles of deposit withdrawals coincide with demands for loan funds. Thus, as the need increases the available supply of money diminishes. Conversely, deposits increase at about the same time that loans are being repaid.

It is significant that 73.6 percent of the institutionally held non-real-estate agricultural debt was held by commercial banks in 1948.

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During a period of shrinking deposits, the banks might be unable to carry as large a proportion of the total as they did in 1948. During the 10-year period 1937–48, the total held by banks was 66.4 percent. Another significant point is the fact that 26.2 percent of the institutionally held non-real-estate debt is held by banks which are not members of the Federal Reserve System and, therefore, do not have as ready access to Federal reserve rediscount privileges as do member banks. In the event of a tight credit situation in the future, nonmember banks not amply supplied with liquid assets might find it especially necessary to limit the amount of farm credit they extend and be forced to call loans outstanding. This would have the effect of placing a heavier load on other lenders.

The production credit associations have also been pace setters in the field of short-term credit especially with regard to terms of loans. The practice of budgeting loans as developed by the production credit associations, that is, disbursing them in installments as needed by the member and repayment when the products financed are sold, has been adopted by some banks. A budgeted loan of this type serves the farmer or rancher in many ways. It assures the member that the funds will be available as needed to meet necessary costs; it reduces greatly the interest expense since interest is charged only for the actual number of days each dollar is outstanding; it saves time and expensive trips; it provides for orderly retirement of the loan as products are sold: and the analysis of credit requirements and repayment ability aids in avoiding overborrowing.

Banks for cooperatives

In 1929, following years of extensive research for ways to improve the orderly merchandising of agricultural commodities, and to make agricultural financing more effective and productive, the Agricultural Marketing Act was passed by Congress and approved by the President. The act laid down a national policy of encouraging and sponsoring the organization of agricultural producers into cooperative associations to be owned and controlled by the farmers, and it provided for the making of loans to farmers' cooperatives for financing their operations and the acquisition of necessary facilities.

In passing this legislation Congress gave recognition to the findings in the study that there was a serious shortage of credit available to farmers for the orderly marketing and distribution of the products produced on their farms and sought to provide a permanent source of credit for them on terms adapted to their needs and at reasonable interest rates. Congress specifically stated that it desired to make available to agriculture the funds needed to enable farmers' cooperative associations to market their own products and that the loans should be made on terms that preserved farmer ownership of the associations.

The Farm Credit Act of 1933 made amendments to the Agricultural Marketing Act and directed the Governor of the Farm Credit Administration to charter the 13 banks for cooperatives, to be capitalized initially with funds salvaged from the assets of the revolving fund originally provided for the Federal Farm Board.

Pursuant to these laws, the banks for cooperatives make three types of loans: (1) Commodity loans, i. e., loans secured by commodities for the financing of seasonal operations; (2) operating capital loans, either on a seasonal or term basis, to supplement the associations' own

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working capital required for general operations such as meeting pay rolls, carrying inventories and receivables, and taking care of normal operating charges; and (3) facility loans, for the construction, refinancing or purchase of fixed assets. These loan purchases are sufficiently broad to serve the complete operating requirements of farmers' cooperatives. Efforts are made to adapt each loan to the specific needs of the borrower in order to further the announced objectives of Congress of building strong and effective farmers' cooperative organizations.

Research has disclosed that around 3,000,000, or about one-half, of the 6,000,000 farmers in this country are members of at least one farmers' cooperative association and some farmers belong to two or three. Probably one-half million more farmers, without accepting the responsibility of membership, rely upon farmers' cooperatives as their main source for marketing or processing their farm products or for furnishing their farm supplies or business services. Experience has demonstrated, both before and after the banks for cooperatives were created in 1933, that farmers' cooperatives cannot get financing of the kind and on the terms they need from ordinary commercial sources.

Besides the banks for cooperatives, commercial banks are the only important source of credit to farmers' cooperative associations. As they are banks of deposit, they must, of necessity, operate under policies designed primarily to protect the interests of their depositors. Statutory provisions limit the amount of funds that may be made available to individual borrowers by commerical banks and these limitations, as well as the requirements of liquidity to meet depositors' demands, also restrict the period of time for which loans may be made. Because of these limitations, the only areas in which commercial banks are able to make financing available to farmers' cooperatives is in connection with their commodity loans (No. 1 above) and those operating capital loans (No. 2 above) which are needed only for short periods of time.

The short-term financing which farmers' cooperatives are able to get from commercial banks is generally limited to those associations located in or near the larger cities. Farmers' cooperatives serve sizable groups of farmers who are, in effect, pooling their commodities or combining their needs for supplies or services. The amounts which the associations need to borrow to handle commodities or take care of peak seasons' capital expenditures are therefore relatively large. The lending limits of commercial banks, plus the usual seasonal shrinkage of funds available for agricultural loans in farming communities makes it difficult for local commercial banks to handle any sizable amount of the short-term financing requirements of the cooperatives.

Only a very small portion of the long-term operating capital loans or the loans needed for physical facilities (No. 3 above) can be obtained from commercial banks, due primarily to restrictions on the periods of time for which commercial banks may lend and the fact that the facilities are not primarily land. The facilities consist of such things as grain elevators, dairy plants, cotton gins, and warehouses. The only source generally adaptable for this type of financing besides the banks for cooperatives is the individual member of the cooperative. Due to the amounts involved, the average member is

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not able, initially, to supply the funds necessary to pay for these facilities although he can and does do so over a period of years.

Without the banks for cooperatives, the associations would have a source of credit (commercial banks) for only a part of their short-term loan requirements and would have no dependable source of credit generally available for their long-term operating capital loans or for the loans necessary to acquire or improve facilities needed for the marketing, processing, or distribution of the commodities they handle.

4. What degree of control over the amounts, interest rates, and other terms of loans by the farm credit agencies under your jurisdiction is exercised by the Farm Credit Administration in Washington? By the authorities in the 12 district offices? By the national farm loan associations and the production-credit associations?

Federal land bank loans

General.—It may be helpful to outline the procedure by which a Federal land bank loan is made before separately discussing the degree of control over the amounts, interest rates, and other terms of Federal land bank loans, which is exercised by the Farm Credit Administration in Washington, or by the authorities in the 12 district offices, or by the national farm loan associations.

Application for such a loan is made through a local national farm loan association, the territory of which includes the farm being offered as security, and the membership of which consists of borrowers from the Federal land bank. A paid secretary-treasurer is the active executive officer of the association and there is also a loan committee of three or more members, all selected by the association board of directors (12 U. S. C. 712). Upon receipt of an application, the loan committee makes, or causes to be made, such investigation as it may deem necessary as to the character and solvency of the applicant, and the sufficiency of the security offered (12 U. S. C. 751). This investigation ordinarily is made by the secretary-treasurer. The committee may also request a report on the value of the security by a land bank appraiser. The land bank appraiser is a public official appointed by the Farm Credit Administration. When the application and association report are submitted to the Federal land bank, the bank will obtain a report by a land bank appraiser if the association has not already done so; otherwise the bank will use the land bank appraiser report referred to it by the association. The Federal land bank, by its proper officers, then makes the final decision as to any loan which may be made or whether the application should be rejected (12 U. S. C. 656, 751). It is the duty of the appraiser to determine the normal value of the farm to be mortgaged as security. In making said appraisal, the value of the farm for agricultural purposes shall be the basis of appraisal and the normal earning power of the farm shall be a principal factor (12 U. S. C. 771, "Fifth"). No loan may be made unless the written report of the appraiser is favorable (12 U. S. C. 753). The loan committee of the association then causes a written report to be made of the results of such investigation or investigations, and no loan may be made by the Federal land bank unless the report of the committee is favorable (12 U. S. C. 751). In cases where the association has obtained a report from a land bank

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appraiser, it may notify the applicant of the amount and terms of the loan approved by the loan committee, subject to subsequent approval or disapproval by the Federal land bank (12 U. S. C. 751).

The Federal land banks may deposit their loans with the farm loan registrar of the district as collateral security for farm loan bonds, subject to the approval of the Farm Credit Administration (12 U. S. C. 857). The Federal Farm Loan Act also requires that loans to any one borrower shall not exceed $25,000 unless approved by the Land Bank Commissioner (12 U. S. C. 771, "Seventh"), and that similar Commissioner permission be given in the case of a loan to a livestock corporation if not all but at least 75 percent in value and number of shares of the stock of the corporation is owned by individuals personally actually engaged in the raising of livestock on the farm to be mortgaged as security for the loan (12 U. S. C. 771, "Sixth"). Authority to act for the Farm Credit Administration and the Land Bank Commissioner in these three respects has been delegated to a reviewing appraiser in each of the 12 Farm Credit districts, who is an official of the Farm Credit Administration and is not an employee of the Federal land bank or any national farm loan association.

Amounts of loans.—Under the Federal Farm Loan Act, the amount of loans to any one borrower shall in no case exceed a maximum of $50,000, but loans to any one borrower shall not exceed $25,000 unless approved by the Land Bank Commissioner (12 U. S. C. 771, "Seventh"). This $50,000 limitation may not be exceeded. As respects approval by the Land Bank Commissioner of loans in excess of $25,000, authority to give such approval has been delegated to the reviewing appraiser in each of the 12 Farm Credit districts, who is an official of the Farm Credit Administration.

In addition to the maximum dollar limitation on the amount of loans, no loan may exceed 65 percent of the normal value of the farm mortgaged as determined by the land bank appraiser (12 U. S. C. 771, "Fifth"). Accordingly, the value assigned to a farm by the appraiser in effect limits the amount of loan which may be made on that farm to 65 percent of that value. The association loan committee, though, may recommend a loan in a lesser amount if security considerations are deemed to so require. When final decision on the amount of loan is made in the Federal land bank, it may not exceed either 65 percent of the appraised normal value, or the amount recommended by the association loan committee, and it may be less if security considerations are deemed so to require.

Interest rates.—Under the Federal Farm Loan Act, the interest rate on Federal land bank loans made through national farm loan associations may not exceed 6 percent per annum (12 U. S. C. 771, "Third"). Otherwise, the basic interest provision now in effect since 1933 is as follows (12 U. S. C. 771, "Second"):

> RESTRICTIONS ENUMERATED.—No Federal land bank organized under this chapter shall make loans except upon the following terms and conditions:
>
> *   *   *   *   *   *   *
>
> SECOND. AGREEMENT FOR REPAYMENT ON AMORTIZATION PLAN.—Every such mortgage shall contain an agreement providing for the repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments sufficient to cover, first, a charge on the loan at a rate not exceeding the interest rate in the last series of farm loan bonds issued by the land bank making the loan; second, a charge for administration and profits at a rate not exceeding, except with the approval of the Governor of the Farm Credit Administration, 1 per centum per annum on the unpaid principal, said two rates combined consti-

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tuting the interest rate on the mortgage; and, third, such amounts to be applied on the principal as will extinguish the debt within an agreed period, not less than five years nor more than forty years: * * *.

The Farm Credit Administration also has the power (12 U. S. C. 831 (b)):

To review and alter at its discretion the rate of interest to be charged by Federal land banks for loans made by them under the provisions of this subchapter, said rates to be uniform so far as practicable.

Inasmuch as the rates of interest now charged on association loans exceed the last bond interest rate by more than 1 percent, such loan interest rates necessarily were approved by the Farm Credit Administration. The current approval for the present interest rates on loans made through an association or by a branch bank (Puerto Rico) is as follows (6 CFR 10.4; as amended 14 F. R. 851):

§ 10.4 *Interest rates on loans made through an association or by a branch bank.*—Approval is hereby given to an interest rate of 4 per centum per annum on loans by banks through associations generally, and to an interest rate of 4½ per centum per annum on:

(*a*) Loans by the Federal Land Bank of Columbia applied for through associations on and after August 1, 1948;

(*b*) Loans by the Federal Land Bank of Springfield applied for through associations on and after January 1, 1949; and

(*c*) Loans made by a branch bank [Puerto Rico] pursuant to section 672, title 12, United States Code;

notwithstanding that the interest rate on the Federal farm loan bonds of the last series issued prior to the making of any such loans may be less than 3 per centum per annum (but for higher interest rates approved for loans on special classes of property in the continental United States, see § 10.5).

The loans in Puerto Rico are made directly to the borrowers. Direct loans may be made in the continental United States only if the Land Bank Commissioner so authorizes in areas where there is no association through which the Federal land bank can accept applications for loans (12 U. S. C. 723 (a)). In that event, the rate of interest on such loans is required to be one-half of 1 percent per annum in excess of the rate on association loans being made at the same time (12 U. S. C. 723 (b)). However, no direct loans are currently being made in the continental United States.

The approval of special interest rates by the Farm Credit Administration, referred to in the foregoing, is as follows (6 CFR 10.5):

§ 10.5 *Special interest rates.*—For bank loans secured by first mortgages on the following farm property in the continental United States:

(*a*) Land that is employed primarily in the production of naval stores as defined by section 2 of the Naval Stores Act (Sec. 2, 42 Stat. 1435; 7 U. S. C. 92);

(*b*) Land used for the raising of livestock, in estimating the earning power and in establishing the value of which leases or permits for the use of other lands were taken into consideration and were a factor in determining the amount of the loan; and

(*c*) A farm property, a substantial part of the earnings from which is from orchard crops.

Approval is hereby given to the following interest rates:

(1) For loans through association, one-half of 1 per centum per annum in excess of the interest rate on loans through associations not secured by mortgages on the foregoing classes of farm property, such interest rate not to exceed 6 per centum per annum;

(2) For direct loans, one-half of 1 per centum per annum in excess of the interest rate approved for loans through associations under subparagraph (1) of this paragraph; and

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(3) For loans under section 25 (b) of the Farm Credit Act of 1937 (50 Stat. 711; 12 U. S. C. 724) through associations, the capital stock of which is impaired, one-fourth of 1 per centum per annum less than the interest rate approved for direct loans under subparagraph (2) of this paragraph.

In the two districts now having a basic 4½-percent rate on association loans, the board of directors of the Federal land bank first adopted a resolution providing for such interest rate, which was then approved by the Farm Credit Administration.

Other terms.—The statutory provision quoted under "Interest rates" (12 U. S. C. 771, "Second"), requires that the mortgage given to secure a Federal land bank loan shall contain an agreement providing for repayment of the loan on an amortization plan by means of a fixed number of annual or semiannual installments over a period of not less than 5 years nor more than 40 years. In Puerto Rico, loans may not be for a longer term than 20 years (12 U. S. C. 672). Actually, most loans in the continental United States are made for a term of from 20 to 35 years. The association loan committee may recommend the term of years for a particular loan; and the report of the land bank appraiser will include a term of years for which he considers the property to be satisfactory security; neither of which may be exceeded by the Federal land bank.

The Farm Credit Administration has approved two general types of reamortization plans. Under the so-called standard plan, the amount of each installment (except the last) is the same, the portion thereof applied on principal increasing, and the portion thereof applied on interest decreasing, as the loan is paid down. The so-called Springfield plan, on the other hand, requires equal installments of principal, the amount of interest decreasing with the unpaid balance. The Federal land bank determines which plan is to be used, either generally or in a particular case, although both the association loan committee and the appraiser may make recommendations as to the plan. Some special repayment plans also have been approved, as where during completion of a conservation program or development of an orchard, etc., lower principal payments are desired than under the two general plans more commonly used.

The note and mortgage forms used in each of the States are prepared by the Federal land bank and submitted to the Farm Credit Administration for approval at the time of each revision and before printing. Aside from provisions designed to give the Federal land bank a valid first lien under State law, and defining the repayment plan, the Federal Farm Loan Act also requires certain other agreements, such as: to pay when due all taxes, liens, judgments, or assessments which may be lawfully assessed or levied against the property; to maintain insurance on buildings and other improvements on the property (12 U. S. C. 771, "Ninth"); and to use the proceeds of the loan solely for the purposes set forth in the application (12 U. S. C. 771, "Tenth").

Federal intermediate credit banks

General.—The 12 Federal intermediate credit banks are primarily banks of discount for agricultural and livestock lending institutions. The credit banks are authorized to discount agricultural paper for, and to make loans secured by such paper to, various types of lending institutions including national and State banks, trust companies, agricultural credit corporations, incorporated livestock loan companies,

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savings institutions, cooperative banks, credit unions, and cooperative associations of agricultural producers (12 U. S. C. 1031 (1)).

Similarly, the credit banks discount paper for, and make loans to, the production credit associations and the banks for cooperatives (12 U. S. C. 1031 (1)). The discounting of paper of production credit associations is presently the major portion of the credit banks' business.

They are also authorized to make loans to cooperative associations of agricultural or livestock producers on the security of staple agricultural products or livestock or other collateral approved by the Governor of the Farm Credit Administration (12 U. S. C. 1031 (3)). Since loans to cooperative associations are generally made by the banks for cooperatives, few loans of this character are made by the credit banks.

The Farm Credit Administration is authorized to make such rules and regulations, not inconsistent with law, as it deems necessary for the efficient execution of the organic statute governing the credit banks (12 U. S. C. 1101). The Farm Credit Administration generally consults with the credit banks before its rules and regulations are issued.

Amount of loans.—A credit bank's discounts for and loans to any one financing institution are limited by statute to an aggregate amount which, when added to the institution's other liabilities, will not exceed the amount of its total liabilities permitted under the laws governing the institution; and will not exceed twice the paid-in and unimpaired capital and surplus of the institution in the case of a National or State bank, trust company, or savings institution, or 10 times the paid-in and unimpaired capital and surplus in the case of paper secured by (12 U. S. C. 1032).

By a regulation of the Farm Credit Administration the maximum amount of any one person's obligations to a financing institution that may be discounted (or accepted as collateral for loans) by a credit bank is limited to 20 percent of the offering institution's paid-in and unimpaired capital and surplus in the case of crop production and general agricultural paper, or 50 percent of such institution's paid-in and unimpaired capital and surplus in the case of paper secured by staple agricultural commodities or livestock; except that these limits may be exceeded with the consent of the Intermediate Credit Commissioner (6 C. F. R. 43.6 (d)). Within those limits, the amount of a credit bank's discounts for and loans to any financing institution is determined by the bank.

Interest rates.—Under the statute the discount and interest rate to be charged by any credit bank is established from time to time by the bank with the approval of the Intermediate Credit Commissioner; and except with the approval of the Governor, the discount and interest rate may not exceed by more than 1 percent per annum the rate borne by the last preceding issue of the bank's debentures (12 U. S. C. 1051). The rate borne by the debentures, which may not exceed 6 percent per annum, is fixed by a committee of the presidents of the banks (or by the individual bank in the case of its individual issue of debentures), subject to approval by the Farm Credit Administration (12 U. S. C. 1042, 1044, 883–884). The last issue of debentures, which was a consolidated issue by all 12 credit banks, bore a rate of 1.30 percent, and the current discount and interest rate charged by the credit banks is 2 percent in 10 districts and 2¼ percent in the other 2, except that the rate in Puerto Rico is now 2½ percent. Special rates may be fixed

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from time to time in connection with the discounting of loans made under certain Commodity Credit Corporation loan programs in which earnings allowed to lending agencies are limited to a rate so low that they would be unable to rediscount the notes with the intermediate credit banks except at a loss. Only a relatively small amount of Commodity Credit Corporation paper has been discounted by the Federal intermediate credit banks in recent years.

The statute provides that a credit bank may not discount paper upon which the financing institution has charged the borrower a rate of interest exceeding the bank's discount rate by more than 1½ percent per annum, except with the approval of the Farm Credit Administration (12 U. S. C. 1052). The Farm Credit Administration, by regulation, has authorized the credit banks to accept paper bearing a rate of interest exceeding the bank's discount rate by not more than 4 percent per annum (6 C. F. R. 42.C).

Other terms.—Under the statute, discounts and loans by the credit banks must mature within 3 years (12 U. S. C. 1033). The regulations of the Farm Credit Administration provide that paper accepted for discount (or as collateral for loans) should generally mature at the usual time for marketing the crops or livestock from which liquidation of the paper is expected; and, with certain exceptions, the maturity of such paper is not to exceed one growing or marketing season, usually not more than 12 months (6 C. F. R. 42.4).

Under the statute, loans by the credit banks to production credit associations or to banks for cooperatives are to be secured by such collateral as may be approved by the Governor (12 U. S. C. 1031 (1)). The statute provides that a credit bank's loans to other financing institutions are to be secured by paper eligible for discount (12 U. S. C. 1031 (1)). Under regulations of the Farm Credit Administration, when discounted paper is in default, the credit bank may accept, in substitution, the financing institution's note secured by bonds or other collateral (6 C. F. R. 43.4); and the credit bank may make interim loans to a financing institution on its note secured by bonds or other collateral, to finance the institution's advances on paper to be submitted to the bank for discount or as collateral for loans (6 C. F. R. 43.5).

Within the stated limits, the credit banks determine the appropriate maturities of their discounts and loans, the acceptability of paper for discount, and the adequacy of collateral for loans.

Production credit corporations and associations

General.—The 12 production credit corporations do not make loans. They have the responsibility of organizing, capitalizing in part, and supervising the production credit associations. At present there are 503 production credit associations, of which 59 are wholly member owned.

The production credit associations make loans to their farmer members for general agricultural purposes (12 U. S. C. 1131g). The production credit associations obtain the major portion of their loan funds by rediscounting their loan paper with, and borrowing from, the Federal intermediate credit banks, and except with the approval of the Governor, they may not rediscount paper with or borrow from any other bank or agency (12 U. S. C. 1131h).

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The statute provides that loans by a production credit association are to be made under such rules and regulations as may be prescribed by the production credit corporation with the approval of the Governor; and that the terms and conditions, rates of interest, and security for an association's loans shall be such as may be prescribed by the production credit corporation (12 U. S. C. 1131g). The production credit corporations generally consult with the associations and with the Farm Credit Administration before rules and regulations are prescribed and approved.

Amounts of loans.—The aggregate amount of loans that a production credit association might make depends upon the amount of its capital and surplus, since the amount of loan funds it might obtain from the Federal intermediate credit bank is limited by the provisions of the credit bank statute (12 U. S. C. 1032) to a maximum of 10 times the associations' paid-in and unimpaired capital and surplus. In practice, the amount of loan funds that the several production credit associations obtain from the credit banks is less than the legal maximum, and generally ranges at the peak of the lending season from about four to seven times the capital and surplus of the various assotions depending upon the financial strength of the particular association and the character of its loans. The amount of an association's authorized capital is prescribed by the Governor (12 U. S. C. 1131d). Each association has two classes of capital stock. Class A (nonvoting) stock held by the Government through the production credit corporations, and which is also owned by farmers and others, and class B (voting) stock acquired by members in amounts equal to $5 for each $100 or fraction thereof of their loans.

A loan to any individual whose indebtedness to the association exceeds 20 percent of its capital and guaranty fund must be approved by the production credit corporation; and if his indebtedness exceeds 50 percent of its capital and guaranty fund, the loan must be approved by the Production Credit Commissioner of the Farm Credit Administration (12 U. S. C. 1131g).

Within the foregoing limits, the amount of any particular loan is determined by the association. Except for loans in excess of 20 percent of the association's capital and guaranty fund, and loans to official personnel for which special approval is required by regulation (6 C. F. R. 50.2 (f)), all loans are approved by the association at its own discretion.

Interest rates.—The rate of interest charged by a production credit association for loans is subject to regulation by the production credit corporation with the approval of the Governor (12 U. S. C. 1131g). Under the general regulation issued by the production credit corporations and approved by the Governor, the rate for various associations is fixed at between 3 and 4 percent above the current discount rate of the Federal intermediate credit bank (6 C. F. R. 50.4). At present, the discount rate of the credit banks is 2 percent in some districts and 2¼ percent in others (2½ percent in Puerto Rico); and the interest rate charged by the various associations ranges from 5 to 6 percent (except that two wholly member-owned associations have been specially authorized to charge 4½ and 4¾ percent respectively). Special arrangements are made on loans guaranteed by the Commodity Credit Corporation to permit the associations to handle paper at rates conforming to Commodity Credit Corporation loan programs.

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The maximum interest rate that associations may charge is also subject to limitation by the Farm Credit Administration, since a Federal intermediate credit bank may not discount paper which bears interest at a rate of more than 1½ percent in excess of the credit bank's discount rate, unless a greater spread is approved by the Farm Credit Administration (12 U. S. C. 1052). The Farm Credit Administration has authorized a spread of not more than 4 percent (6 C. F. R. 42.6).

Other terms.—The terms and conditions of association loans are subject to such rules and regulations as the production credit corporations may prescribe with the approval of the Governor (12 U. S. C. 1133g). Regulations as to security requirements and the maturity of loans have been prescribed in general terms, leaving a broad area of discretion in the associations. The regulations provide that loans may be secured or unsecured, but should not be made on the primary security of real estate (sec. 6, Rules and Regulations for Production Credit Associations). The associations determined what security will be required for any particular loan, and they generally take liens on crops, livestock, and equipment as security. The regulations provide further that loans should usually mature within 1 year (sec. 7, Rules and Regulations for Production Credit Associations). The associations determine the appropriate maturity of any particular loan, and usually fix the maturity at the expected time for marketing the crops or livestock from which repayment of the loan is anticipated, which is ordinarily within 1 year. Loans are generally disbursed in installments as needed by the member and repaid when the products financed are sold. Evidence of ability to repay the loan through normal production sources is a prime factor in approving a loan application.

Banks for cooperatives

General.—The 12 district banks for cooperatives and the Central Bank for Cooperatives are authorized to make loans to cooperative associations of farmers engaged in marketing agricultural products, purchasing farm supplies, and furnishing farm business services, for the purposes of financing the effective merchandising of agricultural commodities, the operations of the associations, and the construction or acquisition of physical facilities (12 U. S. C. 1134c, 1134j, 1141c).

The 13 banks for cooperatives are also authorized to make loans to and discount paper for one another, to participate in each other's loans, and to borrow from and rediscount paper with the Federal intermediate credit banks or commercial banks (12 U. C. 1134c, 1134i).

The Governor of the Farm Credit Administration is authorized to prescribe the division of lending authority between the district banks for cooperatives and the central bank on the bases of classes of borrowers and amounts of loans (12 U. S. C. 1134j). In general, local cooperative associations are served by the district banks while cooperative associations of national or broad regional scope extending over several districts are served by the central bank; and the central bank participates with the district banks in loans which are in excess of the maximum fixed for the district bank loans.

The Farm Credit Administration is authorized to prescribe the terms and conditions under which loans may be made by the banks for cooperatives (12 U. S. C. 1134c, 1134j, 1141f (c)). The Farm

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Credit Administration generally consults with the banks for cooperatives before prescribing general loan policies.

The lending operations of the central bank are under the control of the cooperative bank commissioner who is, ex officio, the executive officer, as well as the chairman of the board, of the central bank (12 U. S. C. 1134g, 1134h).

Amounts of loans.—There is no legal limit on the aggregate amount of loans that may be made by a bank for cooperatives, but that amount is limited in practical effect by the bank's financial resources.

The Governor is authorized to prescribe limitations on the amount of loans which may be made to individual borrowers (12 U. S. C. 1134j). The regulation prescribed by the Governor provides that except with the written approval of the cooperative bank commissioner, loans by a district bank to any one borrower may not exceed the following percentages of the bank's combined capital, surplus, and reserves: facility loans, 10 percent; operating capital loans, 15 percent; commodity loans (excluding loans on Commodity Credit Corporation loan documents), 25 percent; the sum of facility and operating capital loans, 15 percent; the sum of facility, operating capital, and commodity loans, 25 percent (6 C. F. R. 71.1).

When a loan by a district bank would exceed those amounts, the district bank will request the central bank to participate in the loan for the excess amount; or, with the approval of the cooperative bank commissioner, another district bank may participate in the loan (6 C. F. R. 71.2). Such participations are also frequently arranged for loans by a district bank that do not exceed the prescribed limits.

There is no fixed limit on the amount of the central bank's loans to any one borrower, except as noted below, but in actual practice the central bank follows substantially the same limitations as the district banks.

Loans by the banks for cooperatives for the construction or acquisition of physical facilities are limited by statute to not more than 60 percent of the appraised value of the security therefor (12 U. S. C. 1141e (c)). By regulation of the Farm Credit Administration, commodity loans are limited to not more than 65 percent of the value of unhedged commodities or 85 percent of the value of hedged commodities. As a general rule, facility loans are not made in excess of 50 percent of the value of the security.

Within the foregoing limits, the banks for cooperatives determine the amount of any particular loan.

Interest rates.—The Governor is authorized to prescribe the rates of interest on loans by each bank for cooperatives, subject to the following statutory directions: The rate of interest shall not exceed 6 percent in any case; the rate of interest on operating capital loans shall conform as nearly as may be practicable to a rate of 1 percent in excess of the prevailing interest rate paid by production credit associations to the Federal intermediate credit banks; the rate of interest on commodity loans shall conform as nearly as may be practicable to the prevailing interest rate charged by the Federal intermediate credit bank on commodity loans; and the rate of interest on facility loans shall conform as nearly as may be practicable to the prevailing rate on

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Federal land-bank loans made to members of national farm-loan associations (12 U. S. C. 1141f (a)).

The present rates of interest charged by the banks for cooperatives are as follows: $2\frac{1}{4}$ percent on commodity loans except in one district where the rate is $2\frac{1}{2}$ percent; 3 percent on operating capital loans; and 4 percent on facility loans. (For loans in Puerto Rico, the rates are respectively, $2\frac{3}{4}$, $3\frac{1}{2}$, and $4\frac{1}{2}$ percent.)

Other terms.—Facility loans are required by statute to be repaid over a period of not more than 20 years (12 U. S. C. 1141e (d)). In actual practice, these loans are made for a period not in excess of 10 years. No loan for the purchase or lease of facilities is to be made unless it is determined that the purchase price or rent to be paid is reasonable (12 U. S. C. 1141e (c)). The authority to make this determination, placed in the Governor by the statute, has been delegated by him to the several banks.

The regulations of the Farm Credit Administration provide that commodity loans are to be secured by a first lien on farm products or farm supplies approved by the cooperative bank commissioner, of sufficient value to afford an adequate margin of security without other collateral (6 C. F. R. 70.2); and the commissioner has prescribed a list of the classes of commodities acceptable as security for such loans (6 C. F. R. 70.3). The regulations also provide that commodity loans are to mature within the normal marketing period of the commodities securing the loan (6 C. F. R. 70.2).

Under the regulations of the Farm Credit Administration, operating capital loans can be made with or without security of any kind, and are to mature within 3 years.

Subject to the stated limitations, the banks for cooperatives determine the adequacy of the security and the appropriate maturity for their loans.

5. What principles govern the determination of the interest rates charged by the farm credit agencies under your jurisdiction?

Federal land banks

Funds needed by the Federal land banks for making their loans are obtained by the issuance and sale of consolidated Federal farm loan bonds. These bonds are not guaranteed in any way by the United States Government, but are the joint and several obligation of the 12 Federal land banks and are collateralized by the notes and mortgages belonging to the Federal land banks. These notes and mortgages in turn are secured by the farms of the individual borrowers from the banks. The consolidated Federal farm loan bonds are sold to the investing public at rates and terms consistent with money market conditions and the long-term needs of the Federal land banks. In addition to and consistent with applicable statutory provisions, the interest rate policy of the Federal land bank system provides that the rates paid by borrowers shall be sufficient to cover the cost of funds used in its lending operations, the operating expenses of the Federal land banks and national farm loan associations, and adequate provision for reserves in the Federal land banks and national farm loan associations. Since the land banks comprise a cooperative system, earnings in excess of all such fundamental costs constitute savings and may be returned as dividends to the members of the system.

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Federal intermediate credit banks

It has been the consistent policy of the Farm Credit Administration that the Federal intermediate credit banks are to maintain such lending rates as are necessary to cover the cost of borrowed money, other necessary operating expenses (including the cost of supervision and examination by the Farm Credit Administration, and annual audits of the General Accounting Office), and a reasonable margin of net income to build reserves for losses and other contingencies and to strengthen the capital structure of the banks.

Production credit system

The law requires that the rate of interest charged on loans made by a production credit association will be prescribed by the production credit corporation of the district. This rate covers the interest paid by the association to the Federal intermediate credit bank of the district for loanable funds, plus a spread for the association which, together with the income derived from its investments and from loan service fees, should provide the funds necessary to pay its operating expenses, cover any losses on loans, and build necessary reserves.

Until about 2 years ago, this spread was fixed uniformly at 3 percent per annum over the discount rate of the Federal intermediate credit bank of the district. A considerable number of associations, after careful study of their needs for income by their local boards of directors, and on consultation with their member borrowers, determined that it was necessary to increase their interest spread. Accordingly, after consideration of the needs of the associations for income based on operating experience over a period of many years the rules and regulations were changed in 1947 to provide that:

> The interest rate charged the borrowers shall be the rate prescribed by the corporation, which shall be not less than 3 percent per annum nor more than 4 percent per annum above the discount rate of the Federal intermediate-credit bank at the time the loan or advance is made, unless a lower or a higher rate is prescribed by the corporation with the approval of the Production Credit Commissioner.

As of June 30, 1949, the discount rate charged the associations by the Federal intermediate-credit banks varied from 2 to 2¼ percent (2½ percent in Puerto Rico), and more than half of the associations had increased their interest spread above the former standard of 3 percent per annum, but not in excess of 4 percent. These changes in interest spread enable the associations affected to increase their net earnings in order to build reserves faster, in order to be better prepared for future contingencies, to handle an increasing volume of credit, and to accelerate the repayment of Government capital.

Banks for cooperatives

The funds loaned by the banks for cooperatives consist of their capital and funds borrowed from the Federal intermediate-credit banks and commercial banks.

The interest rates on the three types of loans made by the banks for cooperatives are, under the law, based on "the needs of the lending agencies" and the requirements that they must be related to certain types of loans made by the Federal intermediate-credit banks and the Federal land banks. In applying these standards, the Farm Credit Administration has followed a consistent policy of endeavoring to

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establish rates which will cover the cost of money to the lending institutions and pay all operating costs, including provision for such reserves as are necessary to keep the banks in a sound financial position. The corporations under the supervision of the Farm Credit Administration are also assessed for the cost of supervision and examination which are provided by the Washington office of the Farm Credit Administration. These amounts are considered as part of the operating costs which have been mentioned.

6. What policies of the Federal farm-credit agencies (interest rates, amounts of loan, bases for valuing property, etc.) tend toward the maintenance of general economic stability and stable general price levels, and what policies may tend toward instability?

As stated in the answer to question No. 1, one of the principal objectives of the lending institutions comprising the farm-credit system is to provide a permanent and dependable source of credit for agriculture on a sound basis, at the lowest cost consistent with maintaining the lending institutions in a strong financial position, and upon terms and conditions adapted to the needs of farmers and farmers' cooperatives. The fact that these lending institutions are continuously offering sound credit service in their respective fields at minimum cost consistent with the establishment of adequate reserves is an important stabilizing influence in agriculture. Sound lending policies, as followed by the institutions under the supervision of the Farm Credit Administration, discourage inflation during periods of rising prices and provide for the maximum financial assistance to farmers and farmers' cooperatives that appears to be within their ability to repay on appropriate terms from income during periods of declining prices. The benefits of these lending policies and practices accrue not only to those farmers and farmers' cooperative associations financed directly by these institutions but extend to others as well, since the standards set by the Farm Credit Administration have had a far-reaching influence upon the terms of loans granted by other lenders.

The coordination of lending policies through the district boards of directors and through the central office is also a factor contributing toward stability of the agricultural economy.

An important element in the operations of the farm-credit system, which contributes materially to the economic stability of agriculture, is the policy of maintaining a favorable market for securities issued by the institutions of the system. The Federal land banks obtain the major portion of their loanable funds through the issuance and sale of consolidated Federal farm-loan bonds; the Federal intermediate-credit banks finance their lending operations principally through the issuance of consolidated collateral trust debentures; and the Central Bank for Cooperatives is authorized to issue and sell debentures. The United States Government assumes no liability for these obligations, either as to principal or interest. The banks of the system, having established their position in the public money markets, have access to the large reservoirs of funds in financial centers, thereby providing agriculture with a high degree of assurance of a constant ample supply of funds to meet all reasonable needs.

Another element of stability provided by the Farm Credit institutions is their supervision and training program. The operating personnel throughout the entire system are trained in the fundamental

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principles of sound credit and are, therefore, in a position to discuss with the farmer his own financial situation and work out with him a credit program that is likely to be successful to both the member and the lending institution.

In the case of the Federal land banks, the appraisal and loan servicing policies are especially important as stabilizing influences. It is the policy of the Farm Credit Administration to appraise farms offered as security for land-bank loans on the basis of normal agricultural value. This has resulted in valuing some properties above the market value during the early 1930's when the market was extremely depressed and considerably below the market during the inflated period of the war and postwar years. In this manner, considerable support was given to land values during the depression by extending credit courageously. On the other hand, credit is not extended on farm-mortgage security at any time beyond an amount that is justified on the basis of the normal net income from the farm.

The loan-servicing policy of the Federal land-bank system is to offer every assistance available to all worthy borrowers, so they may have every reasonable opportunity to maintain their loans in a satisfactory status and retire the indebtedness against their land. A borrower shall be considered worthy and his mortgage shall not be foreclosed if he (1) is doing his honest best; (2) is applying the proceeds of production, over and above necessary living and operating expenses, to the payment of primary obligations; (3) is taking proper care of the property; and (4) has the capacity to work his way out of a reasonable burden of debt under normal conditions. Loans may be extended, deferred, reamortized, or placed on a variable or suspended payment plan if, from the circumstances in a given case, it appears that the assistance provided by such forebearance treatments is justified and will enable the borrower ultimately to retire his indebtedness.

The same general philosophy applies to loan servicing in all of the lending units of the Farm Credit Administration.

Another stabilizing factor in the operations of the Federal land banks is the use of long-term amortized loans. Annual or semiannual installments are kept within limits which can be met under normal conditions. Also, farmers are encouraged to make advance payments, through the use of the future-payment fund, during years of high farm income, which can be applied during years of low farm income.

The policies followed by the production-credit system contribute to the stability of the agricultural economy. In making loans, the production-credit association emphasizes the repayment ability of the farmer rather than collateral as the principal element of soundness. It is the policy of the production-credit system to analyze carefully applications for loans and, before approving them, determine that the funds are to be used for sound purposes and that they will assist the borrower to produce and market his products in an orderly fashion. The Farm Credit Administration considers it a disservice to permit a farmer to saddle himself with a debt which may require a sell-out of the business to repay, even though he may have sufficient collateral security to make the loan safe for the lender.

Production-credit loans are generally made to mature within 1 year. Advances to meet expenses of a current or annually recurring nature are expected to be repaid from the current year's income. Renewal of a portion of some types of loans, such as those for the purchase of

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heavy machinery and other items of a semicapital nature or those involving the refinancing of debts, are frequently anticipated at the time the loans are made. If at maturity the credit factors remain satisfactory, no difficulty is experienced by either the member or the association in arranging for the renewal. This policy permits spreading the repayment of capital loans over more than 1 year if necessary, thereby gearing repayment to the earning capacity of the farm or ranch business. Associations encourage members to pay debts as rapidly as is consistent with sound business operations and to use surplus cash to buy Government bonds or otherwise to strengthen the financial position of their business. They also encourage farmers to finance their entire business with one lender, thus permitting a better analysis of his business and eliminating the risk of having some part of his chattels foreclosed and sold.

Budgeted loans are set up so that the money is advanced to the individual as it is needed throughout the year and repaid as products financed are sold, thus helping him to prevent overborrowing and gearing his loan to his ability to repay. Interest is paid only for the number of days that the money is actually used by the borrower.

The banks for cooperatives are instrumental in strengthening farmers' marketing, purchasing, and servicing cooperatives. Farmers' cooperatives themselves contribute to orderly marketing and operate as competitive pacemakers in their respective fields, and thus are an influence which tends toward general economic stability.

None of the policies of the Farm Credit Administration or of the corporations or associations under their supervision contribute toward instability of the general economy or of the general price level.

7. To what extent and by what means are the policies of the Federal farm-credit agencies coordinated with the general monetary and credit policies of the Federal Reserve and the Treasury?

The Farm Credit Administration consults with the Treasury prior to the issuance of any bonds, debentures, or other similar obligations by institutions under its supervision. These consultations with the Treasury embrace the timing of the security offering, the amount involved, and the proposed prices, interest rates, and maturities. The Treasury is also consulted by the Farm Credit Administration prior to the consummation of transactions in Government securities to be effected in the market on behalf of such institutions. The latter consultations cover the issues involved, amount, timing of the transactions, and the proposed prices. In practice, the Fiscal Assistant Secretary of the Treasury is consulted with respect to the issuance of securities, and an official of the Federal Reserve Bank of New York with respect to market transactions in Government securities.

The foregoing procedures are consistent with the Government Corporation Control Act (Public Law 248, 79th Cong., approved December 6, 1945), and the directions of the Secretary of the Treasury issued thereunder, with respect to Farm Credit Administration institutions which are partly or entirely owned by the Government. However, similar procedures were followed by the Farm Credit Administration for many years prior to the passage of the act in question and have continued to be followed in cases which are not covered by the act. For instance, all Government capital interest in the Federal land banks has been retired, but financing programs and security

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transactions by these banks are discussed in advance with the Treasury and the Federal Reserve Bank of New York.

In cases where proposed offerings of securities or transactions in Government securities, on behalf of Farm Credit institutions, would have conflicted with financing transactions or policies of the Treasury or the Federal Reserve System, the offerings or transactions on behalf of the Farm Credit institutions have been rearranged to avoid such conflict.

8. In what ways, if at all, does the Federal Government subsidize the Federal farm-credit agencies? If possible, estimate the annual amount of these subsidies.

The assistance of the Federal Government to credit agencies supervised by the Farm Credit Administration, as represented by its current investment in the capital of these agencies, is as follows:

Wholly Government-owned corporations:	
Federal Farm Mortgage Corporation (capital stock)	[1] $10,000
Federal intermediate-credit banks (capital stock) and paid-in surplus	[2] 60,500,000
Production-credit corporations (capital stock)	[3] 46,235,000
Mixed-ownership corporations: Banks for cooperatives (capital stock)	178,500,000
Total	285,245,000

[1] Dividends of $68,000,000 have been paid to the United States Treasury, leaving a balance of earned surplus of $62,661,031 as of June 30, 1949.

[2] Franchise taxes (dividends) of $7,619,521 have been paid to the United States Treasury, leaving a balance of earned surplus, including reserve for contingencies, of $36,089,216 as of June 30, 1949.

[3] Earned surplus of $17,140,663 as of June 30, 1949.

Although the Government is assisting various institutions of the Farm Credit Administration (except the Federal land-bank system) by furnishing all or part of their capital funds and has accorded to them certain tax exemptions, it receives certain returns which, although not directly related thereto, have the effect of reducing materially the cost incurred in furnishing capital and the loss of revenue growing out of tax exemptions. To June 30, 1949, the Federal Farm Mortgage Corporation has paid to the Treasury $68,000,000 in dividends and the Federal intermediate-credit banks have paid franchise taxes aggregating $7,619,521. Moreover, all accumulated earnings of the wholly owned Government corporations accrue to the Government, thereby increasing its equity in the institutions. At June 30, 1949, the earned surplus of the Federal Farm Mortgage Corporation amounted to $62,661,031; the surplus and reserves of the Federal intermediate-credit banks aggregated $36,089,216; and those of the production-credit corporations amounted to $17,140,663.

In addition to these investments, the following amount is available, if need therefor should arise, for capital subscription from revolving funds held by the United States Treasury, all of which are in a stand-by status: Federal Farm Mortgage Corporation, $199,990,000. (The Board of Directors has voted to recommend the return of this amount to the general funds of the Treasury.)

There is also a revolving fund of $125,000,000 in the Treasury in a stand-by status available for subscription to the capital stock of the Federal land banks. The Federal land banks and national farm loan associations are in a greatly strengthened net-worth position. Experience has demonstrated there are numerous steps the banks can

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take to effectively meet operating problems which are limited to individual districts, including interbank assistance. Therefore, the banks consider they have sufficient resources, financial and otherwise, to enable them to carry their worthy members and prospective members through any periods of distress except perhaps an economic emergency of a Nation-wide character. In the event of such an emergency and should the banks be called upon to again finance outstanding farm mortgage debt to the extent of overtaxing their own resources, these funds would be available to be resubscribed in the banks if considered advisable in the public interest.

All expenses of the credit agencies supervised by Farm Credit Administration (including assessments for supervisory and examination expense of the Farm Credit Administration and the expense of audits made by the General Accounting Office) are paid by them from their income and not from appropriated funds. These assessments do not include any charge for office space occupied by the Washington office of the Farm Credit Administration in the Government-owned South Building, or for general services rendered by the Department of Agriculture to its bureaus and agencies.

No contributions are required to be made to the civil-service retirement fund, nor to the Federal Employees' Compensation Commission, by the agencies whose employees are eligible for benefits; the employer's portion is included in the over-all calculation of the amount to be paid into the fund by the Federal Government. The employees eligible for these benefits are those of the Federal land banks, Federal intermediate credit banks, production credit corporations, and banks for cooperatives. Employees of the national farm loan associations and production credit associations are not covered by either the Social Security Act or Civil Service Retirement Act; the associations in each district, however, have developed or are developing a retirement plan for their employees.

Tax exemption of farm credit agencies

The Federal land banks, national farm loan associations, and Federal intermediate credit banks are exempt from Federal and State taxation except upon real estate held by them (12 U. S. C. 931, 1111). Similarly, the banks for cooperatives, production credit corporations, and production credit associations, while they have Government capital, are exempt from Federal and State taxation except upon their real property and tangible personal property; but they become subject to Federal and State taxation whenever all their Government capital is retired (12 U. S. C. 1138c). Of the 503 production credit associations, 59 have now retired all their Government capital and pay Federal and State taxes levied generally on similar private corporations.

The Federal taxes from which the exempt farm credit agencies are immune include: principally the income tax on corporations (26 U. S. C., ch. 1); the stamp taxes on the issue and transfer of corporate securities and on conveyances of realty (26 U. S. C., chs. 11 and 31), but the tax on conveyances would be payable by the other party to the transaction; and excise taxes on the rental of safe deposit boxes (26 U. S. C., ch. 12) and on transportation and communications (26 U. S. C., ch. 30).

As already indicated, the 59 production credit associations that have retired all their Government capital pay all of these Federal

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taxes. Further, the Federal excise taxes payable by manufacturers or vendors of various articles, such as automobiles, tires and tubes, gasoline, lubricating oils, electrical energy, air-conditioners, fans, business machines, rubber articles, etc. (26 U. S. C., ch. 29), are applicable to such articles purchased by any of the farm credit units and are included in the price paid by them for such articles.

All of the farm credit agencies are subject to State and local taxes on their real property. The banks for cooperatives, production credit corporations, and production credit associations are also subject to State and local taxes on their tangible personal property. The tax-exempt farm credit agencies are immune from other State taxes on corporations. These other taxes vary widely among the States, but are levied most commonly on the income of corporations or on their intangible property or both. The 59 production credit associations that have retired all their Government capital pay such State taxes.

The States commonly impose various excise taxes such as those on sales generaly, on gasoline, on various legal documents, etc. The tax-exempt farm credit agencies do not pay such excise taxes on their purchases where the tax is levied on the purchaser; but where such taxes are levied on the vendor, the purchases of all the farm credit agencies are subject to the tax, which is included in the purchase price paid by them. Similarly, excise taxes on legal documents are not paid by the tax-exempt farm credit agencies, but in some instances the other party to the transaction is required to pay the tax.

> 9. Do you favor adoption of the Hoover Commission recommendation that the Federal intermediate credit banks, the banks for cooperatives, and the production credit corporations should be consolidated, and that the merged system should adopt the principle of mutualization? Please give reasons for your answers.

We do not favor the adoption of the above recommendation on consolidation. We favor the principle of mutualization wherever feasible and as rapidly as it can be done and at the same time provide credit at reasonable interest rates. As yet we have been unable to work out a practical plan for farmer-borrowers to acquire ownership of the Federal intermediate credit banks and the production credit corporations.

By reason of the differences in the organizational and financial set-up of the several types of institutions mentioned, including the investments by farmers' cooperatives in capital stock of the banks for cooperatives, and the distinctive character of the several functions of the different institutions, there appears to be no feasible basis upon which these banks and corporations might be consolidated on a mutualization basis.

The Federal intermediate credit banks engage principally in the discounting of seasonal production paper offered to them by and with the endorsement of various types of local lending institutions, including production credit associations, privately capitalized agricultural and livestock credit corporations, and commercial banks. The banks for cooperatives specialize in loans to farmers' cooperative associations. The production credit corporations do not engage in any form of lending, but organize, supervise, and assist in capitalizing a Nation-wide system of local cooperative production credit associations.

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The sources from which these several institutions obtain their capital also differ. The Federal intermediate credit banks and production credit corporations are wholly owned by the Government. The banks for cooperatives are capitalized in part through stock ownership of borrowing cooperative associations and in part by funds provided by the Government. Although the production credit corporations furnished most of the initial capital of the production credit associations, these associations are making rapid progress in retiring Government capital. Of the 503 production credit associations, 59 are now wholly owned by their members and (as indicated under question 1) it is the goal of all the associations to become wholly owned by farmers as soon as feasible.

The Federal intermediate credit banks were not established for the sole purpose of serving production credit associations. Their facilities are utilized by the various types of local financing institutions and cooperative associations. As of June 30, 1949, there were 80 agricultural and livestock credit corporations and 3 commercial banks rediscounting with the Federal intermediate credit banks. If the credit banks were to assume responsibility for the supervision of the production credit associations, that phase of their operation would be in direct competition with the other eligible financing institutions which utilize the discount facilities of the banks.

The consolidation of the functions of the Federal intermediate credit banks and the production credit corporations would present serious problems. As stated, the intermediate credit banks are banks of discount. Since they obtain their lending funds primarily through the sale of non-Government-guaranteed debentures in the investment markets and by borrowings from commercial banks, it is essential that paper offered to them for discount be analyzed objectively from an independent viewpoint without concurrent responsibility for supervising the management of the local lending institutions offering the paper for discount. In this respect the operations of the credit banks are similar to the discounting function of the Federal Reserve banks. The separation of the discounting and supervising functions has long been recognized in the commercial banking structure where the Federal Reserve banks discount paper for commercial banks which, however, are supervised by the Comptroller of the Currency or by State banking authorities. To inject the intermediate credit banks into the operations of the production credit associations through the medium of supervision would be inconsistent with their primary functions.

There are in each district four separate and distinct corporations, whose activities are coordinated or correlated through a common board of directors, the district Farm Credit board. The members of the district Farm Credit board are, ex officio, the directors of the four separate corporations in each district. Through such common directorates, responsible for the affairs of all four institutions, there is opportunuity for consistent policies and practices and for maximum utilization of personnel and facilities.

10. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

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The Hoover Commission, on page 48 of the Report on Federal Business Enterprises, made the following statement:

> We recommended in our report on the Treasury Department that a National Monetary and Credit Council should be appointed by the President to coordinate and direct domestic lending and guaranties by the Government. There is already a successful council concerned with foreign lending. This domestic Credit Council should be located in the Treasury Department under the chairmanship of the Secretary of the Treasury, with representatives of such agencies as the President may determine. This Council should consider the activities of agencies in the credit field so as to secure coordination of purpose, and to avoid overlapping activities and inconsistent credit policies.

On the other hand, the Hoover Commission in its report on the Treasury Department, recommendation No. 9, made the following recommendation:

> We recommend that there be established a National Monetary and Credit Council of domestic financial agencies in connection with the Treasury to advise on policies and coordination of the operations of domestic lending and Government financial guaranties.

The recommendation in the Treasury Department report would seem to limit the National Monetary and Credit Council to an advisory capacity, while the statement in the Report on Federal Business Enterprises indicates that the Council would "coordinate and direct domestic lending and guaranties by the Government" and that "this Council should consider the activities of agencies in the credit field so as to secure coordination of purpose, and to avoid overlapping activities and inconsistent credit policies." We are assuming that the purpose such a council would serve is that stated in the report on the Treasury Department. If this assumption is correct, we have no objection to the recommendation. As to the composition of such a council, we would like to limit our suggestion to the statement that at least one of the members of the Council should represent the interests of the cooperative lending institutions of the Farm Credit Administration.

> 11. What changes, if any, in the organization and administration of the various Federal Farm Credit agencies and in their relationships to each other would you recommend to increase their efficiency and their effectiveness in achieving the objectives listed in (1) above?

As has been indicated in answers to the other questions, the institutions supervised by the Farm Credit Administration were established by the Congress over a period of years to provide permanent and dependable credit facilities for farmers and their cooperative organizations. Under existing provisions of law, the relationships of the Farm Credit organizations in the districts have been made more effective by having the members of the Farm Credit board serve as ex officio members of the boards of directors of the individual banks and corporations than would have been possible with boards composed of different individuals. The national phases of the policies and procedures of the several systems have been correlated through the supervisory functions of the Washington office of the Farm Credit Administration.

Since its creation the Farm Credit Administration and the institutions under its supervision have kept clearly in mind the purposes and objectives for which they were established, and have consistently endeavored to make their services more effective and more fitting for

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the peculiar needs of those engaged in agriculture. On the basis of the experience gained in administering these credit systems and in view of changing conditions, the Farm Credit Administration has made a continuous study of procedures and operations and of the changes that are necessary to accomplish the purposes and objectives to the fullest extent. As a result of the foregoing studies, changes have been made which led to improved services, better coordination, and more economical operations, and which did not require legislation. An outstanding example of this type of change is the decentralization of responsibilities, authorities, and functions to the district institutions and local associations. Other changes have been made through necessary legislation as indicated by the number and frequency of amendments that have been made to the laws governing our operations upon the recommendation of the Farm Credit Administration, and by similar recommendations now pending before the Congress, for the purpose of improving operations and rendering maximum service to farmers and their cooperative organizations. As an example of this, H. R. 3699, now pending in Congress, was recommended and sponsored by the Department of Agriculture and the Farm Credit Administration to bring about certain economies in operations and to provide greater service to those who use the Federal land bank system. Another bill which is also pending in the Congress, H. R. 848, contains provisions which we favor and which, if enacted, would enable the 13 banks for cooperatives to render greater service and to become eventually owned by the cooperative associations which borrow from them. Both types of actions, those requiring legislation and those not requiring legislation, have been worked out with the district Farm Credit boards and officials.

The committee will be interested in the opinions of disinterested bodies who have studied from an objective point of view these systems supervised by the Farm Credit Administration. The following is quoted from the Task Force Report on Agriculture Activities (appendix M) Prepared for the Commission on Organization of the Executive Branch of the Government, January 1949, page 62:

> Cooperative credit for American farmers was established in 1917 with the passage of the Federal Farm Loan Act. Subsequent legislation has resulted in a well-rounded credit system providing both long- and short-term credit to agricultural producers and their cooperatives. While the Congress provided temporary capitalization of the lending agencies, the loanable funds are provided through the sale of bonds and debentures to the investing public. These agencies are rapidly becoming borrower-owned and controlled with Government capital being returned to the Treasury, and with substantial administrative authority being delegated to locally elected association farmer boards of directors. The record of the cooperative credit system through the years is impressive, not only because of the direct service rendered to borrowers, but because of its general pace-setting value as well. It has operated at low cost, with as much control delegated to borrowers as was compatible with sound lending practice. The system has not only set the pace from a cost standpoint, but originated types of special services to borrowers in times of acute distress when private lending agencies were faced with greatly curtailed lending operations. That the interest of the general public was furthered through the distressed decade from 1931 to 1940 would appear to be beyond question.

The following statement is quoted from page 13 of the Comptroller General's Report on Audits of Corporations of the Farm Credit Administration, 1946 (80th Cong. 2d sess., H. Doc. No. 598):

> In our opinion the Farm Credit Administration and the corporations supervised by it have been well managed and effectively operated and have been no-

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tably successful in the credit fields in which they operate. This may be attributed largely to the high degree of autonomy enjoyed in practice by the management of the Farm Credit Administration. Credit for that success is due also to the aggressiveness and resourcefulness of a career-management group who have developed, guided, and operated the Farm Credit Administration and the corporations, and to the perpetuation of that group through continuous development of competent leaders within the system.

We do not see any major changes which appear to be feasible at the present time other than those proposed in pending legislation, upon which we have reported favorably. We shall, of course, continue our studies of the organization. As the need for changes arises we shall make them if within our authority, and if not we shall submit recommendations through appropriate channels.

Appendix to Chapter VIII

August 1949.

QUESTIONNAIRE ADDRESSED TO THE FARM CREDIT ADMINISTRATION

1. What do you consider to be the major purposes and objectives of the Farm Credit Administration and of the farm credit agencies under its jurisdiction?
2. Do you believe that the farm credit agencies under your jurisdiction should operate continuously or that they should operate only in emergency periods? If you favor their continuous operation, what are your principal reasons for this?
3. What, if any, are the gaps or inadequacies in the private financial system that justify the operation of the farm credit agencies that are under your jurisdiction?
4. What degree of control over the amounts, interest rates, and other terms of loans by the farm credit agencies under your jurisdiction is exercised by the Farm Credit Administration in Washington? By the authorities in the 12 district offices? By the national farm loan associations and the production credit associations?
5. What principles govern the determination of the interest rates charged by the farm credit agencies under your jurisdiction?
6. What policies of the Federal farm credit agencies (interest rates, amounts of loans, bases for valuing property, etc.) tend toward the maintenance of general economic stability and stable general price levels, and what policies may tend toward instability?
7. To what extent and by what means are the policies of the Federal farm credit agencies coordinated with the general monetary and credit policies of the Federal Reserve and the Treasury?
8. In what ways, if at all, does the Federal Government subsidize the Federal farm credit agencies? If possible, estimate the annual amount of these subsidies.
9. Do you favor adoption of the Hoover Commission recommendations that the Federal intermediate credit banks, the banks for cooperatives, and the production credit corporations should be consolidated, and that the merged system should adopt the principle of mutualization? Please give reasons for your answer.

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10. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, do you favor the establishment of such a body? If so, what should be its composition?

11. What changes, if any, in the organization and administration of the various Federal farm credit agencies and in their relationships to each other would you recommend to increase their efficiency and their effectiveness in achieving the objectives listed in (1) above?

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CHAPTER IX

REPLY BY FRANK PACE, JR., DIRECTOR, BUREAU OF THE BUDGET, EXECUTIVE OFFICE OF THE PRESIDENT

MY DEAR SENATOR DOUGLAS: In your letter of August 22, 1949, you have asked for the Bureau's views on nine major questions of monetary, credit, and fiscal policy which are currently being studied by a subcommittee of the Joint Committee on the Economic Report under your chairmanship.

Answers to six of these questions are enclosed. The other three questions raise organizational issues which are currently under study by the Bureau and on which, therefore, formal reply would be premature. However, I would be very glad to discuss these issues informally with you whenever convenient, and members of my staff are available to discuss them with any members of your staff whom you may designate.

Sincerely yours,

FRANK PACE, JR., *Director*.

ANSWERS TO QUESTIONNAIRE ADDRESSED TO THE DIRECTOR OF THE BUREAU OF THE BUDGET BY THE JOINT COMMITTEE ON THE ECONOMIC REPORT

2. What role has the Bureau of the Budget played in coordinating the policies of the various Federal agencies that supervise and examine commercial banks? What are the principal obstacles to successful coordination of the actions and policies of these agencies?

The Bureau of the Budget has played a relatively minor role in coordinating the policies of the Federal bank supervisory agencies. During the last decade few serious problems have arisen in this area. Furthermore, direct cooperative action by the agencies has often not required participation by this office. The normal coordination incident to review of agency budgets has not been possible because such budgets are not currently reviewed by the Bureau and the Congress. The Bureau, however, has helped to promote more effective coordination in several ways:

(*a*) As part of the normal process of legislative clearance, the Bureau has regularly referred draft legislation affecting bank supervision and proposed agency reports on such legislation to the various agencies with the objective of developing, wherever feasible, a unified administration position.

(*b*) The Bureau participates in the planning and appraisal of statistical programs of joint concern to the supervising agencies. It has established an interagency committee to deal with problems of banking statistics. One of the committee's achievements has been an

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agreement on a single set of statistics covering all banks in the United States (including those outside Federal supervision) to replace three series previously prepared independently by the agencies.

(*c*) From time to time the Bureau has made studies of the organizational problems of these and related agencies. Staff advice on these topics was provided at the request of the Commission on Organization of the Executive Branch of the Government.

(*d*) The Bureau reviews the administrative expense limitations proposed by the FDIC and sets personnel ceilings for the FDIC and the Comptroller of the Currency.

(*e*) The Bureau recently made a comparative study of examination programs of the three agencies and of the Home Loan Bank Board, and is currently engaged in reviewing the findings with the agencies involved.

(*f*) From time to time the Bureau refers policy problems affecting bank supervision to other agencies in the Executive Office of the President for assistance in review and coordination.

One of the problems involved in securing more complete coordination by either the President or the Congress is the autonomy of the agencies concerned. An additional element of autonomy in the case of the Federal Reserve System is that each of the 12 Reserve banks in practice operates largely as an independent bank supervisory unit with only minor review by the Board.

Other problems of coordination arise from:

(*a*) The divergent major functions and the varying types of banks supervised by the three agencies.

(*b*) Need for cooperation with the 48 State bank supervisors. Many supervisory policies affecting federally insured State banks can be implemented best by joint action.

(*c*) The confidentiality of the basic data. This makes it difficult to appraise the seriousness of existing problems and the effectiveness of the execution of policies to meet such problems.

> 4. What role has the Bureau of the Budget played in coordinating the monetary, credit, and debt-management policies of the Federal Reserve and the Treasury?

The Bureau has not devoted any major efforts to coordination in this area, because of the continuing close relationship between the two agencies and because budgetary issues have not usually been involved. However, the Bureau has played an increasing role in its legislative clearance process in referring legislation and reports on these and related topics to the two agencies. Unresolved policy questions have also occasionally been referred to the Council of Economic Advisers and to the President or his immediate staff.

> 5. Have the policies of the Government agencies that lend and insure loans been satisfactorily coordinated with each other and with general monetary and credit policies? If not, what have been the major deficiencies?

Federal loan and loan-insurance programs fall largely into four major groups, corresponding to the broader Government programs of which they are a part. The major facts in each area are summarized in the following paragraphs:

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(*a*) *Farm credit.*—The main programs are those administered by the Farm Credit Administration, the Farmers Home Administration, and the Rural Electrification Administration. In addition, the Commodity Credit Corporation makes and guarantees short-term loans as an adjunct of its price-support operations, and the Administrator of Veterans' Affairs guarantees farm loans to veterans. With the exception of the last-named operation, all of these programs are supervised by the Secretary of Agriculture. Within the limits set by the basic statutes the policies appear to have been consistent both with the over-all agricultural program and with the prevailing Federal monetary and credit policies; for example, the valuation policies followed on farm-mortgage loans have been based on long-run normal values rather than market prices.

(*b*) *Business credit.*—The Reconstruction Finance Corporation carries on the only active and reasonably comprehensive business-loan program of the Federal Government. In addition, the Administrator of Veterans' Affairs guarantees a large number of relatively small business loans to veterans. The industrial loan and guaranty program of the Federal Reserve banks is now virtually dormant. The RFC maintains close relationships with the VA, and in some cases makes loans to veterans covered by VA guaranties. Credit policies of RFC have from time to time been adjusted to national credit and economic policies; e. g., in recent months special efforts have been made to provide needed credit assistance promptly to businesses in depressed areas.

(*c*) *Housing credit.*—Government credit aids to housing consist primarily of guaranties of private loans by the Federal Housing Commissioner and the Veterans' Administrator and direct loans and mortgage purchases by the RFC. In addition, the Federal home-loan banks advance funds to member savings and loan associations (and other member institutions) and the Public Housing Administration purchases and indirectly guarantees the securities of local housing authorities. Under recently enacted legislation, the Housing and Home Finance Administrator has authority to make loans to local public agencies for urban redevelopment and the Secretary of Agriculture is authorized to make loans for farm housing. The Housing and Home Finance Administrator has general authority over the policy of the three constituent agencies (FHA, PHA, and the Home Loan Bank Board) and also presides over the National Housing Council, an advisory body on which the VA, the RFC, the Department of Agriculture, and other agencies with housing programs are represented.

Coordination of credit and noncredit aspects of the housing program, as well as coordination of the various types of housing credit, have been greatly improved in recent years, but some shortcomings are still evident. The liberal credit terms necessary to help meet emergency postwar housing needs of particular groups have at times conflicted with the need to achieve the lowest possible level of construction costs and sales prices. Similarly, the veterans' preference objectives of the separate VA loan-guaranty program have at times proved inconsistent with the objective of the general housing program to improve housing standards.

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(*d*) *Foreign credit.*—Active foreign lending operations of the Federal Government are centered in the Export-Import Bank, which makes direct loans and guarantees private loans on its own account as well as on behalf of the Economic Cooperation Administration. From time to time the Treasury Department and the RFC have been authorized to make specific loans to foreign governments, but no unused authority is now available. Review of the policy of these and other foreign financing activities of the Federal Government is vested by statute in the National Advisory Council on International Monetary and Financial Problems, an interagency committee headed by the Secretary of the Treasury; other agencies represented include the Export-Import Bank, the Department of Commerce, the Federal Reserve Board, the State Department, and the ECA. With some exceptions, the terms and magnitudes of these operations have been dictated more largely by considerations of foreign policy than of over-all credit policy.

In summary, with the possible exception of certain aspects of the housing credit programs, the credit programs within each area appear to have been coordinated satisfactorily with each other as well as with associated noncredit programs. Coordination of separate credit programs with general monetary and credit policies has not always been fully satisfactory. In part this is the result of the fact that the process of coordination often has involved difficult decisions between two conflicting objectives, both of which were desirable. Aid to veterans' housing (chiefly in the form of easier credit), for example, has at times been given a higher priority than over-all credit policy. By the same token, aid to small business may be so significant at times in maintaining a competitive economic system, or aid to foreign governments so important to our national interest that credit for these purposes is justified even when it conflicts with the objectives of over-all credit policy. The purpose of coordination in such instances is to make sure that decisions are reached on the basis of all relevant considerations, rather than to assure that credit policy objectives are always dominant.

> 6. What role has the Bureau of the Budget played in coordinating the policies discussed in (5) above? What have been the major obstacles to the attainment of satisfactory coordination?

The role of the Bureau in coordinating these policies has varied for different credit programs, depending in part upon the extent and effectiveness of other methods of coordination. Problems of farm credit and foreign credit have required less attention than those of housing credit and business credit. The major types of Bureau activity may be summarized as follows:

(*a*) In the case of agencies submitting budgets, the Bureau has used the budget review process to explore problems of interagency coordination and, where necessary, to bring them to the attention of the President. For example, in preparing the 1949 budget, the rapid expansion in business loans originally estimated by the RFC was called to the attention of the Corporation as inconsistent with the anti-inflation program.

(*b*) As part of its responsibilities for reviewing the organizational structure of the Federal Government, the Bureau has initiated or assisted in numerous reorganizations designed to bring about more

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effective execution of Federal credit programs. The Bureau prepared the original Executive order setting up the National Housing Agency, under temporary war powers, and the more recent reorganization plan providing permanent authority for its successor, the Housing and Home Finance Agency. It participated in drafting the Executive order merging the credit program of the Smaller War Plants Corporation with the business loan operations of the Reconstruction Finance Corporation.

(*c*) In clearing proposed drafts of legislation and agency reports, the Bureau has been able to help resolve many interagency differences on legislative aspects of credit programs and often to secure Presidential determinations when the issues have required such action. The objective has been to make sure that views of all interested agencies are fully considered, and to determine wherever feasible the proposals most consistent with the President's program.

(*d*) The Bureau, on its own initiative or participating with other representatives of the President, has encouraged agencies to revise operating policies which were not fully consistent with related programs or with over-all policies. For example, to help implement the debt-liquidation portion of the wartime economic stabilization program, the President at the suggestion of the Bureau requested various Government credit agencies to review regulations and practices (e. g., FHA requirements discouraging prepayments) with the objective of accelerating retirement of debt.

(*e*) By promoting consistency and comparability in statistics obtained from various sources, the Bureau helps provide a common basis for policy decisions by agencies operating in the same or related areas. In addition to the normal continuing activity of this type in all the major credit areas, special assignments are carried out from time to time. For example, the Clearing Office for Foreign Transactions which summarizes the Government's foreign financing activities for the use of the various agencies with international programs was the result of an interagency study under the Bureau's leadership at the request of the Senate Appropriations Committee.

The special obstacles to fully satisfactory coordination thus far have been:

(*a*) The considerable autonomy or independence of several of the agencies concerned.

(*b*) The authority of some credit agencies to vary interest rates, down payments, etc., with changing economic conditions is limited in certain respects. In other cases the legislative intent is ambiguous, and the agencies in question are understandably reluctant to make the policy shifts which may be required.

(*c*) Some agencies established to combat deflation and unemployment have not always been aware that their operations could aggravate inflation, specifically that even loans for productive purposes at times can be inflationary.

> 8. What in your opinion should be the guiding principles in determining, for any given period, whether the Federal budget should be balanced, should show a surplus, or should show a deficit? What principles should guide in determining the size of any surplus or deficit?

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No simple rule of thumb is adequate to determine over-all budgetary policy. Rather, the policy which should be followed in any given year depends upon a series of considerations, no one of which provides the complete answer.

(*a*) *Requirements of economic policy.*—The Federal Government has a recognized responsibility to promote reasonable economic stability and progress. Fiscal policy represents one of the major methods, if not the primary method, of fulfilling this responsibility. Consequently budgetary policies can be considered sound only if they contribute to sound economic policies. Budgetary policies which do not contribute to these objectives, moreover, are self-defeating, since the volume of budget receipts, and even of certain expenditures, is largely determined by the level of economic activity. As the President emphasized last summer, budgetary surpluses cannot ordinarily be achieved in a declining national economy. Rather the way to achieve such surpluses is to pursue the types of budgetary and other policies which will increase national income and taxpaying capacity.

(*b*) *Long-range fiscal outlook.*—For any given year it is impractical to count on achieving any specific goal, whether a balanced budget, or a predetermined surplus or deficit. Over short periods, in fact, budget receipts and expenditures not only fluctuate with changes in the level of economic activity, but also are relatively uncontrollable for various other legal and technical reasons. Some programs, like interest on the public debt, constitute a fixed charge. Expenditures on others are largely made to carry out firm commitments of various sorts made in earlier years. Still others, e. g., certain public works, can be slowed down or speeded up rapidly only by measures which substantially increase the total cost.

For certain "open-end" programs, the conditions of expenditures are set by the authorizing legislation, but the amounts spent are determined by costs or by decisions of private individuals and organizations or of State and local governments. Short-run, largely unpredictable fluctuations in expenditures not subject to control of either the President or the Congress (e. g., for agricultural price support or mortgage purchases) can substantially change the surplus or deficit. If such erratic changes in the budget outlook were to serve as the basis for budget policy decisions, many continuing programs of great value would be irreparably harmed at some times, and at others programs of lesser priority could be introduced which would be difficult to remove.

Rather the fundamental fiscal consideration should be the long-run outlook for expenditures, receipts, and public debt. The policies contemplated in the budget of any given year, therefore, should be judged primarily in terms of their impact on the budget and the public debt over a period of years, rather than in terms of their interim effects.

(*c*) *Productiveness of expenditures.*—Within the limits set by the previous considerations, it is also essential to give considerable weight to the productiveness of specific major expenditure programs as well as to the effect on private production of the tax structure. Federal investments (including loans) which build up the productive capacity of the Nation in the long run will add to national income and taxpaying capacity. It would be short-sighted either to eliminate such expenditures or to starve the existing Government plant by inadequate maintenance and improvement. In the postwar period we have un-

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fortunately had to hold expenditures of this type to an unduly small share of the budget. These aspects of the budget are receiving increasing attention in planning future programs.

(*d*) *International situation.*—In the last decade the international outlook has often been the major controlling element in the Federal budget. As long as the cold war continues, the national security will require maintenance of a large defense establishment and temporary programs of aid and assistance to friendly nations may also be needed. It is urgent that all efforts be continued to reduce the necessary outlays for these purposes to the bare minimum. Nevertheless, as long as we continue, as in recent years, to limit other expenditures only to prior commitments and other urgently required domestic programs, it may not at times be possible to balance the budget without changes in either domestic or internationl programs which would be contrary to our national interest, or without temporary revisions in taxes which would do more harm than good.

> 9. Do you believe it is possible and desirable to formulate automatic guides for the Goverment's over-all taxing-spending policy? If so, what types of guides would you recommend? What are the principal obstacles to the successful formulation and use of these guides?

Since, as indicated above, the problems of budgetary policy are complicated, automatic guides do not appear feasible. The appropriate policy often involves a decision between two or more conflicting principles. We know of no way in which these conflicting principles can be fitted into a single formula which gives simple and unambiguous answers.

The fundamental importance of basing budgetary policies on long-run rather than short-run considerations has already been emphasized. In this and several other respects, the proposals of the Committee for Economic Development for "a stabilizing budget policy" have considerable merit as a starting point. We do not believe, however, that this policy would be adequate, except for minor business fluctuations, to fulfill the Government's responsibility to use fiscal policy as one major instrument in achieving reasonable economic stability.

Appendix to Chapter IX

August 1949.

QUESTIONNAIRE ADDRESSED TO THE DIRECTOR OF THE BUREAU OF THE BUDGET

1. In what respects, if at all, has the division among Federal agencies of the authority to supervise and examine commercial banks had undesirable results? Has it led to conflicts of policy? To undesirable delays in taking action? To unnecessary expenditures in performing these functions? Would you recommend that this division of authority be altered? If so, in what way?

2. What role has the Bureau of the Budget played in coordinating the policies of the various Federal agencies that supervise and examine commercial banks? What are the principal obstacles to successful coordination of the actions and policies of these agencies?

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3. If the FDIC is continued as an independent agency, should it be subject of title I of the Corporation Control Act of 1945?

4. What role has the Bureau of the Budget played in coordinating the monetary, credit, and debt management policies of the Federal Reserve and the Treasury?

5. Have the policies of the Government agencies that lend and insure loans been satisfactorily coordinated with each other and with general monetary and credit policies? If not, what have been the major deficiencies?

6. What role has the Bureau of the Budget played in coordinating the policies discussed in (5) above? What have been the major obstacles to the attainment of satisfactory coordination?

7. What would be the advantages and disadvantages of establishing a National Monetary and Credit Council of the type proposed by the Hoover Commission? On balance, would you favor the establishment of such a body? If such a council were established, what provisions relative to its composition, powers, and procedures would make it function most satisfactorily?

8. What, in your opinion, should be the guiding principles in determining, for any given period, whether the Federal budget should be balanced, should show a surplus, or should show a deficit? What principles should guide in determining the size of any surplus or deficit?

9. Do you believe it is possible and desirable to formulate automatic guides for the Government's over-all taxing-spending policy? If so, what types of guides would you recommend? What are the principal obstacles to the successful formulation and use of such guides?

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CHAPTER X

REPLIES BY BANKERS, ECONOMISTS, AND OTHERS TO A GENERAL QUESTIONNAIRE

Only the materials included within quotation marks are direct quotations from the respondents' replies. Other materials represent a digest of the replies received.

1. What should be the guideposts and objectives of monetary and credit policies? For example, in formulating these policies what consideration should be given to the behavior of general price levels, to individual prices, to employment, to interest rates, and so on? What are your major criticisms, if any, of the guideposts and objectives of our monetary and credit policies in the past?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: There is no single or simple guidepost. "The general objective should be economic stability and expansion with reasonably full employment and reasonably stable prices * * *."

Elmer C. Bratt: The problem is not so simple as to permit the stabilization of a price index or the setting of quantitative limits on credit for selective areas. The secular trend of prices should be gently upward. Encourage secular increases in credit but discourage cyclical increases.

Neil Carothers: (1) To maintain a sound currency system based on a gold standard; (2) to control credit to the degree that booms will be restrained and depression periods will be ameliorated.

C. O. Fisher: Full operation of the economic system including a high level of employment and production. No one criterion can be relied upon; the authorities must exercise enlightened judgment. "In the recent past, the monetary control has suffered by reason of the fiscal policy of the Government which is designed to maintain the par value of marketable Government securities."

Frank D. Graham: "There are two supreme objectives of rational monetary and credit policy, namely: optimum employment and a substantially stable price level. * * * Monetary authorities, certainly, should make no attempt to influence individual prices, and it is highly dubious whether they should seek to affect the level of interest rates (though obvious aberrations in the relationship of one rate to another might well be attacked). Induced changes in the level of interest rates have widespread repercussions not fully understood but, in large measure, noxious."

Criticism of our policies in the past:

"The main criticisms of our monetary and credit policies in the past are that they have paid no attention to (and the authorities denied concern with) one of the above-stated supreme objectives of a rational

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monetary policy (the substanially stable price level), and that, so far as they have pursued the other, they have shown inadequate resolution and have, in fact, been timid, unimaginative, and tardy even in the inadequate measures taken."

Lloyd W. Mints: The primary aim should be a stable index of wholesale prices. As a means to this end the stock of money should increase at a rate about equal to the rate of growth in the economy. "If we definitely announced that it would be the sole aim of the monetary agents of the Government to stabilize an index of the price level (wholesale) I am convinced that the system itself would without further action maintain a high level of employment and output. There might be some minor variations in employment, but I am doubtful that they would be of much consequence."

Criticisms of past policy:

"In my opinion credit policies since the institution of the Federal Reserve System could hardly have been worse." It failed to adopt any announced and definite criterion, it allowed the volume of money to decline in the depressions following 1920 and 1929, during the recent postwar period it did nothing to prevent inflation, and in the first half of 1949 it actually reduced its holdings of governments and absorbed bank reserves. "* * * during 1920–21 the Board supported deflation; during 1929–32 it failed to do anything of importance to prevent deflation; during the war and from 1945 to 1948 it supported inflation; and when inflation finally ended and deflation set in the Board kept step—it now supported deflation."

Roland I. Robinson: "The first goal of policy should be employment, the second goal should be prices; no other goals need be mentioned. These two goals do not need to be in conflict; if they are, it is because of price rigidities and an excessive degree of labor or industry monopoly. But the maximum national well-being means full use of resources and if the price of that is some moderate fluctuation in the price level, then that price must be paid."

Edward C. Simmons: The primary objective should be stabilization of the cost of living.

Criticism: "In the past we have had no monetary policy because the authorities have been permitted freedom to switch from one goal to another, and thus we have been treated to alternate inflation and deflation."

Philip E. Taylor: Stabilize price levels and industrial production.

Edward F. Willett: Minimum interference with the free working of economic laws. "My chief criticism of past policy is that too much attention, relatively, has been given to the fiscal needs of the Government, as compared with the general economy."

Harry Gunnison Brown: "* * * One of these is stabilization of business in general—not of any particular line or lines of business. The other is the establishment of constancy, and, therefore, fairness, in the standard of deferred payments, so that borrowers shall not gain at the expense of lenders through a rising price level nor lenders gain at the expense of borrowers through a falling price level * * * no great attention, and probably no attention at all, should be paid to individual prices or price changes, * * *."

Albert G. Hart: "* * * We must distinguish: (*a*) Primary objectives; (*b*) supplementary objectives; (*c*) major strategic principles of policy; (*d*) indicators by which action should be guided.

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Most of what I have to say makes sense for both monetary and fiscal policy—which must be viewed as having their major responsibilities in common * * *. The primary objectives of monetary and credit policy (in common with fiscal policy) are best stated as (i) avoidance of mass unemployment; (ii) avoidance of inflation. If these objectives come into conflict * * * it will be because national policy toward wage rates and specific prices needs overhauling."

The principal supplementary objectives are "(i) safeguarding freedom by maximizing reliance on even-handed and impersonal measures, and minimizing discretionary authority to issue 'directives' to individual firms and households; (ii) safeguarding our form of government by preserving congressional authority over basic policy decisions; (iii) minimizing disturbances to the economies of our friends abroad; (iv) protecting the access of small business to loans; (v) holding down the cost and up the quality of financial services used by the public."

The major strategic principles should be monetary security for the public, cutting down the inherent instability of bank credit, learning from experience, and working toward long-run stability on the demand side of the monetary equation.

The principal indicators should be unemployment statistics, price index numbers, and a "feel" of the banking situation.

"* * * I see no sense in trying to use deflationary monetary or fiscal policy to reverse inflationary mistakes in wage policy—I don't think it would work and suspect serious avoidable unemployment would result."

Frederick A. Bradford: "The objectives of credit policy—should be (*a*) the maintenance of sound credit conditions, and (*b*) the stabilization of business at a satisfactory level so far as this is possible and compatible with (*a*) above. I do not favor the stabilization of the general price level as a major objective of credit policy for the reason that a substantial rising or falling price level is the result of maladjustments which have previously developed in the economy. Credit policy should aim at preventing * * * this maladjustment. If successful in this, alarming movements in the general price level will not occur.

"For similar reasons, I do not view the amount of employment as a main criterion of credit policy * * *. The law should require that demand deposits of the banks should be offset on the assets side of the statement by working-capital or self-liquidating paper and reserves only, investment-type assets being limited to the banks' capital funds and savings deposits."

Raymond P. Kent: The major objective should be the full employment of the labor resources of the country at all times. "Stability of the general price level, which theorists used to think of as a prime objective, can hardly be regarded as such at a time when so many key prices do not respond readily, if at all, to changes in market conditions."

B. H. Beckhart: "The guideposts and objectives of monetary policies should in general be (*a*) the checking of inflation and thus the preventing of deflation * * * (*b*) reducing the amplitude of the business cycle; (*c*) providing an appropriate environment, insofar as possible, in which dynamic economic forces can have full sway * * *.

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"Consideration should be given not only to general prices but also to particular prices for the reason that inflation may occur in particular segments of the economy which should be checked before affecting the whole economy * * *.

"The principal criticism of the monetary and credit policies followed since the termination of World War II is that too much emphasis has been placed on the desirability of preventing the prices of Government bonds from falling below par. This precluded the use of the interest rate as a flexible instrument of control.

"Criticisms of policies followed in certain other periods may perhaps be summarized somewhat as follows: Failure to raise discount rates in 1919 (such action, however, was opposed by the U. S. Treasury); the easy-money policies of 1924 and 1927; and the failure to follow a more consistent and decisive policy in 1927 and 1928. In the financing of World War II a different level and structure of interest rates doubtless should have been employed, but the responsibility for selecting the particular level and structure used must be attributed to the Treasury rather than to the Federal Reserve System. As a final observation, I think it is fair to say that the Reserve System has always taken action more quickly to check deflation than inflation. And yet deflation itself may be avoided only if inflation is checked."

Marcus Nadler: "* * * to help prevent major swings in the business cycle. A great deal of attention should be given to the behavior of prices in general but not to individual prices. The same applies to general employment, although not to employment in individual industries. Interest rates should be considered more a means to an end rather than an end in themselves. My major criticism of the past policies of the monetary authorities is that they have been too much concerned with prices of Government bonds and with preventing even a moderate increase in the cost of carrying the public debt."

Seymour E. Harris: "* * * the attainment of a stable and growing economy. Those responsible should watch gold flows, monetary supplies, exchange rates, prices, and the rate of interest as factors influencing economic conditions; and output, employment and unemployment, as high output and employment and low unemployment are the ultimate objectives of monetary policies. In general, the monetary authorities should try to keep interest rates low as a stimulus to business activity * * *. This does not mean that recourse should not be had to higher rates of interest in periods of exuberance; but that policy, because of its cumulative effects, should be used with extreme caution."

Charles C. Abbott: "* * * preservation of balance in the rate of change of critical economic factors should be the chief guidepost. By critical * * *. I mean such elements as the volume of employment, the rate of capital formation, the volume of consumer disposable income, the general price level, groups of related prices (agricultural prices, prices of manufactured goods, stock prices, etc.), wage levels, wages in groups of industries (the building trades, etc.), interest rates, and profits. The kinds of economic rigidity that are often implied in such cliches as 'full employment,' (absolutely) 'stable prices,' 'price parity,' etc., are undesirable goals for monetary and credit policies, and probably are impossible of attainment."

E. E. Agger: "* * * the objective of all governmental policy should be maximum output, relative full employment, and equitable

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distribution of social income. General price levels, individual prices, the status of employment, interest rates, etc., are all data to be taken into account but no one of these can of itself be regarded as sufficient. The major criticism that I should make of our procedures in the past is the lack of appreciation of the broad complexity of the problem. Our Federal Reserve System was conceived as the capstone of a purely commercial banking system, and while in time the concept of the Reserve System responsibility was broadened, and while efforts were made to achieve other important economic objectives, the powers of the System and the area within which it could operate were not adequate to meet modern demands."

Kenyon E. Poole: "* * * consideration must be given to all relevant economic data and not to any one of them * * *. Maximum management flexibility is necessary. The essence of the problem is to put capable economists in the top positions and to encourage secretaries of the Treasury to be interested in the problem of economic stabilization."

Paul J. Strayer: "* * * to achieve the stabilization of prices and the continuance of high levels of employment. Individual prices should not be controlled if a free market is to be preserved. With minor exceptions the same position must be held with regard to interest rates. The major problem is the appropriate policy to follow if prices start to rise while there is still unemployment. In this event the maintenance of price stability should dominate and other remedies for unemployment should be used.

"The major criticism of past policy is that it has been timid and ineffectual. A positive aggressive policy is needed."

James B. Trant: The guideposts and objectives should include behavior of prices, interest rates, employment, international trade, and general economic conditions.

Anonymous: The objective should be the stability of the economy. In a recession or depression easy money policy may contribute to recovery, provided that expectations of entrepreneurs are favorable. In the past the administration in power has fostered legislation which contributed to an unfavorable outlook for profits and thus offset the effects of an easy money policy. Recent monetary policy has been in the direction of easier money but at the same time the administration appears to be favoring a fourth round of wage increases, high support prices for farm products, and so on, so that political measures may defeat economic measures that are making for stability. Interest rates cannot be given much weight so long as there is no free market for Government securities.

C. R. Whittlesey: Under ordinary peacetime conditions the main objective should be the level of productive employment. The other standards which have been employed (exchange rates, price level, interest rates) are better viewed as means than as ends of policy. In the past they were usually treated too mechanically and too little attention was given to other factors which were also significant.

George R. Walker: The over-all objective should be to maintain a high level of employment, a reasonably steady general price level, and a steadily increasing national production and income. Both inflation and deflation should be avoided. Under conditions of full employment there will be a tendency toward rising wages, rising costs, and price inflation. The policy then should be to arrest the inflation even

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if the result is moderate unemployment (3,500,000). This assumes, of course, an adequate system of unemployment benefits.

George N. Halm: The objective should be a high degree of economic stability though not necessarily "full" employment. Next to fiscal policies our monetary policies are the most important instrument of control in a free economy. They should be greatly strengthened. A main criticism of the present state of affairs is that the monetary authorities have been deprived of the power of influencing the rates of interest.

E. Sherman Adams: "The general objective of monetary policy should be to contribute to economic stability. The essential task is to curb inflationary uses of credit during boom periods. In recent years too much emphasisis has been placed upon the sheer volume of money and credit, upon the cost of servicing the public debt, and upon stability of interest rates and bond prices."

Howard S. Ellis: "The main guideposts to monetary and credit policies should be the behavior of some important index of prices and the volume of employment. However, it is probably impossible to restrict the aims to a cut-and-dried formula. At times the behavior of inventories and of certain individual prices, particularly of industrial raw materials and of securities, might assume great significance. At other times, the state of international trade and capital movements might be highly important.

"My major criticism of past money and credit policies would be that the Federal Reserve has not realized the full potentialities of its existing powers for contributing to the stability of prices and employment."

Edward S. Shaw: "The objective of monetary and credit policies should be to avoid sharp inflation either of prices or of unemployment. Most significant indexes include cost-of-living prices, money-wage rates, and employment data. The development of more complex indicators should be pressed, including among others, surveys of business and consumer plans for expenditure.

"Significant errors have been made in selecting guideposts and objectives of policy. It has been a major error, for example, to fix a pattern of interest rates on Government securities, since the result has been to turn full responsibility for the money supply over to money users."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: The most helpful guideposts are changes in the volume of credit and in the manner in which it is being used, general conditions of business, the over-all price structure, the employment situation, and gold movements and international conditions. "The objectives of monetary and credit policies, reduced to their least common denominator are very well defined in the Banking Act of 1933 as 'The maintenance of sound credit conditions and the accommodation of commerce, industry, and agriculture.' To that very concise statement might be added further objective, viz, the adjustment of the volume of credit to the volume of business. If there is one thing that the banking system needs more than anything else, that one thing is certainty. The rules may be harsh and difficult, yet if there is continuity of thought and action bankers will adjust themselves to the situation and business will move along on an

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even keel. It is the everlasting threat of change that keeps things in a constant state of flux and unrest."

Anonymous: "Monetary and credit policies should be shaped by the object in view of keeping the economy on a stable level, keeping in mind at all times the long-range best interests of the country. My major criticism of the monetary and credit policies of the past is that they have been shaped with too much emphasis on keeping that party which is in control in power."

Anonymous: Assure stability and safety of the Federal financial structure and banks; keep the price level as near stable as possible and aid in stabilizing employment. "Stabilization of interest rates I think should be subordinated to the above requirements."

R. C. Leffingwell, of J. P. Morgan & Co., Inc., New York: These policies should be directed toward maintaining a favorable general atmosphere for private enterprise. "We want neither inflation nor deflation but flation; we want business to breathe * * *. The frozen pattern of interest rates, the bond pegging policy of 1948, was not wise. The price of money, that is, interest, is the most important of all prices * * *. Our authorities undertook to freeze rates in a perfect pattern covering maturities over a quarter century to come, to abolish the price system for money * * *. That was not good."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: The purpose should be to maintain a sound currency and confidence in our Government. "Major criticisms are that the guideposts are too often plagued by administrative and political yielding through influences brought by powerful organizations—labor unions, veterans, etc. Except our Government operate within its reasonable income, free from strangulation of worthy effort, it is difficult to maintain confidence."

Otis E. Fuller, Security State Bank & Trust Co. of Beaumont, Tex.: "Get Government out of all loaning or guaranteeing, like FHA."

H. H. Gardner, the Birmingham National Bank & Farndale National Bank, Mich.: A fundamental consideration is the continuing effectiveness of a sound, flexible, and responsive commercial banking structure. Considerations of price and employment levels should of course influence policy, as factors affecting the credit structure. "It is not, however, the function of the banking system to shore up prices, or to depress them, or to lend forced stimulus to a theoretical level of employment as an objective * * *. Policies involving management of money and credit should apply only to the prevention or correction of abuses or destructive trends * * *."

J. R. Geis, The Farmers National Bank, Salina, Kans.: The objectives should be to provide a sound currency, cut down Government expenditures by elimination of many credit and other agencies which are now unnecessary to the maintenance of a sound economy, balance the budget, and cut down the national debt.

"* * * With the increase in the money supply, largely occasioned through deficits in the Federal budget and the creation of a tremendous debt, monetary authorities find their hands pretty well tied when it comes to effective measures through adjustment to any extent of the bank rate or through open market operations."

William S. Gray, Central Hanover Bank & Trust Co., New York: The main objective should be to help prevent wide swings of business

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activity and of commodity prices. The major criticism is that the credit policies on the whole have been inflationary.

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: To alleviate wide fluctuations, but not attempt complete stabilization. I do not want a planned economy * * *. Long-range public works should be planned for those periods of severe distress and widespread unemployment.

Criticism: Policy seems to have been one of conflicting objectives and frequent changes. Do not like apparent objectives.

Ben DuBois, secretary of the Independent Bankers Association, Sauk Centre, Minn.:

"The objectives of monetary and credit policies should be to secure a reasonable degree of stability in our economy. There must be, we presume, some elasticity in general price levels and considerable fluctuation in individual prices. Technology does not permit a strait-jacketing of individual prices. Monetary and credit policies, if properly directed, can go a long way in obtaining the desired objective."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "Except during the period of war, I feel that the law of supply and demand should be allowed to take care of price levels, employment, interest rates, etc."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: " * * * The objectives * * * should apply principally to employment problems and to the maintenance at all times of sufficient credit facilities to insure as great a degree of stability in our economy as is possible. I am afraid that we have tried to cover too many objectives in the past."

C. H. Kleinstuck, the First National Bank and Trust Company, Kalamazoo, Mich.:

"The objective * * * should be the maintenance of a sound economy. Changes in prices and in employment are indicators or guideposts of the trends of general business conditions."

Fred W. Glos, the First National Bank, Elgin, Ill.: "It is time to do something about taxes if the Administration really wants to give the free-enterprise system a chance to extricate the country from the current recession without pushing us further along the road toward state socialism."

L. M. Giannini, Bank of America, San Francisco: These policies should in the first instance be designed to maintain a sound currency which will command confidence in domestic and foreign commerce. They should permit the maintenance of a generally high and gradually expanding level of production. It should not be assumed that satisfactory monetary and credit conditions are the only prerequisites for the attainment of this general objective. These policies should also be designed to contribute to stability in the general level of prices, but except in periods of general price inflation or deflation of major proportions, this objective would be of a secondary nature. In the interest of preserving our Republic it is mandatory that Congress maintain its traditional control over the purse and sword of the Nation. To do otherwise would be to lay the foundation for dictatorship.

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: In formulating these policies consideration should be given to supply and demand and general business conditions. Price levels cannot be handled by these

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policies. Employment should be solved by general business conditions. There has been too much emphasis on the philosophy of pump priming.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia, Pa.: The objective should be avoidance of inflation and deflation by mitigating the fluctuations in business activity and the price structure without destroying private enterprise and private investment. The general level of prices, employment, and interest rates should be given consideration, but the most emphasis should be placed on the causes of the fluctuations in these factors. The major criticism of monetary objectives in the past has been the use of deficit financing to spur business activity, with the result that it discouraged private enterprise and private capital investment.

Anonymous: The objectives should be to facilitate the extension of sound and essential business credits, to avoid credit excesses, and to contribute as much as possible to economic stability. My principal criticism of monetary and credit policies in the past is that too much emphasis has been placed on them. There is a tendency to place too much blame on current lending policies and to restrain even essential credits in periods of inflation.

C. ANSWERS BY STATE BANKING COMMISSIONERS

Eliott V. Bell, New York State Banking Department: "The primary objective of monetary and credit policies should be to contribute to stable economic progress. In formulating these policies, the * * * authorities should be guided not by specific levels of prices, interest rates, or other elements in the economic picture, but rather by the general trend and behavior of these economic indicators. No simple, automatically operating rules can or should be laid down."

The principal weaknesses of monetary and fiscal action in the past have been: (1) Too much was expected and claimed for them; (2) too little political independence was permitted those who had to formulate and carry them out; (3) actions were frequently built up by publicity as a means of appearing to take appropriate action when in fact they were no more than a smoke screen to cover lack of effective action. The basic weakness of attempts to influence economic conditions through monetary and credit policies is that such attempts tend to become a one-way affair. So long as Government has a controlling voice, there will always be resistance to taking measures of an unpopular character, and inflationary measures are always unpopular.

Donald A. Hemenway, Commissioner of Banking, State of Vermont: The objectives of monetary and credit policies should be (*a*) maintenance of sound conditions; (*b*) accommodation of agriculture, commerce, and industry.

D. ANSWERS BY OFFICERS OF LIFE-INSURANCE COMPANIES

Alexander T. Maclean, Massachusetts Mutual Life Insurance Co., Springfield, Mass.: "* * * As far as the life insurance company is concerned, we are naturally anxious that the financial policies of the Government should result in a sound monetary system in which the people would have confidence, and under which the value of the dollar would change as little as possible. This is the very basis of successful business, and the means of a satisfactory financial mode of

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life. * * * We cannot be in sympathy with any plan whereby the Government supplies the banks with excess funds, and in that way depreciates the value of the dollar."

E. ANSWERS BY OFFICERS OF OTHER FINANCIAL INSTITUTIONS

Paul E. Haney, Washington research representative, Scudder, Stevens & Clark: The chief objective of monetary and credit policy should be to make the maximum contribution to reducing economic instability. Within this broad objective are other objectives which can and should be emphasized at different times: (1) Encouragement of production and consumption and its counterpart, the discouragement of overconsumption, overinvestment, or excessive borrowing; (2) the maintenance of public confidence in Government credit; (3) facilitate rearmament for defense; (4) the facilitation of reconversion to a peacetime economy; (5) contribution toward a proper management of the public debt. The principal criticisms of policies followed in the past are that they have at times been too narrowly concentrated on one limited objective and that they have tried to accomplish too much without a sufficient degree of cooperation and coordination with other Government fiscal and economic policies.

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: Monetary and credit policies should and must concern themselves in varying degrees with at least the following types of things: (1) Healthy business and general economic conditions; (2) any speculative or other undue expansion of business inventories, capital investment, security or real-estate booms, consumers' durable goods, or other commitments requiring credit; (3) marked distortions in comparative price levels; (4) distortions amongst each other of prices, wages, and profits which may be at least partly correctable by credit controls but which credit controls alone cannot eliminate and should not seek to; (5) interest rates, which in present conditions are only a minor factor as a guidepost or objective and which are always a tool of credit control rather than an objective.

Our past monetary and credit policy is subject to a number of criticisms. In fact, it would hardly be unfair to say that these policies could not be criticized because they did not exist. Our practices in the monetary and credit field have been largely a succession of ad hoc expedients, piecemeal actions (or inactions), and not too infrequently inconsistencies or contradictions of past or even concomitant practices. Among these episodes are: (1) The complete subordination of the Reserve System to the Treasury even in World War I, to say nothing of World War II; (2) the monetary and credit policy that led up to 1929; (3) the way Messrs. Roosevelt and Warren devalued the dollar, day by day; (4) the acceptance by President Roosevelt of the Thomas greenback amendment of 1933 (he signed the bill); (5) the innumerable piecemeal amendments to the Federal Reserve Act; (6) the control of margins in the stock market by the Federal Reserve; (7) the impossible attempt to control inflation in 1947–48 by credit regulations, reserve changes, etc., while the Reserve banks stood

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ready to buy Federal securities in unlimited amounts in order to preserve an "orderly condition" in the Government bond market.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: Economic stability is the primary objective of monetary policy. In general, the Federal Reserve should restrict the money supply and tighten the reserve position of the banks in times of business expansion and rising prices, and expand the money supply and ease the reserve position of the banks in times of falling production and prices. "Some observers feel that, in the late twenties, the Federal Reserve Board might have applied the brakes at an earlier date than it did—namely, August 1929—because such a large volume of stock-exchange and real-estate credit was built up in the years from 1925 to 1929. I believe there is some justification for this view. Some observers also believe that the Board should lay somewhat more weight on the general economic situation and somewhat less weight on the stabilization of the Government debt. I am inclined to believe that there is also some justification for these views."

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: Monetary and credit policies should be designed to advance the general welfare through the healthy expansion of the economy, and this can be best accomplished by minimizing the extreme fluctuations of the business cycle. There is too much confidence in some quarters in our ability to manage the economy by means of technical devices. Monetary policies wisely conceived and judiciously applied can guide the economy in the right direction, but there is a great difference between guidance and direct control. My principal criticism of the policies that have been adopted in the past is that they have frequently been contradictory, as, for example, our efforts to maintain low interest rates.

> 2. In formulating its policies, what attention should the Federal Reserve give to interest charges on the Government debt and to the prices of Government securities? What should be the guiding principles for any Federal Reserve action relating to the yields and prices of Government securities?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: There is no simple or general answer. "Interest charges on the Government debt, the prices of Government securities, and the general credit position of the Government are surely among the many factors to be considered in monetary policy. The importance of these particular factors will vary from time to time, depending on psychological attitudes of the public and on the current responsibilities and commitments of the Government."

Elmer C. Bratt: "As soon as possible, Government securities should be traded on a free market." Do not, however, withdraw support too rapidly.

C. O. Fisher: "If politically possible, the Federal Reserve should permit the prices of Government securities to fall somewhat below par, if necessary for the maintenance of sound monetary policy. The protection of bondholders, by the assurance of the maintenance of

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par value of securities, is an empty illusion if this be accompanied by an inflation of prices which, in its economic impact, is more serious than would be a decrease in the prices of Government securities. It would be well, for example, to adopt a monetary policy which, if needed, would permit Government securities to fall to some such figure as 90 percent of par value."

Frank D. Graham: "It would be correct, and easy, to say that, ideally, the Federal Reserve should give no attention to interest charges on the public debt or the prices of Government securities, but this, no doubt, would result in its dissolution. If the charges are a matter of major concern, as now seems to be the case, the Government debt should probably be segregated from other obligations. The best means to this end, as I see it, is for the Federal Reserve to continue to stand ready to take over all Government debt offered to it at a stated price (par?) under granted power to change reserve requirements at will or to borrow reserve funds from the members banks at fractionally higher interest rates than the Government bonds sold to the Reserve banks might carry. Neither of these operations would impose any substantial cost on the Reserve banks and either would remove the threat of inflation inherent in the policy of supporting the Government bond market without any offsetting machinery."

Lloyd W. Mints: "* * * I think the Federal Reserve System should completely ignore the prices of Government bonds. The Government itself should have no policy in regard to this matter other than selling at whatever yield may be necessary for the purpose of obtaining the funds that are to be acquired by borrowing."

Roland I. Robinson: "Any time when money supply started to increase very much, then the Federal Reserve should abandon price support and curb the monetary increase. But under conditions of 1947, when money supply was not increasing, I am disposed to believe that their policy was correct. But I should not be in favor of such support at all times. The first responsibility of the Federal Reserve is monetary; but, when monetary factors are not contributing to instability (and I do not think they were in 1947), then assistance to the Treasury in financing is not inappropriate."

Edward C. Simmons: "Interest charges on the Government debt (or prices of Government securities, which are the same thing) should be disregarded. If the debt were once funded into consols without maturity, the current nonsense could be eliminated. Since we muddled the financing of the war by borrowing too much, we do not have to continue with the same errors indefinitely. Let us pay a good high price to salt down the debt and not go on with more inflation indefinitely, simply to be able to boast that the annual debt service charge is, after all, not large."

Philip E. Taylor: "* * * The Treasury's concern with interest changes results in appropriate action when it is desired to expand employment, but it is counter to public interest in periods of potential inflation."

Edward F. Willett: "Very little attention should be given to interest charges and prices of Government securities. As far as possible, they should be allowed to reach their natural level in a free market. Short-run stabilization, as opposed to long-run control, may seem desirable in case of emergency to prevent panic selling. The cost of a naturally higher long-run rate than a lower one artifically maintained would be

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small as compared to the danger to our economy of keeping an artificial rate and unbalancing our economy."

Harry Gunnison Brown: "* * * If it must seek to keep the interest charge on Government borrowing lower than it would be in an uncontrolled market, it may be forced to adopt policies tending to price level instability. Fluctuating price levels and fluctuating business activity are evils too serious to consider lightly. The Federal Reserve System is, I believe, competent to deal with them effectively if it is not interfered with by contrary duties. * * * In my opinion, the yield and prices of Government securities should not be a responsibility of the Federal Reserve System. I do not mean to assert dogmatically, however, there could be no excuse for Federal Reserve action favorable to Government borrowing in a national emergency such as a desperate war. Nevertheless, even in such a case, the considerations favoring drastic taxation as against reliance on borrowing from the banking system to such an extent as to bring extensive inflation are very strong."

Albert G. Hart: "* * * I do not believe monetary policy can afford to be hobbled by a requirement to hold the yield on Government securities within narrow bounds preassigned. Neither do I believe it best to rely on this rate as the main tool of monetary policy, and 'let the chips fall where they may' on the bond market.

"We do not have to be concerned with the annual interest charge. My first recommendation here would be to stabilize interest paid to bank creditors. I would reconcile this with the need for some flexibility in interest rates by adopting the 'security reserve' suggestion much discussed in recent years (but with a very high reserve requirement), and thus relieving the banks of the temptation to dump low-yield Governments whenever higher yield assets are available. The rate to be paid here should be related to the services banks provide gratis to customers.

"As to bond prices, it seems to me essential to avoid breaking down symbols of monetary security. On this ground I would object to a dramatic discount on Federal bonds. * * * On the other hand, part of the strategy of debt management is to get bondholders to feel that they have 'investments' rather than 'liquid assets.' From this standpoint, public knowledge that bond prices may fluctuate is a good thing. And under inflationary conditions, bond prices appreciably below par (requiring holders to forego hope of capital gain, and in many instances to sell below par value in a way they are reluctant to do) can help keep the holders of our large mass of bonds from counting on them as a liquid reserve and thus being willing to pare down cash or incur debt. * * * But my main concern with this complex of questions is to get away from the recent obnoxious situation where 'the commitment' on the bond market has kept the Federal Reserve from using a tightening of bank reserves to check undesirable credit expansion. In view of the strain on our economy resulting from the 'cold war,' danger of undesirable credit expansion will probably recur, so that I deplore the recent tendency to assume this issue is dead."

Frederick A. Bradford: "* * * the Federal Reserve should be free to buy and sell Government securities as desired without concern about the effect of such action on the prices or yields of Government obligations. * * * Generally speaking, the Treasury should fix the interest rate on its obligations according to conditions determined

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in a free market, leaving the Federal Reserve free to buy or sell Governments in accordance with sound credit policy."

Raymond P. Kent: "The Federal Reserve authorities should be free of any responsibility to maintain a particular level of interest rates upon the Government debt. It should, as always, 'maintain an orderly market' in Government securities, but it should be free to permit the prices to go below par if it is convinced that such a result is necessary to achieve the objective of continued full employment. The contention that a heavier burden of interest rates upon the national debt is much cheaper in the long run than the costs of a severe inflation, though often repeated, remains very pertinent."

B. H. Beckhart: "The Federal Reserve * * * should give minor consideration to interest charges on the debt and to the prices of Government obligations. Interest rates need to be used as an instrument of control and inability to make use of the interest rate, as such an instrument means a loss of credit control by our monetary authorities.

"The Federal Reserve would be justified in intervening in the bond market in case panic selling developed in Government obligations. Such intervention, however, should be for short periods and should not be directed toward maintaining the yields or prices of Government obligations at any particular level."

Marcus Nadler: "* * * The maintenance of an orderly Government bond market should be one of the principal objectives of the Federal Reserve authorities. I believe, however, that the Reserve authorities and particularly the Treasury have laid too much emphasis on the rate of interest which the Treasury pays on the public debt. The floating debt has increased too rapidly and may cause trouble unless materially reduced in the not distant future."

Seymour E. Harris: "* * * interest rates on Government securities are a matter of major importance for the country and, therefore, in formulating policies, the Federal Reserve should consider the effects of its policies on these rates. * * * this case does not mean that the Federal Reserve should influence rates in a manner to provide the Government with the lowest possible interest rates. In fact, there is a great danger that the interests of the Government may take precedence over those of the economy as a whole."

Charles C. Abbott: "If we are to preserve a free market economy, we must have a much freer money and capital market than we have had since August 1945. Fluctuations in the money and capital markets should be confined only within those considerable limits which, if exceeded, involve a threat to the stability of other markets."

Karl M. Arndt: "Interest charges on the Government debt—the price of Government securities—belong to the class of secondary or circumstantial objectives of Federal Reserve policy. I think it is expedient to stabilize the bond market, but only if that can be done without tying the hands of the System in its efforts to keep the economy running at a high level * * *. I should like to see the Federal securities market under some other discipline than that of just Federal Reserve policy, such as for example a specific legal requirement that all banks of deposit must hold Government bonds in secondary reserves * * *."

E. E. Agger: "* * * the Federal Reserve must inevitably give considerable attention to the interest charges on the Government debt and to the price of Government securities * * *. However, the

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most important objective here is not the lowest possible rates in the fiscal interest. The problem should be considered in the light of the whole economic situation."

Kenyon E. Poole: "The Federal Reserve has no choice but to follow the Treasury on interest policy on the Government debt * * * though the maintenance of a fixed pattern of interest rates has considerable appeal, this policy has been carried too far * * *."

Paul J. Strayer: "The Federal Reserve must pay attention to the Government bond market but cannot discharge its other responsibilities if this consideration is allowed to dominate. A minimum program would require the Federal Reserve to assure an orderly market and attempt to prevent panic selling, but not to peg the level of bond prices at any level. A rise in the interest charges on the Government debt is less to be feared than a continuance of inflation."

James B. Trant: With our present debt structure the Federal Reserve should give considerable attention to yields and prices of Governments. It was, however, poor policy to build up such debt structure with such low interest rates. The consequence has been a price level too high and therefore a higher cost to the public than a greater interest charge would have been.

Anonymous: The Federal Reserve must give consideration to prices of Government bonds so long as refunding operations run at the present high level. But the policy should not be to maintain yields on Governments at low levels unless this is compatible with the stability of the economy. The policy since VJ-day has contributed to rising price levels. "The Treasury has in the past pointed with pride to the low interest rates on the Federal debt but nothing has been said about the fact that these low interest rates were maintained by expansion of the money supply when the only effect of the expansion must be a rise of prices. Such procedure implies that the average citizen is easily deceived or misled in that he will not recognize the fact that the saving on the service charge of the debt is offset and more by the rise in prices * * *. The Treasury cannot have its cake and eat it too. It must not therefore dominate Federal Reserve policy * * *."

George R. Walker: "The Federal Reserve should not allow Government securities to fall below par or the interest rate on long-term bonds to rise above 2½ percent * * *."

C. R. Whittlesey: "Cost of debt financing should be, at most, an incidental consideration—not more important than has been the case since 1940 * * *. Policy of maintaining orderly conditions should, by all means, be continued. To the extent that flexibility can be combined with orderliness it should be sought. Where, as happened in 1947–48, rigidity develops, other methods should be used for controlling credit * * *."

George N. Halm: The present policy of stabilizing the yields and prices of Governments has gone too far. A rigid rate of interest is clearly wrong. The rate of interest has the important function of directing the available loanable funds into the most productive uses. We cannot dispense with this guidance in our capitalistic economy.

E. Sherman Adams: Interest charges on the debt and prices of Governments should not be ignored, but they should not be regarded as major objectives or criteria. The Federal Reserve should of course prevent disorderly conditions in the Government securities market and

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wide gyrations in interest rates, but this is very different from a rigid support-at-par program.

Howard S. Ellis: "In a war, the Federal Reserve has categorically an obligation to support the Government bond market. In peacetimes, by and large, the prices of Governments should be determined by free market forces, since the holdings of small individual savers are chiefly in the form of redeemable issues. In the postwar period, the Federal Reserve System has been hamstrung in the exercise of central banking functions by its categoric acceptance of the support of the Government (or Treasury) pattern of interest rates, as its first obligation."

L. Albert Hahn: "* * * as a matter of principle the monetary policy should not be influenced by any consideration of fiscal policy. It is obviously impossible to maintain a sound monetary policy—aimed at stabilizing the cycle—if the chief weapon, raising interest rates, cannot be used because it would affect the position of the Treasury. I therefore also consider the large issue of savings bonds, which are practically redeemable at sight, as a major mistake because it made it practically impossible to raise interest rates. The orthodox idea of converting as much as possible of the Government debt into long-term obligations still remains valid."

Edward S. Shaw: "The principle of fixing a pattern of interest rates on Government securities amounts to resignation of monetary controls over commodity prices, factor prices, and employment. A greater degree of flexibility must be allowed in Government security prices, and more serious efforts must be made to put the public debt into firm hands. By all means, the burden of interest charges in the Federal budget must not be a consideration of monetary control."

B. ANSWERS BY BANKERS

Grover Keyton, Union Bank & Trust Co., Montgomery, Ala.: "* * * the Government should at all times maintain its bonds at par and should never let them go below par in the open market at any time." Except for this policy it should not buy and sell bonds in the market either to boost or depress their prices.

Anonymous: The Federal Reserve should attempt to keep interest rates low, but at times it may be in the long-range interest to let some Government issues secure their natural level.

Anonymous: "As a governmental agency I think the Federal Reserve should endeavor to keep the interest rate on governmental debt at as low a figure as possible."

W. Lucal Woodall, Pitkin County Bank, Aspen, Colo.: "I oppose depression of interest rates."

R. C. Leffingwell, J. P. Morgan & Co., New York: "Instead of manipulating reserve requirements, the Federal Reserve should permit or cause interest rates and Goverment bond prices to vary, but should maintain orderly markets. * * * Its action should be prompt but mild in either direction. The guiding principle is to maintain an orderly market and a favorable atmosphere, but not a frozen market. It is not the function of the Federal Reserve to fix prices and yields of Government securities. The general welfare is more important than the price of par."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "A low interest rate should be sought by the Federal Reserve; however, a

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reasonable return should be given to the investor holding these securities. Bonds should be pegged at least at par to generate confidence in Government securities."

Anonymous: "The guiding principle should not be the control of interest rates, yields, or prices of Government securities, but efforts to achieve relative stability of the value of the dollar. * * * The glaring example of inappropriate policy was during the recent inflation when monetary policy was directed primarily to control interest rates or to peg prices of Government securities instead of doing everything possible to curb inflationary forces. * * * The argument that rising interest rates entails cost to the Treasury and the taxpayer is inconsequential when compared with the social cost involved in clipping the value of the dollar."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: Government bonds should be pegged at par. I further believe the Federal Reserve has done a fine job in holding the bonds at the pegged prices.

H. H. Gardner, the Birmingham National, and Ferndale National, Michigan: Though every national facility must be utilized to implement a war effort even at the cost of financial orthodoxy, in a postwar period the Federal Reserve should revert to its primary status as the regulator of credit conditions. In a time of undue credit expansion all borrowers, including the Treasury, should be subject to the discipline of higher interest rates. "* * * The resources of the Federal Reserve System should not be used to exempt Government from the disciplines which, for the good of all, are applied to the citizen, whether in an individual or corporate capacity."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "The Federal Reserve System should not be charged with the duty of maintaining Government bond prices or keeping interest rates low for purposes of encouraging more liberal Government spending; however, that has been the policy for the past 15 years. * * * Promises have been made to the investing public that the price of Government bonds would be protected for the foreseeable future, and, under such conditions, it will certainly be difficult to shift the position of the Federal Reserve bank to the extent that would be necessary to insure an effective fiscal and credit policy."

William S. Gray, Central Hanover Bank & Trust Co., New York: "Because of the huge public debt, the Reserve authorities must maintain confidence in Government obligations. The guiding principle should be to keep the Government bond market orderly; interest charges should be secondary to a sound financial policy."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "* * * For the sake of confidence in Government securities, there should be little fluctuations in prices and the Federal Reserve seems to be in a position, through buying and selling of Government securities, to maintain a price that fluctuates mildly. This policy should not be pursued so far as to jeopardize the pursuit of stability in the economy as a whole."

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: The Federal Reserve should give some attention to interest charges and the prices of Government securities but "such attention should not be sufficient to hinder the System in carrying out its broad function of credit control. * * * From November 1947 through November 1948 the Reserve banks were buying United States Treasury bonds in

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large amounts to support bond prices. This action was directly inflationary and in a period when anti-inflationary moves were in order. * * * At the start of the business recession last winter the Reserve banks in selling large amounts of Government bonds were exercising a deflationary policy at a time when such action should have been reversed. This is clear evidence of its impotence to bring to force its full powers to control credit while supporting Government bond prices. * * *"

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "Other Government agencies borrow money on the open market and pay rates according to what the lenders believe the market and the use justifies. I believe the Federal Government should operate on a similar plan."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "* * * The guiding principle of the Federal Reserve should be stabilization of the Government bond market * * *. Due to the size of the Government debt, prices of Government securities and interest yields will very definitely determine the general interest rate level for all other securities. A substantial fluctuation in long-time interest rates can be very disturbing to both borrowers and lenders * * *. Of course, certain natural laws cannot be ignored, but nevertheless it would seem that a properly conducted Federal Reserve System could eliminate radical credit fluctuations."

C. H. Kleinstuck, the First National Bank and Trust Co., Kalamazoo, Mich.: The prime objective of the Federal Reserve should be the maintenance of a vigorous and stable economy and to this end it should regulate the availability and cost of credit. "* * * It is for that reason desirable that the Federal Reserve Board be unhampered by any other consideration than to maintain a sound economy and to prevent the extremes of price fluctuations and the resulting booms and depressions. The Federal Reserve therefore should be relieved in times of peace from the necessity of maintaining a price structure on Government bonds. * * *"

Fred W. Glos, the First National Bank, Elgin, Ill.: "To maintain a policy of at least par for Government securities, especially from a psychological standpoint * * *."

Leo W. Seal, Hancock Bank, Bay Saint Louis, Miss.: They should not let the fluctuation be too great. The Federal Reserve policy toward the Government debt should prevent the public from becoming panicky and lose confidence. As inflation begins to balloon, sell bonds; and when deflation becomes apparent, buy bonds.

L. M. Giannini, Bank of America, San Francisco, Calif.: The interest charge on the Government debt is only one of the elements in the total cost of Government and only as such should it be given serious consideration in an appraisal by the Federal Reserve of prevailing general conditions. Support of Government bonds to a reasonable extent would be in order to maintain the confidence which is essential to the maintenance of a sound economy.

Anonymous: Interest charges on the public debt should not be important factors in the determination of Federal Reserve policies, though a certain amount of stability in Government security prices must be maintained. With the present enormous debt, wide fluctuations in interest rates and bond prices would prove hazardous to our

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whole economy and business structure. The strenuous credit measures of former days cannot now be undertaken with impunity.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "Total interest charges on Government debt should be given only minor consideration by the Federal Reserve in the formulation of its policies. The guiding principle relating to yields on United States Government securities should be the maintenance of a sound banking system by the regulation of interest rates in such a manner as to control extension of credit and still permit banks to operate profitably and maintain their solvency."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: In time of war a central banking system must become subordinate to the financial requirements of the conflict. But if this role is maintained for any extended period the normal functions of the central bank become atrophied, or at least unavailable. "* * * Thus, in the period of postwar inflation, the compulsion which the Federal Reserve System felt itself under to peg rigidly the Government security market made it impossible for the System to take any effective measures to reduce inflationary pressures. Instead, the Federal Reserve System was forced to resort to increases in reserve requirements which were in turn largely nullified by the fact that it was compelled to purchase the Government securities which the banks sold in order to meet these increased reserve requirements * * *."

In the face of a Government debt of some $250,000,000,000 the central bank must inevitably have regard for the existence of an orderly market; there can be no such thing as allowing the Government bond market to fluctuate with complete freedom. "* * * But it should be made plain, much plainer than has yet been done, that the obligation of the central banking system is not to guarantee any fixed price for any particular Government issue, but is rather to see to it that there is always a market for any quantity of Government securities at some level reasonably close to the last previous sale * * *."

E. F. Haworth, Commissioner of Finance of the State of Idaho: "Present rates fair to both Government and investor. Should be supported at par."

E. ANSWERS BY OFFICERS OF OTHER FINANCIAL INSTITUTIONS

Paul E. Haney, Scudder, Stevens & Clark, Washington, D. C.: Though the Federal Reserve should give immediate attention to interest charges on the Government debt, this should not be a primary objective when in times like the present the total Federal interest burden is not out of line with national income. It is important that the Federal Reserve should maintain an orderly market for Government securities. A fixed price structure should not become an end in itself. "A flexible price structure on Government bonds is preferable to a fixed structure. The guiding principle for Federal Reserve action relating to yields and prices of Government securities should be to integrate such actions with other monetary and credit policies so that in harmony with fiscal and other economic policies they would

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best serve the objective of maintaining economic and monetary stability."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: "As a primary consideration, the Federal Reserve Board should give *no* attention to interest *charges* on the Government debt or to the prices of Government securities. * * * The less the Federal Reserve intervenes in supporting the Government security market, the less encouragement it gives to unsound Federal finance. Nor should it intervene too readily even if the bond market runs away on the up side. Obviously, anything resembling panicky conditions on the down side in the Government bond market are undesirable, in view of the public ownership of tens of billions of dollars' worth of bonds, and even though most of those owned by ordinary individuals are nonmarketable and have no price fluctuations.

But given the fact that banks can value their Government and holdings at par, for rediscounting and for valuation of assets, and given the fact that no selling based on fear of Government insolvency is probable, and given on top of that, the fact that the Federal Reserve *can* exercise practically unlimited powers of bond-market support, is there not a tendency on the part of the Reserve officials to play 'firemen' too soon and to see 'disorderly' conditions where they do not exist?"

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: "* * * I am of the opinion that the support policy was not well considered. There was justification for the support of bond prices at some point. but the decision to place the support level above par seems to me to have been unwise. In my opinion, the effect of slightly lower bond prices would not have been serious, the effect of moderately higher interest rates would have been helpful."

3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies?

A. ANSWERS BY ECONOMISTS

Elmer C. Bratt: "I believe that substantial centralization of authority in the Federal Reserve System is inevitable. It may have gone too far, but I have no suggestions to offer."

Neil Carothers: "No changes are vitally necessary."

C. O. Fisher: Select as members of the Board only "such people as have demonstrated capacity for monetary statesmanship."

Lloyd W. Mints: "I see no need for a change in the method of selection of officials of the individual Reserve banks. * * * it seems entirely inappropriate that there should be both an Open Market Committee and a Board of Governors. The former should be abolished and its power given to the Board. Furthermore, I can see no sense whatever in a board of as many as seven members. If Congress would designate the guide to action to be followed not more than one person would really be required, although a board of three would be acceptable. But even though Congress should continue the discretionary power of the Board there is no need for more than

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three members. The Secretary of the Treasury should again be made a member of the Board. * * *"

Edward C. Simmons: "Monetary policy is a Government function and should therefore not be farmed out to bankers or any other business group. I would replace the Federal Reserve banks with a Government-owned central bank, control of which would rest with a three-man board of Government appointees. With the policy goal set by Congress as maintaining stability of the cost of living, there would be little high policy to be made."

Harry Gunnison Brown: "* * * Something is probably to be said * * * in favor of having a unified authority controlling both the rediscount rate and open market operations, etc."

Frederick A. Bradford: "The division of authority within the Federal Reserve System appears to be satisfactory. In my judgment, however, the Federal Reserve banks should be represented on the Board of Governors. In 1935 I suggested a board of 15 members of which the chairman and 2 vice chairmen should be appointed by the president * * * the other 12 members to be selected by the 12 Federal Reserve banks. Some such arrangement still seems desirable. If 15 is felt to be too large a number, the representatives of the Reserve banks could be reduced to 6, thus providing for a 9-member board. The functions of the Federal Open Market Committee * * * should be taken over by the Board, the Open Market Committee as a separate body being abolished."

B. H. Beckhart: "* * * as a tentative suggestion I would propose that the Federal Open Market Committee * * * be enlarged to include a representative from each Federal Reserve bank. This proposal would increase the membership from 12 to 19 persons. To the Open Market Committee as enlarged should be delegated not only its present powers over open market operations but also the powers of the Board of Governors * * * over changes in discount rates, in member bank reserve requirements, and in margin requirement on security loans.

"The advantages of this change would seem to be twofold: (1) the Open Market Committee would possess all credit control powers * * * and (2) the enlargement of the Committee to include representatives of all the Reserve banks would permit continuous expression of opinion by each of the regional banks."

Marcus Nadler: Increase the powers of the Open Market Committee to include the power to raise reserve requirements and margin requirements. "The number of members representing regional banks should be increased. In selecting members of the Board of Governors of the Federal Reserve System, the utmost care should be taken to pick men of outstanding ability and with wide experience in business and finance."

Seymour E. Harris: "* * * The tendency apparent since 1929 of increasing the authority of the Board against the Reserve banks is the desired direction of movement. Even today the Reserve banks exercise too much influence. The Reserve banks largely reflect the views of bankers and large business. In the inflationary period of 1946–48, the Reserve banks along with the bankers were in the forefront in the opposition to what would have been a correct policy, namely immobilization of additional Government securities with a view to protecting the Government security against a hardening of

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rates and some tightening of credit. So long as the bankers retain much control of the System, so long will the System be operated too much from the viewpoints of their interests. The airways companies do not control the CAB, nor the brokers and investment bankers the SEC * * *. We still have to give expression to the theory that banking is a public interest industry which should be operated on behalf of the country."

James B. Trant: More responsibility for credit control should be with the Federal Reserve banks themselves instead of placing all the authority in the hands of the Federal Reserve Board, as is now the case.

Anonymous: There is undue concentration of power in the Board. The Reserve banks are closer to the country than the Board of Governors and for that reason should have more weight on the Open Market Committee and in other respects. Board policies have often defeated Reserve bank efforts to build up good working relations with member banks. Members of the Board as well as the presidents of the Reserve banks should be selected and appointed because of their general economic literacy. In particular, the presidents are often named by the Reserve bank directors because they are believed to be good executives. The executive duties in a Reserve bank should be delegated to the first vice president and the president should devote his time to the study of monetary and credit policy with special reference to their impact on his own district as well as its national impact.

E. Sherman Adams: "It might be desirable to have the presidents of the Reserve banks serve in rotation as members of the Board. Salaries of Board members should be increased. Geographical limitations upon membership should be removed."

Howard S. Ellis: "I do not see any especial need for change."

Edward S. Shaw: "In general the division of authority is satisfactory. The principal objection to the structure of the Federal Reserve management has to do with the quality of the Board of Governors. In general it is undistinguished. The recommendations of the Hoover Commission are sound in this respect.

"The principle on which directors are chosen for the individual Reserve banks does not make sense. Directors should be chosen, not for their representation of special interests, but for their capacity to contribute to intelligent banking policy."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "* * * There should certainly be no further centralization of power, and what is left of independence in the 12 Reserve banks should be carefully preserved. * * *"

Grover Keyton, Union Bank & Trust Co., Montgomery, Ala.: "I am opposed to the centralization of further powers with the Federal Reserve Board in Washington. Why not decentralize these powers and put them back where they were originally intended, with the 12 Federal Reserve banks?

"As it was originally intended, the 12 Federal Reserve banks were represented by a majority on the Open Market Committee. I think as the matter stands now, the Reserve Board has a majority repre-

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sentation and therefore dominates this committee. I think this should be corrected."

Anonymous: "More power should be given to the separate Federal Reserve banks. The number of Governors on the Federal Reserve Board could very easily be reduced to three."

R. C. Leffingwell, J. P. Morgan & Co., New York: "I am not prepared to suggest any change in the division of authority within the Federal Reserve System. The present division of authority is cumbersome and complex, but it is democratic and allows for regional expressions of opinion and some regional variations in practice. * * *"

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "No change should be made."

Anonymous: Some of the possibilities that might be considered are the following: (*a*) Increase salaries of Board members to at least $25,000 in order to attract men of high caliber; (*b*) select Board members and Reserve bank presidents on the basis of their broad knowledge and experience in the field of finance and economic processes: (*c*) reorganize the Board to include the Secretary of the Treasury, the Comptroller of the Currency, and probably the Chairman of the FDIC in order to secure greater coordination and responsibilities. Two or three presidents of the Reserve banks could be added to the Board on the rotation principle so as to add regional knowledge and experience. The present membership of the Board would of course be reduced accordingly; (*d*) with such a reorganization, combine the powers of the Board and the Open Market Committee; (*e*) the chairman of the Board should be selected by the Board rather than appointed by the President, in order to add to the Board's independence; (*f*) the board of directors of the regional Reserve banks should be given greater responsibilities than they now have. "* * * Local boards, representing many very able men, have been reduced to a perfunctory status without having adequate voice in matters of policy or administration. * * *"

H. H. Gardner, the Birmingham National and Ferndale National Bank, Mich.: "The Federal Reserve Board should be recognized as a judicial body to interpret the act and to function as the counselor and coordinator of the activities of the 12 banks. Though the Board has an agency relationship to the Treasury, it was not intended to be a department of the Treasury. To the greatest extent possible, the 12 banks should be accorded autonomy, subject to the jurisdiction of the Board, which should enjoy virtually the status of the Supreme Court, within the prescribed purposes and limits of the act. The resources of the Federal Reserve System are drawn from the people, through the member banks. The greater the independence of the Federal Reserve Board, and the broader the autonomy of the 12 banks operating within the act, the more secure will be the ultimate welfare of the people."

Anonymous: Authority should not be further decentralized within the System. "* * * It seems to me that the Board of Governors should be the top authority in making policy within the System. The Board should work closely with other Government agencies in order to avoid cross purposes in economic policies of the Government. Further decentralization within the Federal Reserve System would add confusion and weaken the necessary coordination within Government."

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J. R. Geis, The Farmers National Bank, Salina, Kans.: "* * * I believe the Advisory Committee of the Federal Reserve Board should be given more than pure advisory authority. There has been too much centralization of authority in the Reserve Board at the expense of the district banks."

William S. Gray, Central Hanover Bank & Trust Co., New York: "Greater power should be given to the Federal Open Market Committee. Each Federal Reserve bank * * * should retain a reasonable degree of independence in matters related to their respective sections, and each Federal Reserve bank should have a greater voice in the formation of over-all policies."

Ben DuBois, Secretary, Independent Bankers Association, Sauk Centre, Minn.: Perhaps the Federal Reserve Board should have greater authority over the 12 regional banks. "* * * I do believe that there is one segment of the banking fraternity that is not properly represented on the Board, and that is the smaller banks of the country. * * * We believe that an addition to the Board of what might be called 'a country banker' would be helpful to the System and to the economy as a whole. I can see no reason for the Federal Advisory Council. We believe it has a tendency toward confusion."

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: Since the powers of the Board of Governors are very great, our democratic principles demand that membership on the Federal Reserve Board should be broadly representative. It should include representatives from each Reserve district.

Fred W. Glos, the First National Bank, Elgin, Ill.: "None—except all political party considerations should be eliminated and purely qualifications of personnel considered."

L. M. Giannini, Bank of America, San Francisco, Calif.: The directors of each Reserve bank should appoint the chairman, and the directors' appointment of the president and first vice president should not be subject to approval by the Board of Governors. This would insure more independence of action by the district banks. The Secretary of the Treasury should, ex officio, sit in with the Open Market Committee as an adviser, for the actions of the Committee vitally affect the Treasury, and the actions of the Treasury, current and contemplated, will vitally affect the conditions under review by the Committee.

Anonymous: More of the policy-making powers of the Federal Reserve should be centered in the Open Market Committee. That Committee now determines open market policies, but the Board alone decides on reserve requirements and discount rates. These policies should always be coordinated and there is no need for a division of authority. If all decisions regarding credit policies were placed in the Open Market Committee, this would give the regional banks more voice and influence in credit policy. Such an arrangement seems wise in a country as large and as diverse as ours. It is a mistake not to let the Federal Reserve officers located in the large money markets, who are most familiar with market conditions, have more of a voice in the determination of credit policies. Members of the Federal Reserve Board should have the status of Cabinet members and be paid accordingly.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is felt that too much power is concentrated in the Board of Governors of the Reserve System. This concentration of power, as

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provided for in the Banking Acts of 1933 and 1935, has resulted in mitigating the effectiveness of the regional system. The Board of Governors is a powerful body and the fact that its members are appointed by the President makes it vulnerable to political direction. It is believed that the Board of Governors should be elected by the directors of the regional banks rather than appointed by the President."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Eliott V. Bell, New York State Banking Department: "The point of greatest weakness within the System is the Federal Reserve Board. The Federal Reserve Act of 1935 probably went too far in building up the Board's power at the expense of the regional Federal Reserve banks. While building up the power of the Board, no adequate measures were taken to build up the caliber of the Board. As at present constituted, the Board of Governors probably has too many members and the term of 14 years seems excessively long. Compensation paid to the Board members is certainly inadequate and is disproportionately small in comparison to the compensation paid the presidents of some of the Federal Reserve banks over whom the Board exercises authority.

"Under existing circumstances there is little to be said for proposals to increase the Board's power. On the contrary, a case could be made for concentrating all Federal Reserve System powers with respect to credit policy in the Open Market Committee which provides a broader basis of representation, although still leaving a majority voice to the Board."

D. ANSWERS BY OFFICERS OF LIFE INSURANCE COMPANIES

Alexander T. Maclean, Massachusetts Mutual Life Insurance Co.: "We believe that the Federal Reserve Board should be controlled by the banks in the System and not so much by the Government. We believe this for the reason that, naturally, the banks in the System are more in touch with the business needs of the various localities than anyone else is likely to be."

E. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, president, Libbey-Owens-Ford Glass Co.: "This issue does not seem a critical one, as there is a large degree of consultation and coordination in the Federal Reserve System."

4. What changes, if any, should be made in the standards that banks must meet to qualify for membership in the Federal Reserve System? Should any banks other than national banks be required by law to become members of the System?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "I should prefer that all banks be national banks, and that all banks be members of the Federal Reserve System and of the FDIC. To accomplish this, I should recommend a lowering of the capital requirement for membership in the Federal Reserve and for a national charter. National supervision of all banking would be

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quite consistent with the power of the Federal Government to regulate the money supply."

Elmer C. Bratt: "I think all banks should be required to be members of the Federal Reserve System. The standards to qualify for membership should be the standards otherwise required for any bank."

Neil Carothers: "Careful study should be made to determine conditions under which State banks could enter Federal Reserve without inconvenience. Once the conditions have been determined, all State banks should be forced into Federal Reserve. Pending this, no Federal Reserve privileges should be granted State banks not in System."

C. O. Fisher: "Subject to a finding by the Federal Reserve Board, all sound commercial banks should be permitted to join the System, even though the technical requirements presently existing cannot be met. All commercial banks, excepting possibly those with capital stock of $25,000 or less, which are serving communities of small population, should be required to join the Federal Reserve System."

Frank D. Graham: "All banks should by law be required to be members of the System."

Lloyd W. Mints: "I see no need for changes in the standards which qualify banks for membership in the Federal Reserve System. It is not a matter of much importance whether other than national banks are members, although on balance the arguments are in favor of including all banks. This would prevent States from permitting banks to operate with reserve ratios below those of the national banks, and low reserve ratios are undesirable."

Roland I. Robinson: "Think the excessive capital requirement for branch operating banks should be reduced. Would not require nonnational banks to join System."

Edward C. Simmons: "* * * all commercial banks should be chartered by the Federal Government and be forced into the Federal Reserve System. Unquestionably Congress can do this."

Philip E. Taylor: "Ideally all commercial banks should be members of the System."

Edward F. Willett: "If the Federal Reserve System is to operate efficiently it should probably include State banks, but this would be a further important step in the direction of complete centralization of power in the hands of the Federal Government. This trend should, in general, be vigorously opposed if we wish to avoid the danger of 'statism' in some form."

Raymond P. Kent: "All commercial banks should be required to be members of the Federal Reserve System *or* they should be required to observe the same requirements, loan and investment restrictions, etc., which are applicable to member banks. In general, nonmember banks should be required to conform to Federal Reserve standards—either through formal membership or the extension of regulatory laws to them—in all instances where nonconformity gives them a material advantage over member banks in earning capacity. Though the total resources of nonmember banks are small in comparison with those of member banks, we must take account of the fact that wholesale shifts of member banks to the nonmember status may take place. * * * Nonmembership should not be attractive as such."

Roy L. Garis: "Although I approve the dual system of banks—National and State I think all banks should be required to join the Federal Reserve System."

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Frederick A. Bradford: "The standards for membership * * * should be as high as those required for the organization and operation of national banks. Membership should be required of all banks that maintain checking deposits. If a State bank wishes to carry checking deposits for the convenience of its customers and does not wish to join the Federal Reserve System, it should be required to maintain 100 percent reserve (in cash or on deposit with a Federal Reserve bank) against such checking deposits. * * *"

B. H. Beckhart: "* * * I would suggest that all insured commercial banks be required to comply with the reserve requirements applicable to member banks. At this juncture I am not sure that I would require banks other than national banks to become members of the Federal Reserve System. Some banks could not qualify on the basis of their present capitalization and I doubt if it would be desirable to allow State banks to enter the Federal Reserve System with a capital lower than that permitted for national banks."

Seymour E. Harris: "The qualification for membership should be less rigid than at present. The best solution would be compulsory membership for all banks—on the assumption that this is constitutional. A universal Federal Reserve System would facilitate control of reserves of the system."

Karl M. Arndt: "Any institution that can qualify at all as a bank of deposit—that serves as a part of the national monetary machinery—should be in the Federal Reserve System. * * *"

E. E. Agger: "With the insurance of bank deposits now pretty well established as a permanent policy, admission to membership in the Federal Reserve System might be further eased. The objective to be accomplished by a possible legal requirement that all banks doing a checking business become members of the Federal Reserve System can, I think, be attained in some other less drastic way. * * *"

Paul J. Strayer: "All banks should be required to become members of the Federal Reserve. * * *"

James B. Trant: No changes should be made in the present requirements for membership and the State banks should not be required to become members of the System.

Anonymous: All insured banks should be required to become members of the Federal Reserve. At the present time many State banks refrain from membership because they can obtain all the benefits of membership without accepting any of the responsibilities. In addition, the income derived from exchange charges on their own checks, i. e., refusal to remit at par, keeps a large number of State banks out of the System. This charging of exchange for the payment of their own checks is a parasitical practice which is contrary to the national welfare. State banks do not issue circulating notes but they do create deposits which they refuse to pay at par. State banks are also in one form or another subsidized indirectly under the present arrangements with respect to membership in the Federal Reserve. Another factor to be taken into account is the tendency of metropolitan banks to think of themselves as central banks, and to that end they build up correspondent relations. The correspondents are often dissuaded from coming into the System when they are not members already, on the

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ground that the large city banks can do for them all or even more than the Federal Reserve is able to do.

E. Sherman Adams: "There are some good arguments for having all commercial banks become members of the Reserve System, but as a practical matter it is not very important. A far more serious problem is the need for establishing adequate regulations of savings and loan associations."

Howard S. Ellis: There is no especially urgent need for change in the standards that banks must meet for Federal Reserve membership. All commercial banks should be required by law to become members of the Federal Reserve.

Edward S. Shaw: "All commercial banks should be required to become members of the Federal Reserve System and to abide approximately by the present requirements for membership. Eventually, standards of capitalization should be raised very considerably."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "No change should be made in the standards that banks must meet to qualify for membership in the Federal Reserve System. No banks other than national banks should be required by law to become members of the System. An attempt to require nonmember State banks to become members would strike at the fundamentals of the dual banking system. That system should be preserved and any attempt to destroy or even to detract from it, would be bitterly opposed even to the extent of endangering national unity in banking policy. Furthermore, of the total deposits of all banks, approximately 85 percent or more are held by member banks. The end, therefore, would hardly justify the means."

Anonymous: "Our dual system of banking has been an important safeguard to our present economic system for 85 years. Legislation which would require State banks to become members of the Federal Reserve System would be a long step toward the elimination of the dual banking system, and would be highly undesirable.

"In the judgment of the writer the independence of the two systems represents a most important outpost of protection from the total socialization of our economy."

Anonymous: "The standards for membership for the smaller banks could be lowered without losing any strength for the system."

Anonymous: "In my opinion all the banks should be required by law to become members of the Federal Reserve System."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "We believe that the dual system of banking makes a stronger system, and that State banks should not be compelled to join the Federal Reserve System against their wishes."

L. M. Giannini, Bank of America, San Francisco, Calif.: No changes are recommended in the standards that banks must meet for Federal Reserve membership. State-chartered banks should not be required by law to become members of the System. "The sovereignty of the States, under whose charter the nonmember banks exist, should protect these banks against compulsory membership and attendant Federal regulation. It is in the best interests of the economy to maintain the present effectiveness of the dual banking system."

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Leo W. Seal, Hancock Bank, Bay Saint Louis, Miss.: State banks should not be required to become members of the Federal Reserve.

R. C. Leffingwell, J. P. Morgan & Co., New York: "I do not suggest any changes in the standards that banks must meet. I do not favor forcing nonmember banks to become members of the System. One of the few restraints that now exist against the abuse of power by the Federal Reserve authorities is the fear that State member banks will withdraw from the System. It is not good for government bureaus to be unrestrained."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: Present membership requirements are reasonable and adequate. State banks should not be required to join the Federal Reserve.

W. R. Gott, the National Deposit Bank, Arnold, Pa.: Bank examiners do not have enough authority to make the necessary recommendations on the successful operation of banks. Too many banks, and especially the small ones, have too many risk assets in relation to their capital. "* * * I think that all banks should be requested to become members of the Federal Reserve System, by law."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: No changes should be made in standards, and State banks should not be required by law to become members of the Federal Reserve.

H. H. Gardner, the Birmingham National and Ferndale National, Mich.: Membership in the Federal Reserve is a privilege and standards should be high. "Since the operation of the System benefits the entire economy, all banks should be members, if qualified, as a matter of principle. A bank should not enjoy the benefits indirectly, while failing to accept the responsibility of membership. The dual system of banking has many advocates and supporters. If a bank chooses to operate under a State charter, it does not seem appropriate to bring it under Federal law against its will by forcing membership in the system. * * *"

J. R. Geis, the Farmers National Bank, Salina, Kans.: There is no need at the present time for changes in membership requirements, and "* * * I am strongly opposed to the enactment of any law which would require nonmember banks to become members of the System. The dual system of banking provides a strong deterrent against the concentration of the money power in the Federal Government, and this, in my opinion, is desirable."

William S. Gray, Central Hanover Bank & Trust Co., New York: "No change is necessary or desirable."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "All right as is."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "* * * Lowering the standard would not bring in voluntarily many of the smaller banks. If all banks were required to belong to the Federal Reserve System, it might be a step toward the elimination of our dual banking system. Most of the bankers of the country believe that there is strength in having a national system of chartered banks and a system of State-chartered banks. They feel perhaps that it is a check upon too much centralization and arbitrary regulations. Considerable could be accomplished I believe, by working out a more equitable system of reserve requirements. * * * The dual system of banking hooks with the States' rights theory and a change would be more controversial than would seem justifiable."

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R. J. Hoffman, American National Bank of Cheyenne, Wyo.: No changes should be made in requirements for membership; State banks should not be forced to join the System, though they should be encouraged to join.

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "* * * While I think it would be more satisfactory if all banks belonged to the Federal Reserve System, yet I doubt if they should be required by law to join."

Fred W. Glos, the First National Bank, Elgin, Ill.: "* * * To compel all banks to join the System might eventually become a wedge to eliminate the dual banking system."

Anonymous: Membership in the FDIC should qualify a bank for membership in the Federal Reserve and State banks should not be required to become members.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "No changes are considered necessary in the present standards that banks must meet to qualify for membership in the Federal Reserve System. It is not believed that banks other than national banks should be required by law to become members of the System. The continuation of a dual banking system would seem desirable. While at present there are a great number of banks outside of the System, nevertheless the bulk of the banking assets are controlled by the Federal Reserve."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "The capital requirements for small member banks operating branches are somewhat high. These should be restudied.

"Voluntary membership for State banks in the Federal Reserve System, as in the Federal Deposit Insurance Corporation, is the only basis on which the dual banking system can exist. This arrangement does not impair the strength and effectiveness of either the Federal Reserve or the FDIC."

F. F. Haworth, commissioner of finance of the State of Idaho: The State banks should not be required to become members of the Federal Reserve.

Paul A. Mitchell, superintendent of banks, State of Ohio: "The present standards for membership in the Federal Reserve System are satisfactory and no major changes are deemed necessary. To require banks other than national banks to become members of the System would be an infringement upon State's rights and would seriously jeopardize our dual banking system. Such a law would place excessive and unwarranted authority in the hands of a few people, giving them complete control over the banking system of the country and would eventually lead to the nationalization of the banking industry. The various States have, in general, sound banking laws governing the operation of State banks and the supervision given their banks is at least equal to the supervision exercised by either the Federal Reserve System or the Comptroller of the Currency. The benefits of the System accruing to the small country banks would be negligible as few of their loans would be eligible for rediscount in case of emergency. With the exception of placing control of the country's banking system in the hands of the Board of Governors nothing would be gained by

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the passage of a law requiring banks other than national banks to become members of the System. Rather than being beneficial, such a law could eventually prove highly dangerous to the successful operation of the Nation's banks and could deny credit facilities to the farmer and small business man."

C. A. Gough, deputy and acting commissioner, State of New Jersey: "Existing standards governing qualification for membership in the Federal Reserve System appear to be satisfactory and I see no reason for suggesting any changes therein.

"Although conceding that there is much to be said for the advantages which would flow from having all of the country's banks in that system, I believe that membership should continue to be voluntary, as I am fearful that forcing banks to join could eventually result in a single bank system which, in my opinion, would be highly undesirable."

A. A. Rogers, superintendent of banks of the State of Oregon: The present standards for membership in the Federal Reserve should be retained in their present form. The State banks should not be required by law to become members of the Federal Reserve, but their joining or not joining the System should be a matter to be determined by their boards of directors.

J. F. McLain, director of banking, State of Nebraska: As a minimum qualification for Federal Reserve membership the applicant bank should have a paid-in capital stock of not less than $50,000 regardless of its location—perhaps the minimum should be more. Membership in the Federal Reserve should not be compulsory. There can be no justification for requiring any State bank to become a member of the Federal Reserve System. Membership should continue to be on a voluntary basis.

W. Royden Watkins, chief examiner, board of bank control, South Carolina: "The standards and requirements for a bank to qualify for membership in the Federal Reserve System are reasonable. The writer is of the opinion that State requirements could better be raised to meet the national bank standards than to lower the national standards for the admission of State banks to the System. It is my belief that no banks other than national banks should be required by law to become members of the System."

Donald A. Hemenway, commissioner of banking, State of Vermont: Banks other than national banks should not be required by law to become members of the Federal Reserve System at this time. Any effort to enact such requirement would be extremely controversial, since we are now adjusted to functioning as a dual system. Furthermore, only a small part of commercial banking assets are in nonmember banks.

Benjamin O. Cooper, auditor of public accounts, Illinois: "The most logical and probably the most effective program would be for the various Federal Reserve banks to be allowed to function as 'banks for bankers,' servicing the needs of their individual membership, offering assistance in the solutions to problems peculiar to their districts, and performing certain services to the Treasury such as in the capacity of fiscal agents, depositaries, and custodians.

"Membership should be voluntary, possibly even to national banks, with the advantages obvious and attractive enough to induce membership to become general among bankers.

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"Standards for membership are of subsequent consideration as membership must first be made generally attractive.

"The functions of the Federal Reserve banks should be less emphasized as instruments in the management of Government debt and as administrators of fiscal policies. As banks for bankers, through their power and authority in currency matters, in rediscount operations and as depositories for the reserve funds of its members, the System would still exert an enormous and advantageous influence on the national economy if soundly administered.

"One of the most serious deterrents to membership in the System seems to be the apparent belief that the actions of the Federal Reserve Board are not free of political dependence and that the Board is subservient to the desires of the Treasury.

"All but a small minority of bankers would be not only willing, but very likely, eagerly cooperative, if the advantages to both themselves and the national economy were made reasonably apparent."

Maurice C. Sparling, superintendent of banks, California: "One desirable change in membership requirements is a reduction in minimum capital requirements. In California we have a considerable number of banks operating from one to three or four branches. Some of these banks wish to join the Federal Reserve System but are unable to do so because of the $500,000 minimum paid-in capital now required. If the Federal Reserve System wishes to expand and to increase its membership by adding even moderate-size banks with branches, I believe it would be desirable to consider the establishment of a minimum more in accordance with the size of the banks and the nature of the communities they serve.

"I do not believe that State banks should be required by law to become members of the Federal Reserve System. Most of the banks chartered in recent years in California have become members of the Federal Reserve because they considered it desirable and worth while to do so. This is as it should be. To compel banks to become members of the System in order to obtain deposit insurance would be an encroachment on right of the States to charter and supervise banks, and would be wholly inconsistent with basic principles of the dual banking system."

Richard Rapport, bank commissioner, Connecticut: "It would seem that the present minimum capital requirements for admission to the Federal Reserve System are higher than may be necessary in some cases where the applying banks are sound.

"If we are to maintain in our banking system the American principle of checks and balances, it means the continuation of the dual system of State-chartered and federally chartered banks. This also means that each institution must have the right to choose for itself whether or not it will join the Federal Reserve System. All our experience indicates that this right of voluntary action will not impair the strength and effectiveness of the Federal Reserve. According to the Federal Reserve Bulletin of July 1949 there were on December 31, 1948, 9,183 State-chartered banks. Although, of these only 1,927 had elected to join the Federal Reserve System, this group had total deposits of $39,955,000,000, as against deposits of $21,497,000,000 in the 7,256 banks which were not members of the Federal Reserve. When we add to the deposits of State member banks the deposits of national banks, we find that all members of the Federal Reserve have total

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deposits of $121,362,000,000, or about 86 percent of all the commercial bank deposits in this country."

Frank E. Goldy, State bank commissioner, Colorado: "Consider the capital requirements more in accordance with the size of the banks and type of communities they serve.

"Membership in the Federal Reserve should be voluntary on the part of each bank seeking membership and should be based on the desire to have the advantage of their services and not be a condition of obtaining deposit insurance."

E. ANSWERS BY OFFICERS OF OTHER FINANCIAL INSTITUTIONS

Paul E. Haney, Scudder, Stevens & Clark, Washington, D. C.: The banks that can meet whatever standards are adapted for membership should be forced to become members of the Federal Reserve System. "* * * This would apply to both State nonmember insured banks and State nonmember noninsured banks. Whatever contribution Federal Reserve monetary and credit policy can make to the objective of economic and monetary stability will be increased by an extension of Federal Reserve control to important areas not now under such control. Within limits this should include a certain amount of influence over the activities of Government lending agencies."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "This issue does not seem to be critical, as somewhere around 91 percent of those banks which have sufficient capital are already members."

5. With its present powers, how effective can the Federal Reserve be in maintaining a high level of employment and relatively stable price levels? What are the principal limitations, if any, on its effectiveness for these purposes?

A. ANSWERS BY ECONOMISTS

Howard A. Bowen: "No central bank can, single-handed, maintain a high level of employment and relatively stable prices."

Elmer C. Bratt: "The Federal Reserve, by itself, contributes only a part of the essential integrated policy to provide high employment or stable prices, and this is as it should be. The limitations are principally that a satisfactory integrated policy for these purposes requires more than a monetary policy or than a set of monetary and credit controls."

C. O. Fisher: "With the present governmental fiscal policy, the Federal Reserve is largely ineffective in the attainment of the objectives indicated. As a means of providing for unforeseen contingencies, the Board should have renewed its control over installment credit and a further increase in reserve requirements."

Frank D. Graham: "In my judgment the Federal Reserve could be very effective in maintaining a high level of employment and a relatively stable price level. The principal limitation on its effectiveness might be the reserve requirements imposed on the Reserve banks (which should be abolished).

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"The reserve requirements for the Reserve banks were intended to restrict the scope of their operations and, if ever useful, are now an anachronism. The idea was taken from the Germans and has no counterpart in the most representative central banks."

Harold M. Groves: "* * * Recent experience, and that of the thirties, has indicated that central banking policy is an important factor in support of the Government's stabilization program but may have little effect by itself. A change in the Government's fiscal operations unsupported by monetary action of the Federal Reserve would probably be as difficult as the same in reverse. In this light I feel that the present powers of the Federal Reserve are adequate as long as they are properly coordinated with the Government's other policies."

Lloyd W. Mints: "* * * My own suspicion is that if the Treasury did not act in a manner to offset the attempts of the Board, the latter could be quite successful. The principal limitation is that the operations of the Treasury are of great importance in the monetary sphere, and they could on occasions be of such a nature as to vitiate any attempt by the Board to stabilize the level of prices."

Roland I. Robinson: "The Federal Reserve, by itself, can avoid letting monetary factors disturb the balance of the economy, but its positive contribution to restoring some desired level of economic activity is, I fear, small."

Edward C. Simmons: "Present powers are adequate. Perhaps the upper limit on member bank reserve requirements should be removed, but this is not essential."

Philip E. Taylor: "* * * the Federal Reserve can be more successful fighting inflation than fighting deflation. The banking system can hardly force spending, though it can more nearly prevent it. The principal limitations upon its effectiveness would appear to be the influence of the Treasury upon monetary policy and the unwillingness of the Congress to grant sufficient operating authority to the Federal Reserve."

Edward F. Willett: The Federal Reserve can contribute to stability but probably its contribution cannot be decisive under present conditions. "The chief limitation on its present effectiveness is the division of power between the Federal Reserve and the Treasury."

Harry Gunnison Brown: "Even with its present powers only, I believe the Federal Reserve can be very effective indeed in maintaining a stable level of prices and a high level of employment. * * *"

Albert G. Hart: "Against inflation, credit-tightening action can be pretty effective. This has been inhibited by the policy of supporting Government securities though. * * *

"Against unemployment, the main thing the Federal Reserve can do under existing conditions is to create an atmosphere in which banks will not make matters worse by squeezing their debtors. This may be quite important; default on this side in 1931-32, in my judgment, was what transformed a bad depression into a catastrophe. Besides, the Federal Reserve may on occasion exercise leadership (as in 1949) which helps other agencies shift their policies toward abatement of unemployment."

Frederick A. Bradford: "Not too effective. It is possible for the Federal Reserve to pursue an easy-money policy under present conditions, the proper policy in a period of recession or depression, but experience has shown that an easy-money policy is not necessarily

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effective in inducing business revival. Present support of the Government bond market interferes with proper restraining policy to prevent an inflationary movement should such occur."

Marcus Nadler: "The Federal Reserve authorities cannot be effective in maintaining a high level of employment and relatively stable price levels. Direct intervention by the Federal Government and Congress and numerous laws passed in recent years have a more direct bearing on employment and prices than the activities and policies of the Reserve authorities."

Seymour E. Harris: "With its present powers, the Federal Reserve unaided cannot assure a high level of employment and relatively stable price levels, and for the following reasons: (*a*) Prices and employment depend on total spending. The Federal Reserve at most can control the total supply of money. (*b*) Total spending depends on the fiscal policies of government, on the income policies of labor, farmers, and business, and so forth. * * * What can the Federal Reserve do to extricate the country from a depression if the Government cuts expenditures and raises taxes and labor insists on an annual 10-percent rise in wages? (c) * * * unfortunately * * * there is a serious obstacle in the control of monetary supplies in addition to those adumbrated above. This arises from the unusual degree of liquidity in the system. * * * (*d*) Although the United States is the leader in international monetary policy it is still true that policies and developments abroad influence the American price and employment level. * * * (*e*) The requirements of Government finance are an additional obstacle."

Charles C. Abbott: "* * * postwar difficulties of the Reserve System result chiefly from the greatly enhanced monetary powers of the Treasury, rather than from deficiencies in the powers of the Federal Reserve System. * * * To avoid a race for power between the Treasury and the Reserve System the desirable policy is to decrease the powers of the Treasury, not to enhance the prerogatives of the Reserve System. In my opinion the Congress may be open to criticism for not heretofore considering ways and means of decreasing these new and greatly expanded Treasury powers, which were not received by it as a result of any congressional mandate."

E. E. Agger: "The Board is not adequately implemented to maintain the high level of employment and relatively stable price levels at this time. The limitations grow out of lack of more flexible control of reserves, of the volume of deposit credit that does not come under their control, and the complete independence of the Treasury to follow lines dictated by purely Treasury interests."

Kenyon E. Poole: Cannot do much at present: "First, its discretion is severely limited by the priority necessarily given to Treasury finance, and, second, monetary policy alone is known to be ineffective during depression. A third point might be made, namely, that so far as the Federal Reserve is concerned, it is politically extremely risky for the Board to come right out and attempt to regulate business conditions. This was demonstrated in the 1921 episode * * *."

Paul J. Strayer: "The major contribution * * * will be in preventing the distortions that arise when boom conditions tend to get out of hand. Prices can be prevented from rising and speculation minimized by appropriate Federal Reserve action. In the event of a depression little can be done by the Federal Reserve but it is obligated

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to establish favorable conditions for recovery * * *. In time of depression, a period of price rise or fall, the Federal Reserve cannot do the job alone * * *."

C. R. Whittlesey: "Single handed, it can do very little. Nevertheless it is a vital part of any program for achieving this end. At a minimum, attention must be given to avoiding policies and practices which impede the attainment of desired objectives * * *."

George R. Walker: The most important function of the Federal Reserve is to maintain a stable or slowly rising money supply. Under its present powers it is better equipped to prevent an undue expansion than to forestall contraction. It now has no power to prevent the accumulation of idle excess reserves at banks.

George N. Halm: "With its present insufficient powers the Federal Reserve cannot be made responsble for either a high level of employment or for relatively stable prices or for any other policy. It never could control private investment. Today it cannot even prevent overinvestment if for some reason or other an overinvestment boom should develop. It has practically no control over interest rates and over bank reserves."

E. Sherman Adams: "Monetary policy is * * * only one of many factors affecting economic conditions. It may at times be important in curbing a boom but is of almost no use as a positive stimulus to business revival. These limitations are inevitable. Nevertheless, monetary management could be made more effective by removing other limitations which are not inevitable; namely, (1) lack of adequate flexibility of general credit policy; (2) domination of policy by the Treasury; (3) inadequate selective controls; (4) lack of control over the credit policies of Government lending and loan-guaranteeing agencies * * *."

Howard S. Ellis: "With the exceptions noted under No. 6, I do not believe that the Federal Reserve System has in general lacked the powers necessary to the effective discharge of central bank responsibilities. But a central bank cannot in the nature of the case be certain of achieving either stable prices or full employment. On the side of restraining inflation, its work can be undone by large political-pressure blocs, e. g., farm bloc, labor unions, etc., or by Government extravagance. On the side of combating deflation and depression, the monetary and credit mechanisms have less potency than on the side of restraining inflation. If a recession is anything more than transitory, fiscal policy becomes more important than monetary policy, but the latter should continue to exercise its appropriate role."

Edward S. Shaw: "With its present powers, the Federal Reserve is capable of disastrous effects on employment and prices. But alone it is quite incapable of affecting the degree of stabilization about a steady secular growth in production that is desirable. The changes in market terms for loanable funds that it can enforce are not a sufficiently powerful instrument to do the job of stabilization that is needed. Fiscal policy and wage policy are more powerful forces than monetary policy. The important thing is that these variants of policy should be coordinated."

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B. ANSWERS BY BANKERS

Anonymous: "The Federal Reserve System is merely one cog in the wheel of maintaining a high level of employment and relatively stable price levels. It cannot be effective if its actions are countered by other agencies of the Government taking opposing action."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "By tieing in the Federal Reserve System with Government fiscal policies too tightly, it means a total collapse can happen. Certainly in many respects it can be tied in, such as making money plentiful or scarce, providing it is well handled."

R. C. Leffingwell, J. P. Morgan & Co., New York: The power of the Federal Reserve is immense but it can be largely offset by such things as fiscal policy, the great credit-creating powers of the innumerable lending agencies of the Federal Government, and national policies in other fields.

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "It is doubtful that the Federal Reserve can be materially effective in maintaining relatively stable price levels and employment. I am opposed to the Federal Reserve being given more power to deal with these problems."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: "I don't see how the Federal Reserve can be so effective in maintaining a high level of employment. I believe the Federal Reserve Board should be given authority to control some kind of a system similar to regulation W. I think a system of this type operated by the Federal Reserve instead of by Congress would be far more satisfactory."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "The Federal Reserve is O. K. but all people should go to work and produce * * * not just put in time."

William S. Gray, Central Hanover Bank & Trust Co., New York: "Because of other legislation—for example, farm support law, high taxation, great expenditures of the Government, etc., the policies of the Reserve authorities cannot be very effective. * * * The supply and cost of credit and capital are only one of the important factors in the economy."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: Monetary and credit policies play a very important part in maintaining a stable economy. If the FDIC can continue to maintain confidence of the depositor we will be over one hurdle that has bothered us in the past.

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: The Federal Reserve does not have the power to control completely the level of employment or price levels; there are too many other influences over which it has no control. But the powers of the Federal Reserve "* * * became ineffective if the broad functions of the Reserve banks are subordinated, as they have been, to controlling the prices of United States Treasury securities."

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: The price at which money can be borrowed has a substantial effect on business conditions and these can be influenced by the Federal

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Reserve. "* * * It is desirable that the exercise of those powers be untrammeled by any other considerations than for the maintenance of sound, stable, and vigorous economic conditions. The interests of the United States Treasury are not always consistent with the ends which should be sought by the Board of Governors."

Fred W. Glos, the First National Bank, Elgin, Ill.: "Sufficiently effective. We surely do not want our economic system to be entirely tied up within meets and bounds so that business becomes a purely regulated procedure."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: It was never the purpose of the Federal Reserve to attempt to regulate employment. Banks should be instruments of business, not masters of it. Banks exist for the accommodation of the public, not for the control of business or the control of employment.

L. M. Giannini, Bank of America, San Francisco: It can only help to provide a favorable monetary and credit climate; many other factors are important and may interfere with the effectiveness of monetary and credit policy.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "The present powers of the Federal Reserve seem adequate to supply bank reserves to meet demands for credit necessary to maintain a high level of employment but not sufficient to maintain a relatively stable price level. Its powers in combating inflation have been limited by the maximum reserve requirements imposed by law and the discontinuance of the bulk of its qualitative credit controls."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: It has yet to be demonstrated that control over the cost and supply of money can be successful in maintaining a high level of employment and stable price levels. If applied with sufficient vigor, it can undoubtedly check an inflationary boom but by itself is a feeble means of combating deflation. "* * * Governmental actions, such as price supports, commodity purchases, housing subsidies, veterans' bonuses, public-works expenditures, and a wide variety of other actions involving the creation and distribution of increased money supplies, can always offset central bank action."

Donald A. Hemenway, commissioner of banking, State of Vermont: "The principal limitations upon the effectiveness of Federal Reserve policies are the multitudinous activities, both political and economic, that are outside of Federal Reserve control, and the fact that the psychological reactions of the populace are not subject to precise or even approximate determination by any small body of persons."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: Neither with its present powers nor with any powers which it conceivably could or should have, can the Federal Reserve System effectively maintain or be expected to maintain a high level of employment and a reasonably stable price level. That is not its job, or one of them. No one can be compelled to spend money. Therefore, no matter how low the discount rate may be placed or how much buying of Government securities the

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Federal Reserve may carry on, it may not be effective in expanding spendings or increasing employment.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo, Ohio: "With its present powers, I believe the Federal Reserve, if it acts promptly and resolutely, can check a boom when it assumes unsound proportions. The powers of the Federal Reserve Board to combat a depression, however, are naturally limited. They can cheapen credit and increase the monetary supply, but businessmen are not apt to borrow on any terms if they do not feel they will make money by doing so. Nevertheless, action by the Federal Reserve Board in a depression is helpful. I doubt whether any additional powers should be given the Federal Reserve Board to make it more effective in a depression."

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: "The Federal Reserve is in a position to apply reasonably good brakes in a period of excessive expansion. By easing credit, it can be helpful in a declining economy, but its powers are less effective in these circumstances. * * *"

6. What changes, if any, should be made in the powers of the Federal Reserve in order to increase its effectiveness?

A. ANSWERS BY ECONOMISTS

C. O. Fisher: Renew its control over installment credit and permit further increases in member bank reserve requirements.

Frank D. Graham: "The Federal Reserve should be given power to change in any degree the reserve requirements for member banks. The power should be used in the one direction to halt inflation and, in the other, to counter deflation and depression."

Lloyd W. Mints: "The Board has all the power it needs or should have so long as it continues to be independent of the Treasury. During the last few years the Board has asked for more power, but the apparent need for additional power was solely the consequence of the fact that the Board had unwarrantedly tied its own hands with respect to open market operations by its bond support program."

Edward C. Simmons: "None. The powers now exceed the skill of the managers. There are possibly too many weapons. If there were fewer, the managers might develop greater proficiency."

Edward F. Willett: "Free the Federal Reserve from any trace of domination by the fiscal authorities of the Treasury Department."

Neil Carothers: "None."

Albert G. Hart: "* * * I have a very drastic proposal to make. In my judgment, the Federal Reserve System rather than the Treasury should handle debt relations between the Government and the public. Specifically, I recommend: (*a*) Authorizing the Federal Reserve System to incur interest-bearing debt by issuing securities * * * and by holding interest-bearing deposits for commercial banks; (*b*) not only authorizing but instructing the Federal Reserve System to buy from the Treasury all new and refunding issues of Treasury certificates—with exceptions noted under (*g*) below; (*c*) refunding all publicly held Treasury bills * * * as they mature, by flotation of Federal Reserve securities (or if banks prefer, by refunding bank-held issues into interest-bearing deposits); (*d*) authorizing the Federal Reserve System to place deposits with commercial banks—subject

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to rules which prescribe uniform treatment of balances with broad classes of banks, to avoid dangers of discrimination; (*e*) instructing the Treasury to carry all its cash (above a modest maximum for working balances better kept in other forms) as a deposit balance with Federal Reserve banks; (*f*) reenacting the 90 percent 'franchise tax' on Federal Reserve earnings; (*g*) excepting from the presumption against direct Treasury issues to the public: (*i*) new and refunding issues of savings bonds, (*ii*) treasury bonds issued during war emergencies. The object of this recommendation is to cure the existing diffusion of open market policy between Treasury and Federal Reserve, and set the Federal Reserve free to use open market policy and interest rates for monetary purposes. * * *"

B. H. Beckhart: "* * * The Federal Reserve System should have powers of selective control over various homogeneous types of credit."

Seymour E. Harris: "(*a*) Reserve requirements for the Reserve banks should be much more flexible. A minimum requirement might be set at one-half the present levels, thus enabling the Reserve banks to make effective use of their reserves * * *; (*b*) the Federal Reserve should have much greater control of reserve requirements; (*c*) the Federal Reserve, in conjunction with a Domestic Monetary Advisory Council, should have the right to vary the price of gold and hence the price of the dollar vis-a-vis foreign currencies * * *; (*d*) improved relations between the Treasury and the Federal Reserve vis-a-vis Federal fiscal policies might strengthen the Federal Reserve."

E. E. Agger: "* * * I should advocate a broadening of the powers of the Board of Governors with respect to reserves, to open-market procedures, and even to selective credit controls. There should be some provision that Treasury policy also be adapted as nearly as possible to the monetary and credit policy determined by the Board to be necessary for the economy as a whole."

Karl M. Arndt: "The Federal Reserve should * * * have further power to regulate the percent and the content of banking reserves—both primary and secondary * * * also * * * the System should have general power to participate in but more often to guarantee (with funds supplied by the Treasury) private productive loans."

Kenyon E. Poole: "I think the banking system is about at the limits of its effectiveness in accomplishing the objectives. * * * The next steps involve fiscal policy and probably even a degree of direct intervention, which are the province of Congress and the administration, not the Federal Reserve."

Anonymous: "The powers of the Board should be increased in the following respects: (*a*) Power to increase reserve requirements; (*b*) power to regulate consumer installment credit; (*c*) power to more effectively regulate holding companies; (*d*) power to determine the adequacy of the capital of State banks applying for membership. * * *"

C. R. Whittlesey: "Extend powers to impose reserve requirements by increasing range and including all State banks; extend control over consumer credit; consider other possible controls, including a special security reserve requirement. * * *"

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George N. Halm: "The Federal Reserve should again be enabled to control member bank reserves, to eliminate excess reserves and to use open market sales effectively to tighten credit conditions if this should be necessary."

E. Sherman Adams: The Federal Reserve should be strengthened vis-a-vis the Treasury in order to reduce domination by the latter. In addition the Board should have permanent power to regulate consumer credit and some measure of control over real estate credit.

Howard S. Ellis: Under the present extraordinary condition of high liquidity on the part of business and individuals "* * * it would be advisable for the Federal Reserve System to have the power to impose additional reserve requirements (up to 100 percent) for increases of deposits on the part of commercial banks past a given date (if and when necessary, of course; it is not just at this moment necessary).

"In the second place, the Chairman of the Board of Governors should be a member of the Cabinet. This is a suggestion offered in informal discussions by E. A. Goldenweiser, to which quite inadequate publicity has been given. Monetary policy is inherently as important as fiscal policy for the country's economic well-being. It is an anomaly that only the latter is explicitly represented in deliberations at the Cabinet level.

"Alternatively some form of the special cash and Government-security reserve proposed by the Federal Reserve about 2 years ago might be enacted. Either measure could be so framed as to accomplish substantially the same restraining effect upon credit expansion. The Federal Reserve proposal is less onerous upon the earnings of the commercial banks; but it is a rather complicated mixture of two motives: restraining credit expansion and supporting the Government security market. Careful analysis should be devoted to the merits of the two alternatives named here; but a variant of one or the other would seem to be highly desirable."

Edward S. Shaw: "The Federal Reserve should be permitted to specify a minimum ratio of bank net worth to bank earning assets. It should be permitted, too, to specify a 'security reserve' of bank holdings of Government securities. The cash reserve requirement is not powerful enough and needs the supplementation of these capital and asset requirements.

"The Federal Reserve should be permitted to exchange securities of any maturity from its portfolio against new issues directly from the Treasury of maturities that may be adapted better to the Federal Reserve's operational requirements.

"The Federal Reserve should have the same authority to regulate State banks that it has for national banks."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "There is no necessity whatever for any change in the powers of the Federal Reserve in order to increase its effectiveness. The powers already possessed by it, if properly and consistently used, would bring about that result."

Anonymous: "I see no need to make any changes in the powers of the Federal Reserve."

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W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "They have enough power for a strong system."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: Decentralize the power in Washington. Let the 12 Reserve banks function by taking the leading part in local action in their respective districts.

L. M. Giannini, Bank of America, San Francisco, Calif.: The present powers of the Federal Reserve are extensive and cogent, and to augment these would tend to establish an all-too-powerful bureaucracy. At some future date it might be well for Congress to consider revoking the power to regulate margins in connection with listed security loans. It appears desirable to shorten the term of the Governors of the Federal Reserve Board to 4 or 5 years and to prohibit appointments for more than two terms under any circumstances. Bona fide residence in a Reserve district to qualify for membership should be required and for a sufficiently long period, at least 5 years, to enable a prospective member to thoroughly understand the historical and prevailing economic conditions in his district.

R. C. Leffingwell, J. P. Morgan & Co., New York: "* * * They are too effective already, as shown in 1920, 1929, 1937, and 1948. If the * * * Federal Reserve Board had had and exercised the powers over bank reserves which they again and again demanded of Congress, this country would have endured a deflation in the last 12 months which would have made 1932 seem like boom times."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: No additional powers should be given. "* * * Our need seems to be for knowledge to grow up to the present degree of authority, free from minor objectives."

H. H. Gardner, the Birmingham National and Ferndale National, Michigan: "No major changes are suggested. The Federal Reserve System is a very flexible, cooperative, and constructive agency as it now stands."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: It is not the function of the Federal Reserve to control employment or price levels—only the limited effect that might follow credit control actions.

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "None for Federal Reserve but a change in attitude of people is needed—cut out 'gimme' and go to work or we will go to hell."

J. R. Geis, the Farmers National Bank, Salina, Kans.: No changes need to be made in the Federal Reserve Board, but open-market operations and discount rates should be subject to the majority approval of the Federal Advisory Committee.

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "No further powers needed. Present adequate, if used at proper time."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is believed that the Federal Reserve should have more power to increase reserve requirements, and the power to exercise such qualitative credit controls as it deems necessary. In the past when such controls were needed, their application was unduly delayed because Federal Reserve had to apply for and await legislative permission to enforce them."

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C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: In general, the System does not need larger powers. "* * * I would not, however, rule out the desirability of restoring to the Reserve System some authority over consumer credit."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Meyer Kestnbaum, Hart, Schaffner & Marx, Chicago: " * * * The Federal Reserve now has substantially all of the powers that it needs for the exercise of its proper role. Its greatest opportunity lies not in further control of the banking system but in the exercise of a large degree of wise leadership * * *."

7. What changes, if any, should be made in the reserve requirements of member banks? In the authority of the Federal Reserve to alter member bank reserve requirements? Under what conditions and for what purpose should the Federal Reserve use this power? What power, if any, should the Federal Reserve have relative to the reserve requirements of nonmember banks?

A. ANSWERS BY ECONOMISTS

Howard A. Bowen: "The Federal Reserve might well be given unlimited authority over reserve requirements of all banks. * * * The power to change reserve requirements would be used principally as a brake on unwholesome general credit expansion."

Elmer C. Bratt: "I doubt if any changes are currently required in reserve requirements of member banks. The Federal Reserve should be given far greater authority to alter reserve requirements in the interest of preventing the development of purely cyclical credit or preventing the deflation of what should be secular credit. Control should apply equally to member and nonmember banks."

Neil Carothers: "Federal Reserve should have freer powers to alter reserve requirements."

C. O. Fisher: "As a means of controlling credit expansion, reserve requirements of all commercial banks should be subject to the control of the Federal Reserve Board."

Frank D. Graham: "The Federal Reserve should be given power to change in any degree the reserve requirements for member banks." In answer to Question 4 I stated that all banks should be required by law to be members of the System.

Lloyd W. Mints: "The reserve requirements for all member banks should be made the same. The present structure of reserve requirements goes back to conditions before 1913, when country banks held part of their required reserves in the form of balances with Reserve City and Central Reserve City banks. Differences in reserve requirements mean that a transfer of funds from a given bank to another with different reserve requirements may require a contraction of the volume of bank loans and hence of deposits, or permit an expansion thereof.

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The danger of any significant development of this kind may not be great, but I see no reason for its presence at all.

"I would eliminate the authority of the Board to change reserve requirements. Open market operations are an adequate weapon for control. Ideally, reserve requirements should be 100 percent, * * *. Any increase in reserve requirements would be a good thing, however, and therefore it is desirable to raise requirements above their present level, even though they still might be far short of 100 percent. It is because I do not like to see reserve requirements any lower than they now are that I would eliminate the power of the Board to control reserve ratios."

Roland I. Robinson: "* * * As to the administrative changes in reserve requirements, I have come to be dubious of such frequent changes as have been made. I think well of the authority but regret its overfrequent employment. I do think that reserve requirements should apply to all insured banks since they, as well as member banks, are beneficiaries of the reserve flexibility provided by the Federal Reserve System. Everybody should pay for the fire department, not just a subscription list."

Edward C. Simmons: "* * * Uniform reserve requirements should apply to all commercial banks, not merely to member banks. As to the variable reserve ratio, this is a useful weapon even if the authorities have not yet learned to use it with great skill. To tie them up by a formula would be unwise. If they have common sense, they will use the variable reserve ratio only occasionally, but no attempt should be made to restrict this use by a legal formula."

Philip E. Taylor: "* * * I should like to see the Federal Reserve equipped with power to raise reserve requirements to 50 percent. It should use this power against a condition similar to that of 1946–48. It follows, of course, that the more broadly applicable this power, the more effective it is likely to be." I therefore believe that all banks ought to be members of the Federal Reserve.

Edward F. Willett: "Complete control over reserve requirements should rest with the Federal Reserve if it is not dominated by the Treasury."

Roy L. Garis: "I am opposed to 100-percent money, but I would give the Board authority to fix legal reserves at any percentage up to 100 percent but keep present minimum reserves. However, until we find answer to the present monetization of the public debt, these and all other credit controls will prove ineffective. * * *"

Harry Gunnison Brown: "I am not prepared to say categorically what changes should be made in reserve requirements of member banks or in the authority of the Federal Reserve to alter member bank reserve requirements. The authority to alter member bank reserve requirements does add to the techniques the Federal Reserve can use in seeking business and price level stabilization. Something is to be said perhaps in favor of giving the Federal Reserve authority to determine the percent reserves required of all commercial banks, whether members or nonmembers. But if such authority were to be given it is hoped it would be used with discretion. * * *"

Albert G. Hart: "* * * I have another drastic recommendation: A ceiling reserve of 100 percent on bank deposits. Specifically, I recommend: (*a*) A 100-percent reserve requirement on all deposits at each bank in excess of an exemption; (*b*) calculation of the exemp-

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tion from the bank's outstanding net private credit (i. e., the amount of loans and non-Federal bonds held, less the bank's capital funds) at a base date. To avoid hardship cases, I recommend making the exemption 103 percent or 105 percent of base period net credit; (*c*) counting toward the reserve: (*i*) Reserve balances with Federal Reserve banks; (*ii*) vault cash; (*iii*) Government securities held by the bank at the base date and stamped as reserve-eligible by its Federal Reserve bank; (*iv*) Federal Reserve bank-eligible securities (or interest-bearing Federal Reserve balances) obtained in exchange for maturing reserve-eligible securities; (*v*) special issues of Federal Reserve securities (or interest-bearing balances) put out in connection with expansionary fiscal policy or open market purchase of nonreserve securities; (*d*) applying these requirements to all commercial banks; (*e*) making a legislative declaration that the constitutional power over money extends to all banks, and to operations analogous to commercial-bank deposit-holding carried on at savings banks, savings and loan associations, and insurance companies. * * *"

Frederick A. Bradford: "I endorse the recommendations of the Federal Reserve Committee on Bank Reserves, which would base reserve requirements on a combination of the volume and velocity of turn-over of deposits. Such a reserve requirement, once fixed, should be allowed to remain in force without the possibility of change by the Board of Governors. Unduly large gold imports could be sterilized by the Treasury if desirable. It is also desirable to allow member banks to count as reserves at least some part of their vault cash."

Raymond P. Kent: Expand the legal capacity of the Board to change reserve requirements up to, say, 40 or 50 percent. "Only in this way, as I see it, can the Board be given the means to make its policies effective if and when the commercial banks decide to unload a substantial portion of their holdings of Government obligations. The Board's proposal * * * that it have the privilege to permit commercial banks to hold short-term Governments in lieu of cash reserves is quite * * * appropriate * * *. The Board * * * should be authorized to vary reserve requirements without regard to the present classification of localities as central Reserve cities, Reserve cities, and country districts."

B. H. Beckhart: "* * * I would propose that member bank * * * reserve requirements against net demand deposits be based upon the type of deposit held by a member bank rather than upon the geographical location of the member bank. Reserve requirements against time deposits are now uniform for all banks. They should also be made uniform against net demand deposits. A higher reserve possibly might be required against bankers' balances than against other types of demand deposits.

"The authority of the Federal Reserve Board to alter member bank reserve requirements should in my opinion be eliminated. This power embodied in the Banking Act of 1935 justified itself prior to 1941 for it allowed the Reserve System to raise * * * requirements at a time that gold was flowing into the country at a rapid rate. * * * However, now that the open market portfolio is large enough to care for all contingencies, this power should be eliminated. Increases or decreases in member bank reserve requirements is a very clumsy and awkward weapon of central bank control.

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"Should this country become involved in large volume of deficit financing, arising from war or other causes, the Federal Reserve System might be given the authority to raise reserve requirements on increases in deposit totals. This would tend to restrain the multiple expansion possible at such a time by reason of the inevitable increases in Federal Reserve credit.

"* * * I suggested that all insured commercial banks be subject to member bank reserve requirements. The present situation * * * results in an unequitable situation."

Marcus Nadler: Present reserve requirements are inadequate and need thorough revision. "I am in favor of uniform reserves for all banks with similar types of deposits, irrespective of location. * * * I am also in favor of the certificate reserve which, if properly handled, would enable the Board to support Government bonds without at the same time having to penalize the earnings of the banks. All commercial banks of the country should be subjected to the same reserve requirements as the member banks."

Seymour E. Harris: There is no logic in the requirement that reserves vary according to the size of the city. The Federal Reserve should have authority to raise or lower reserve requirement of banks to a much greater degree than is possible now. Even this power, however, would not be sufficient without a compulsory immobilization of Government securities. "* * * the control will be less than perfect so long as nonmembers are not subject to it. In fact, this increased authority imposed upon the member banks only would offer a stimulus to desert the system."

Charles C. Abbott: If the Federal Reserve had not felt the necessity to support the prices of Treasury securities it is doubtful if there would be any reason for permitting the Federal Reserve to change the reserve requirements for member banks. "My feeling is that the present law should not be changed or, if further power is given to the Reserve System, it should be given very cautiously and sparingly."

Karl M. Arndt: The reserves of all banks of deposit should be under the discipline of the Federal Reserve.

E. E. Agger: "* * * I should advocate a wider flexible authority for the Board in connection with member bank requirements * * *. The early rough-and-ready adaptation of reserve requirements to population * * * has lost its significance * * *. In view of the fact that nonmember banks make an important contribution to over-all effective money supply, the broad reserve regulations should be made applicable to them as well as member banks."

Kenyon E. Poole: I approve in principle the suggestion on reserve requirements in the Board's 1948 annual report. "Nonmember banks should be brought under reserve requirement control if this is constitutional."

James B. Trant: "* * * I doubt the wisdom of a long-run policy which would allow the Federal Reserve any authority with reference to reserve requirements of nonmember banks. There are arguments, however, for varying the reserve requirements of all FDIC members."

George N. Halm: The Federal Reserve should not be restricted in its power to alter the reserve requirements of member banks nor to ask for secondary reserves consisting of Government securities. It must be able to eliminate excess reserves which are, for example, caused by

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abnormal gold inflow. It is unreasonable to ask the Federal Reserve to control the credit system or to reach any objective whatsoever if it cannot control the reserves of the member banks.

Anonymous: The uniform reserve requirement plan should be adopted, for it would constitute a vast improvement over the present system. The Federal Reserve should have power to impose reserve requirements upon nonmember commercial banks, subject to the exception that these reserves need not be held by a Reserve bank. Additional powers with respect to nonmember banks would not be needed if all insured banks were required to become member banks. When the Board used its recent temporary power to raise reserve requirements nonmember banks had a decided competitive advantage over member banks in the same communities and used it to the limit. This caused much ill-will toward the System on the part of member banks and there were threats of withdrawals from the System. Bad bank relations were generated and more harm than good resulted for the System. Effective cooperation of member banks with respect to monetary policies is seriously lessened by the present differentiation between member and nonmember banks.

C. R. Whittlesey: "* * * I am inclined to favor the revision of member bank reserve requirements proposed by the committee of experts of the Federal Reserve System but am not convinced that it is a matter of very great importance."

E. Sherman Adams: "Changes in bank reserve requirements are neither desirable nor effective as a method of short-run credit control as long as the Reserve System adheres to a policy of supporting Government bond prices at par. If the Reserve System can regain greater flexibility of open market policy, the regulation of bank reserve requirements would not be necessary."

Howard S. Ellis: "See No. 6. If membership in the Federal Reserve System is not made obligatory upon all commercial banks, then the Federal Reserve System should be given authority to impose the reserve requirements mentioned under No. 6 upon all banks."

L. Albert Hahn: "I have no doubt that under the prevailing system the Federal Reserve System could have had the power to enforce any interest rate in the economy it wished. The trouble was that for fiscal reasons it did not want to use the power. If one is afraid that the Government bonds will sink below par and is prepared to support the par price, no reserve requirements whatever will prevent the banks from creating all the reserves they need. What is wrong and should be changed is the approach to the debt problem and the prevailing illusion that easy money guarantees full employment."

Edward S. Shaw: "There is no economic justification for the differentiation of requirements according to the location of member banks or for the imposition of requirements on time accounts. Obviously the present system cannot be dropped quickly, but in time it should be abandoned. It is also undesirable that the range of possible variation in reserve requirements should be as narrow as it is and should be changed episodically by congressional action.

"The Federal Reserve should have unrestricted authority to change reserve requirements of member banks.

"The Federal Reserve should develop the practice of using member reserve requirements as a flexible instrument of control, a companion piece for open-market operations. Small, frequent changes in reserve

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requirements can be a more powerful and pervasive device than the open-market operation. The Federal Reserve should have control over the reserve requirements of all commercial banks."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "At the present time there appears to be no necessity whatever for any change in the law covering the reserve requirements of banks. No change should be made in the authority of the Federal Reserve to alter member bank reserve requirements.

* * * * * * *

"The Federal Reserve should have no power relative to the reserve requirement of nonmember banks. * * * An attempt to give the Federal Reserve power over the legal reserves of nonmember banks would tend to discourage the spirit of cooperation and unity of purpose which now exists between the two banking systems."

Anonymous: "Reserve requirements have been unnecessarily high. The authority of the Reserve to increase the requirements is sufficient to deter banks from unnecessary lending. The Reserve Board has used this power to a much greater extent than was necessary. Federal Reserve should have no power over reserve requirements of nonmember banks."

Anonymous: "Think the Federal Reserve should use its power to alter member bank reserve requirements when it seems that such change would aid in reaching objectives. * * *"

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "The power to regulate reserves of banks in general by the Federal Reserve Bank is dangerous if not used correctly. Local conditions might be unsuitable for such actions on a national scale. Country banks, or nonmember banks, do not need compulsion, and in general would follow member banks if their condition warranted it."

R. C. Leffingwell, J. P. Morgan & Co., New York: The reserve requirements should be fixed by Congress, should be uniform for all member banks, should not exceed 15 or 20 percent of demand deposits, and the authority of the Federal Reserve to alter reserve requirements should be rescinded. The Federal Reserve should have no power over the reserve requirements of nonmember banks.

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: No change should be made in the reserve requirements of member banks. The Federal Reserve should not be given additional powers to increase reserve requirements and it should not have authority over the requirements of nonmember banks.

Anonymous: "The determined drive to increase power over reserve requirements seems to be resulting in a circuitous, dead-center type of thinking as if the solution to all our problems was hidden in the mystery of reserve requirements. It is a crude and sweeping instrument that can be and has been used like a sledge hammer where knowledge and skill are required to deal with delicate situations. The instrument of reserve requirements was meant to be used in unusual situations such as an extraordinary inflow of gold or an excessive extension of Federal Reserve credit. If used arbitrarily or capriciously, the over-all power over reserve requirements could put banks out of commission or nationalize them * * *."

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W. R. Gott, the National Deposit Bank, Arnold, Pa.: "The Federal Reserve Board seems to be doing a very fine job in regard to reserve requirements both in tightening those requirements when necessary and in recently releasing a part of the reserve."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "None."

H. H. Gardner, the Birmingham National, and Ferndale National, Michigan: In general the Federal Reserve has used this power wisely and effectively. Nonmember banks can hardly be subjected to Federal Reserve requirements without virtually incorporating them in the System, but there should be understanding and cooperation between Federal Reserve authorities and the State banking departments.

Anonymous: The whole system of reserve requirements needs overhauling.

"* * * The present classification of member banks into three groups for purposes of reserve requirements is out of date and illogical under present conditions * * *. Any new system of reserve requirements ought logically to be extended also to nonmember banks, but this should probably await a complete overhaul of the Federal bank supervisory agencies."

J. R. Geis, the Farmers National Bank, Salina, Kans.: These reserve requirements should be statutory and the Federal Reserve should have no power to alter them, certainly not unless the power is restricted by requiring the approval of the Federal Advisory Committee. The Board should not have power to alter the reserve requirements of nonmember banks.

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "No change recommended. Should confine to member banks."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The fixing of reserve requirements based on the location of the individual bank is inequitable. Uniform requirements, regardless of the location of the individual bank, would be more equitable; but the establishment of such or any policy related thereto should not be used as a means to interfere with or affect the normal and free conduct of business between commercial banks, and any bank's deposits with a Federal Reserve member should be treated as legal reserves at least to the extent that such member bank is required to carry a reserve with the Federal. Changes in reserve requirements should be made only rarely. Reserve requirements of member and nonmember banks should be uniform; however, nonmember banks should not be required to carry reserve balances in Federal Reserve banks."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "Reserve requirements seem ample to me. The requirements should at all times be such that the banks can take care of their demands for withdrawals. Do not believe that Federal Reserve Board should use this power to regulate prices except during periods of war. Should have the same power over nonmember banks."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "* * * The Federal Reserve should be given plenty of authority. Changes in reserve requirements should be made as infrequently as is possible. If possible it would seem that this power to regulate reserves should include nonmember banks."

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Fred W. Glos, the First National Bank, Elgin, Ill.: "None if our system is to stay semifree. If it is to become completely regulated, then the System should have control over nonmember banks."

L. M. Giannini, Bank of America, San Francisco, Calif.: No change is recommended in the present laws governing member bank reserve requirements and there should be no change in the authority of the Federal Reserve to vary reserve requirements. There is sufficient flexibility in the present range and the present ratios applicable appear to be in order. Generally speaking, the Federal Reserve should use its power to change reserve requirements to arrest dangerous inflation or deflation. It should not have any power over nonmember banks, either in the matter of reserve requirements or otherwise.

Anonymous: "No change is needed in the authority of the Federal Reserve to alter member bank reserve requirements. The powers there are ample to meet any contingencies in the foreseeable future. The rise in reserves due to gold imports can be more smoothly and effectively offset by open-market operations than by raising reserve requirements. The Federal still has nearly $18,000,000,000 of Government securities which it can sell.

"As a matter of fact, little or nothing can be accomplished by raising reserve requirements as long as the Federal finds it necessary to support Government security prices and stabilize interest rates. Under those conditions raising reserve requirements simply drives Government securities out of the commercial banks into the Federal Reserve banks. A study of the banking figures for 1948 will support that viewpoint.

"I see no basic objection to giving the Federal Reserve System power to impose upon nonmember banks the same reserve requirements that prevail for member banks. If it is sound policy to require specific reserves for member banks as a regulatory measure, it seems to me completely logical to make the same requirements for all insured banks. This would improve the effectiveness of Federal Reserve control, and I cannot see in it any threat to the dual banking system.

"The suggestion that reserve requirements should be based upon the type of deposits rather than upon geographical location has merit and should be given consideration."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "The power of the Federal Reserve to increase reserve requirements should be broadened in order to permit more freedom of action. Member banks should be permitted to carry a certain portion of their required reserves in short-term United States Governments. Such a policy would tend to freeze a portion of bank reserves in income-producing assets, which assets would not be used to raise additional reserves through sales to the Federal Reserve, thus mitigating the effect of the increased reserve requirements. Such a policy would provide for more stability in interest rates and would relieve, to some degree, operations of the Open Market Committee in supporting the market in times when the opposite results are desired.

"The power to regulate reserve requirements of nonmember banks is desirable as it would place all banks under the same regulations; however, the small amount of reserves involved appears to make any action unimportant."

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C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "The aim should be to keep reserve requirements as stable as possible. Changes should be made to reflect basic shifts in the banking position such as would result from large movements of gold into or out of the country and major changes in currency circulation. Reserve requirements have come to be a main policy reliance in the last few years largely because the more traditional instruments of credit policy—the rediscount rate and open-market operations—were made unusable by the rigid bond-pegging program. With the return of greater flexibility to the Government securities market, the importance of reserve requirements as an arm of policy will dwindle."

E. F. Haworth, commissioner of finance of the State of Idaho: The Federal Reserve should not have power over member-bank reserve requirements.

Paul A. Mitchell, superintendent of banks of the State of Ohio: "No changes should be necessary in the reserve requirements of member banks and the Board of Governors of the Federal Reserve System has sufficient authority over reserves under existing statutes. Under no circumstances should the Federal Reserve have any authority to regulate reserve requirements of nonmember banks. The authority to regulate reserve requirements for nonmember banks should rest solely with the various States, and to deny them that authority would destroy States' rights along with centralizing control in one Board. In Ohio, for example, the banking advisory board is vested with authority to change the reserve requirements of nonmember banks either by increasing or decreasing the requirements from the statutory 15 percent on demand and 10 percent on time deposits. Our reserve requirements in Ohio for nonmember banks usually exceed the Federal Reserve requirements except in reserve cities. In my opinion, the changing of reserve requirements has had no effect in combatting either inflation or deflation, as was demonstrated during the current year. To give the Federal Reserve control over reserves in nonmember banks would not increase the effect of combatting inflation or deflation, since the amount on deposit in nonmembers and the loaning potential of the nonmembers is but a small percentage of the over-all total of the banking system. The stress laid on extensions of credit by the banking system as a prime contributing factor to inflation appears more imaginary than real. The rapid increase in commercial bank loans in the 2 years after the end of the war was a normal economic reaction, and the rate of increase for the years 1948 and 1949 is negligible in comparison. The decline in the rate of increase was due to a combination of a tighter loaning policy by banks and a slackening of demand for loans rather than to the changes in reserve requirements by the System."

C. A. Gough, deputy and acting commissioner of the State of New Jersey: There is no reason why the present reserve requirements of member banks should be changed or that the authority of the Board to change these requirements should be altered. "* * * The System, in order to be in a position to exert maximum power to increase or decrease funds available for bank credit, should, I believe, have the

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power to prescribe or alter reserve requirements for all banks, whether or not members of the System, despite the apparent encroachment on the rights of States involved in such an arrangement."

A. A. Rogers, superintendent of banks of the State of Oregon: No changes are now necessary with respect to the reserve requirements of member banks, and it would be an encroachment on State rights for the Federal Reserve to require an increase in the reserves of nonmember banks. "* * * When the reserve requirement was increased by the Federal Reserve bank a year ago, the only result that I could see was that the member banks sold Government bonds so as to increase their deposit with the Federal Reserve bank. I do not believe that the increase of reserves was necessary nor that it attributed anything toward lessening the inflationary trend. I hold that State banks which are authorized and chartered by the separate States should be supervised by the States and not be subject to the rulings of the Federal Reserve Board."

J. F. McLain, director of banking, State of Nebraska: Policy should aim for a greater stability. Frequent changes in reserve requirements do not augur for planned financial stability. Reserve requirement changes that have been inaugurated for the most part have swung too far with the resultant effect of overcontrol and then too much decontrol—too much 'emergency' thinking. The Federal Reserve should not have the power to regulate the reserves of nonmember banks. This power, if granted, would leave a large segment of the financial field free to function as their conscience may dictate, especially a vast number of Federal agencies, all of which in a measure nullify any edict that the Federal Reserve may proclaim. There does not appear to be any agency where the Federal agencies must report direct obligations outstanding and the total amount of guarantee commitments outstanding.

Donald A. Hemenway, commissioner of banking, State of Vermont: For the present the Federal Reserve probably has ample authority to alter member bank reserve requirements. It should have no power relating to reserve requirements of nonmember banks inasmuch as nonmembers hold so small a part of the total of commercial banking assets and because State authorities have been more and more effective in that direction.

Benjamin O. Cooper, auditor of public accounts, Illinois: "The right to set reserve requirements of member banks from time to time is already a power of the System and bankers accept the System's prerogative in that respect as a condition of membership. Any criticism, constructive or otherwise, in regard to the use of that authority should come from the membership of the System As a bank supervisor, my office feels that reserves are management matters, from which we remain aloof until such time as the operations of an individual bank cease to be healthy or profitable. However, in respect to nonmember reserves, compulsory adherence to Federal Reserve requirements is as objectionable and ill-advised as compulsory membership. Power to control all banking functions is but a short step beyond the power to control the cash reserves of every bank."

Maurice C. Sparling, superintendent of banks, California: "The Federal Reserve should have authority to alter reserve requirements within a moderate range, but this authority should not be extended to apply to nonmember banks. Too much has been expected of re-

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serve controls. Excess reserves have been created by conflicting policies as previously stated. Attention should be given to control of too liberal credit extended by Federal agencies in direct competition with banks. Effective control over inflationary forces cannot be obtained by controlling bank reserves alone.

"Mr. Lawrence Clayton, a member of the Board of Governors of the Federal Reserve System, in an address before the Ninth Annual University Conference of the Virginia Bankers Association, at the University of Virginia, on September 8, 1949, made it clear that he believed that an over-all sound fiscal policy for the country must include management of the public debt and also control over the reserves and lending power of all commercial banks. He indicated that control over excess reserves is necessary to the maintenance of effective control over 'the cost and supply of credit.' He defended the policy of pegging the price and interest rates of United States Government securities, which he considers has made it necessary to give the Board authority to establish excess reserve requirements.

"Assuming that such controls are necessary, Mr. Clayton asks why nonmember banks should not be subject to them, as well as member banks. I consider it unwise and unsafe to give the Federal Reserve or any other Government agency, blanket authority to control 'the cost and supply of credit' of the country as a whole. Although Mr. Clayton states that such authority, if held, would be used only in extreme emergency, we are too familiar with the readiness of the Government in recent years to create emergencies overnight and deal with everything as a crisis which must be met by giving additional authority to some Government agency, or by the exercise of some agency of authority intended to be used only in extreme emergency.

"As to giving the Federal Reserve authority over nonmember bank reserves, I consider that this would be an encroachment on States' rights and on the independence of State banks which is their inherent right under the dual banking system. To compel State banks to become members of the Federal Reserve System, as a means of controlling their reserves, is equally objectionable."

Richard Rapport, bank commissioner, Connecticut: "Originally and traditionally, reserve requirements of member banks have not been, in themselves, a complete arm or instrument of credit policy. They have been relied on (ineffectively) in the last few years as a main policy instrument largely because the traditional tools of credit policy, that is, the rediscount rate and open market operations, were made unusable by the rigid bond-pegging program. This program, in the face of the tremendous holdings by banks of Government securities, makes it possible for banks to obtain additional loanable funds or additional reserves by selling their Government obligations. It would seem desirable to keep reserve requirements as stable as possible, changing them only to reflect basic shifts in the banking position such as would result from large movements of gold into or out of the country or major changes in currency circulation. There is little question but what the dependence upon reserve requirements as an important arm of the credit policy will dwindle with the return of greater flexibility to the Government securities market.

"For the reasons contained in the above paragraph and particularly because of the reasoning and figures given in the answer to question 4, I do not believe the Federal Reserve should have any power relative to

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the reserve requirements of nonmember banks. As noted in the answer to question 4, the Federal Reserve already has control over the reserve requirements pertaining to 86 percent of commercial bank deposits in this country. Whether or not the dependence on reserve requirements as an important arm of credit policy will dwindle, as is set forth in the previous paragraph, the power to set reserve requirements for the 14 percent of commercial bank deposits in the hands of nonmember banks seems relatively unimportant, particularly when such power, if granted, would have the effect in a large measure of forcing all banks into the Federal Reserve System. This would be repugnant to the American system of checks and balances, States' rights, and the preservation of the dual banking system."

Frank E. Goldy, State bank commissioner, Colorado: "Keep reserves as stable as possible.

"Federal Reserve should have the authority to change reserve requirements in order to control inflation or meet changes in money circulation.

"Power of reserve requirements of nonmember banks should rest with State authorities if we are to keep the independence of State banks."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: There seems to be no present reason for changing the Federal Reserve power over member bank reserve requirements. "* * * It is probably fair to agree with the Federal Reserve authorities that they should have the same power over reserves held by nonmember banks *which are members of the Federal Deposit Insurance Corporation* as they have over those of member banks. This is not a major economic issue but rather a matter of equalizing competitive conditions between banks—and also perhaps a means of coaxing more State banks into the Reserve System—always a desire of the latter."

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "I would not think that the Board should have the power to increase reserve requirements unless it becomes clear that their present powers are inadequate to prevent an unsound boom. The nonmember banks do not seem important enough to require new legislation at this time."

> 8. What changes, if any, should be made in the power of the Federal Reserve to exercise selective credit controls? Has its regulation of margin requirements on security loans had any undesirable effects? Should it have the permanent power to regulate consumer credit? Should selective controls be applied to any other types of credit? If so, what should be the guiding principles?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "The Federal Reserve might well be given unlimited authority to impose selective credit controls, with due provision for preventing unjust or unnecessary discrimination. This would give it the power to restrict credit at the precise points where unwholesome expansion is occurring."

Elmer C. Bratt: "* * * The Federal Reserve System should have permanent power to control consumer credit. I think its control

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of margin requirements on security loans, on the whole, has been good. Other selective control powers should be extended if the need arises."

Neil Carothers: "Selective credit controls are an arbitrary and possibly dangerous interference with private enterprise, of uncertain value and limited influence. It is a serious question whether the Federal Reserve should have any such controls. Certainly they should not go beyond margin requirements and installment rates."

C. O. Fisher: "* * * Margin requirements have apparently caused no serious injury. The Board should have permanent power to regulate consumers' credit. Additional selective controls should be delayed pending the appearance of new maladjustments. * * *"

Lloyd W. Mints: "The Board should have no power whatever to exercise selective credit controls. The use of selective controls implies that funds which get into circulation by way of given transactions do not permeate to other parts of the economy, which is an unwarranted assumption. Monetary control is in nature a general, over-all, influence. Detailed, specific controls are inappropriate."

Roland I. Robinson: "I favor both margin and consumer credit limitations, but would like to see them held steady at reasonable levels rather than jockeyed around so frequently. I would not apply direct control beyond these two cases except possibly in housing credit because of the Government's importance in this field."

Edward C. Simmons: "I have little use for selective credit controls. They represent a line of approach that is out of harmony with the real purpose of a central bank which is to control the aggregate stock of money."

Edward F. Willett: "I am opposed to selective credit control in any form except in time of real national emergency."

Harry Gunnison Brown: "*Selective* controls, whether discriminating between production of capital goods and production of consumer goods, or between different kinds of one or both of these, seems to me wholly bad and entirely unnecessary * * * Instead of having Government interference * * * at every point in the economy, we need only use the system of *general* control of the volume of circulating medium through such devices as the discount rate, open market purchases and sales, without discrimination among industries, etc."

Albert G. Hart: "I am not deeply concerned about 'selective credit controls'—though I suspect them of being a kind of busy-work developed in a period when monetary policy proper was out of action."

Frederick A. Bradford: "Power to exercise selective controls is helpful. I do not think that control over margin requirements has been harmful and it might prove extremely useful in the event of a bull market. * * * I also favor control over consumer credit on a permanent basis. I see no occasion for other selective controls, except the prevention of the creation of checking deposits for long-term investment purposes. * * *"

Raymond P. Kent: Regulation of margin requirements on security loans has been most salutary and should be extended to all such loans, not merely those on securities traded on national exchanges. The Federal Reserve should have the permanent power to regulate consumer credit because it is a class of credit which, if unregulated, tends to accentuate swings of the business cycle.

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B. H. Beckhart: "The Federal Reserve System should be given permanent power to regulate consumer credit and, in addition, should be given powers of selective credit control over real-estate loans. It would then have selective credit control powers over the three types of credit which are homogeneous in character and appropriate for such control-security loans, consumer credit, and real-estate loans. If given powers of selective credit control over real-estate loans, its powers in this respect would have to be reconciled with those of the FHA and the VA. * * * Selective credit controls are not * * * a substitute for general credit control. * * * The raising of margin requirements on security loans to 100 percent on January 21, 1946, undoubtedly did have an adverse effect on the full and efficient functioning of the Stock Exchange. * * * Such action was quite unwarranted for the reason that brokers' borrowings on stock collateral were not contributing to inflation at the time."

Marcus Nadler: "* * * Margin requirements have not had any undesirable effects. However, at times they were not expertly handled."

Seymour E. Harris: The case for these controls is probably greater than ever because both the banks and the public are largely free of control by the central banking system. "The Government might seriously consider the extension of these controls insofar as the required controls would not be confronted with excessive administrative problems. * * *"

Charles C. Abbott: "* * * I do not believe in the efficacy of such controls, nor do I think the future of effective central banking lies in that direction. At bottom, selective controls are arbitrary restrictions on the uses to which money or earning power can be put, and that I think is repugnant to a free market economy in time of peace."

Karl M. Arndt: "* * * The Federal Reserve System should have power to regulate loans in all major categories, whether classified on the basis of the purpose for which the loans are made or more practically on the basis of the collateral behind them."

E. E. Agger: The present powers should be broadened. The regulation of margin requirements has not had any undesirable effects. There should be selective control of consumer credit as well as credit elsewhere in the system.

Kenyon E. Poole: "A rough selective control is enough. If it is very detailed the Federal Reserve runs the risk of intervening excessively in business decisions. I do not think that excessive credit of the type indicated here is our main inflation problem. * * *"

George R. Walker: The Federal Reserve should have power to exercise selective credit control over margin requirements and permanent power to regulate consumer credit.

Anonymous: Cyclical fluctuations of installment credit are of considerable significance. The Federal Reserve should retain the power to regulate margin requirements and its control of consumer credit should be restored. We should also study seriously the possibility of imposing selective controls on real-estate credit, though this has serious difficulties. Because selective controls are relatively new they are generally opposed by the banking community and the public in general. Indeed, most reforms of banking and monetary systems are accomplished under the pressure of great emergency such as a war

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or a deep depression. Selective controls are all the more important when quantitative controls cannot be effective.

Howard S. Ellis: "The regulation of margin requirements has in general had no undesirable effects; on the contrary, it has made a substantial contribution to economic stability by making a repetition of the 1929 episode improbable, so far as concerns the security market.

"Power to regulate consumer credit * * * should be made a permanent Federal Reserve System power. Its role can never be more than ancillary to the main credit control weapons; but it is a useful and relatively unobjectionable supplement to control powers. Looking to the future emergencies, the selective credit controls might well be extended to include urban real estate and agricultural loans."

L. Albert Hahn: "In principle I do not believe in selective credit controls. All credit markets are interconnected, not entirely but to a large extent, so only general credit controls, especially raising the interest rate, will be effective for any length of time."

Edward S. Shaw: "In general, I am opposed to the principle of selective controls. It is a deviation from the basic theory of monetary control, that monetary instruments have a pervasive and impersonal influence. However, certain fields of credit are subject to peculiar abuse, so that limited selective controls may be desirable. I would prefer that they take the form of high, stable margin requirements—on security loans, consumer loans, real estate loans. Variation in the requirements should be an emergency device only."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "No change should be made in the power of the Federal Reserve to exercise selective credit controls. Although its 100 percent margin requirement order may have been a little too severe, yet on the whole it is to be doubted that its margin requirements on security loans have had any undesirable effect. The Federal Reserve should not be granted the power to regulate consumer credit, nor should exisiting credit control powers be broadened."

Anonymous: "The regulation of margin requirements has been very wisely used and I can see no undesirable effects. I see no need for the Federal Reserve to have permanent power to regulate consumer credit."

Anonymous: "* * * I do not believe that margin requirements on security loans have been otherwise than beneficial to the country. I believe the Board should have permanent power to regulate consumer credit in the interest of preventing overexpansion."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "In principle we are against power of Federal Reserve System to enforce credit controls such as regulation W other than to say as to what paper is eligible for discount with them. We believe, however, that they furnished a wise yardstick for banks and credit givers to follow, and made it easier for them to do so. We see no great danger in this power and should too easy credit be again established, this is one way to stop it."

R. C. Leffingwell, J. P. Morgan & Co., New York: It is desirable to have some method of restricting the abuse of credit facilities for the buying or carrying of stocks, consumers' goods and real estate, and to

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restrict the activities of the speculatively minded. There is, however, grave objection to a grant of excessive power to a Government bureau, and grave peril in the exaggerated swings which might result from too violent and too frequent changes in these credit controls. On the whole it seems best that fairly high minimum requirements in these fields should be fixed by Congress and that the Federal Reserve should have power to impose increased requirements only in periods of emergencies. Such emergency controls should be relaxed in periods of falling prices.

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: No change should be made in these powers of the Federal Reserve. It should not have permanent power to regulate consumer credit. Neither should it be given additional power to control other types of credit.

Anonymous: Selective credit controls should rest in Congress and should not be granted to any agency on a permanent basis. Recent experience justifies the belief that Congress has a much better understanding as to when and how this power is to be placed in the hands of an administrative agency when the need arises.

H. H. Gardner, the Birmingham National, and Ferndale National, Michigan: Selective credit controls are discriminatory and should not be used. Margin requirements on security loans are not an exception. When commercial banks tend to loan too freely on securities, thereby jeopardizing the public interest and their own stability, there is ample power in the offices of the Comptroller of the Currency and of the State banking departments to check the trend.

Anonymous: The Federal Reserve should be permitted to increase its use of selective credit controls because they are useful to supplement straight quantitative controls. The guiding principle should be that selective controls should be used when general quantitative controls are inadequate. Many of the critics of selective controls really do not want central banking to be effective, even though they pay lip service to central banking principles. There is altogether too much of a tendency to assume that the traditional methods of central bank controls carry some special merit because we are used to them, but it is not generally appreciated that the traditional methods were new methods themselves at one time.

J. R. Geis, the Farmers National Bank, Salina, Kans.: "The present powers to use open-market operations and to change the rediscount rate should be the extent of the Board's authority to exercise credit control."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The powers of the Reserve authorities to exercise selective credit control are adequate."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "* * * The Federal Reserve has accomplished considerable we believe in margin requirements on security loans. It would seem that it is proper for the Federal Reserve to have the power to regulate consumer credit, perhaps not so much on account of the consumer credit that banks grant but the consumer credit granted elsewhere. Consumer credit, of course, is a stimulant to business but it tends to stimulate too much in good times, and is therefore inflationary, and to retract in bad times, adding to deflation."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "Except in times of war, do not believe the Federal Reserve should

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have the power to exercise selective credit controls. The bankers of this country are aware of the dangers of extending credit improperly and can be depended on to act wisely."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: Selective controls should be limited. They might include power to regulate consumer credit, and it is possible that some control over security margin requirements might be desirable. "* * * However, I am not very strong for selective controls of any type of credit."

Fred W. Glos, the First National Bank, Elgin, Ill.: "Such regulation as to keep it from a 'run-away' market both on security loans and consumer credit but elastic enough to have general economic conditions play some part in the market operations."

L. M. Giannini, Bank of America, San Francisco, Calif.: The granting of additional authority for selective credit controls is not warranted either by wartime or postwar experience. The regulation of margin requirements has contributed in some measure to the unsatisfactory equity market but it has probably not been the major unfavorable factor in this situation. The Federal Reserve should not have the permanent power to regulate consumer credit, and selective controls should not be applied to any other types of credit.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is felt that the Federal Reserve should have the power to exercise selective credit control and such power should be permanent. The regulation of margin requirements on security loans has been desirable in removing a vast amount of speculative loans from the banking system. It has been undesirable in depriving industry of a certain amount of risk capital which could have been raised under more liberal margin requirements."

Anonymous: It is neither desirable nor feasible to allow the Federal Reserve to exercise selective credit control. The central banking authority's function can best be exercised on the over-all supply of money and on the rates at which it is obtainable. The regulation of margin requirements on security loans has not had undesirable effects although an increase of margins to 100 percent should never occur and there should be fewer changes in requirements. Frequent changes would place the Federal Reserve Board in the role of a stock-market forecaster. It is doubtful whether any kind of permanent consumer credit control can be very effective or very useful in the long run. Aside from its theoretical merits or demerits, it is probably subject to too many methods of evasion.

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "The Federal Reserve System should have the permanent power to regulate consumer credit. Apart from this, I do not recommend at this time any additional power to exercise selective credit control."

Donald A. Hemenway, commissioner of banking, State of Vermont: "I have little faith in the use of selective credit controls as instruments in maintaining sound conditions and in accommodating agriculture, commerce, and industry."

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F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: There is not a prima facie case for selective credit controls by the Federal Reserve. Under present conditions it is doubtful that Federal Reserve control of margin requirements on security loans is needed.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo, Ohio: Except for stock margin requirements, I do not believe the Federal Reserve Board should have the power to regulate consumer credit or selective control on any other type of credit. It should operate only on the general volume of credit.

Meyer Kestnbaum, Hart, Schaffner & Marx, Chicago, Ill.: "There are times when selective credit controls are useful but I am of the opinion that they should be used very cautiously because they call for a degree of wisdom and foresight which is not ordinarily available. We cannot demonstrate, for example, that it was wise to keep small investors out of the stock market; we may have shut off a very good source of risk capital. Another example of selective controls that has not worked out as anticipated is regulation W. It means almost nothing at the present time."

9. What changes, if any, should be made in the division of monetary and credit-control powers between the Federal Reserve and the Treasury? In the methods of coordinating their policies? Would you advocate increasing or decreasing the degree of independence of the Federal Reserve?

A. ANSWERS BY ECONOMISTS

Elmer C. Bratt: "Coordination should go further than just between the Treasury and the Federal Reserve. * * * I am not sure that the place where the control is applied is too important, but, on the whole, I favor the Federal Reserve because it would appear to be less political. The Federal Reserve cannot be independent in a satisfactorily coordinated national integrated policy."

C. O. Fisher: "Some methods should be worked out whereby the Federal Reserve would be less dependent than at present upon the United States Treasury."

Frank D. Graham: "The important thing is to have monetary and credit functions divorced from and quite independent of fiscal functions. How to get this desideratum it is not easy to say. My own view is that the Treasury will inevitably dominate the Federal Reserve and it would, therefore, be best to make the Federal Reserve a department of the Treasury, with the Secretary of the Treasury then having full responsibility in both the monetary and fiscal fields. This would be a reform in consonance with the well-recognized maxim that neither responsibility without power nor power without responsibility is to be recommended."

Lloyd W. Mints: "If it were possible to make monetary control independent of the administrative branch of the Government I would have no objection to making it so; but it is not possible. The budget position of the Federal Government inevitably has an influence on monetary matters, through its surpluses and consequent possible impounding of money, or through deficits with the possible result of creating additional money with which to meet the deficit. Any at-

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tempt to make the Federal Reserve System independent of the Treasury I fear will serve to delude all of us into forgetting that the Treasury does have monetary responsibilities. The Secretary himself is more likely to suffer from this delusion if the Reserve System is at least nominally independent, and the Secretary is the more likely therefore to act in monetary matters in an irresponsible manner. I would therefore in some manner bring the Board and Secretary closer together, in the hope that in time, at least, we could make our Secretaries of the Treasury realize more fully their monetary responsibilities and act in a more reasonable manner. There is no one way of doing this, that must be preferred to others, but I would suggest as one reasonable procedure that of reducing the Board to three members and making the Secretary ex officio one of the three. He could not then so easily ignore his inescapable responsibilities."

Roland I. Robinson: "All right as it is now. Federal Reserve should be independent in structural sense as it is now; cannot be independent in a policy sense—as it is not now."

Edward C. Simmons: "* * * Most of the problems would disappear if Congress were to lay down principles for national debt management. Now the Treasury has altogether too much freedom for its own good. Operated by amateur investment bankers, the Treasury is a threat to all that is sensible in monetary affairs."

Philip E. Taylor: "If possible, I should like to see the Federal Reserve quite independent of the Treasury. In most cases, there would be no conflict of policy, but where a conflict of interest occurs, I would hope to have the Federal Reserve's policy prevail. This is, of course, an idealistic view, and I have no suggestions for its implementation."

Edward F. Willett: "The present division of power between the Federal Reserve and the Treasury is highly undesirable. In general, I would recommend giving more power to the Federal Reserve, and less to the Treasury, except in time of war."

Roy L. Garis: "Divorce Treasury. Federal Reserve should not be a subsidiary of Treasury, which it is."

Albert G. Hart: "* * * In brief, I suspect the Treasury tradition on public debt will always stand in the way of restrictive monetary policy with the present relation of the two agencies. So I propose to concentrate responsibility with the Federal Reserve * * *."

Frederick A. Bradford: I favor a greater degree of independence for the Federal Reserve. "If the Treasury follows sound fiscal policy there would be little doubt that the Federal Reserve would cooperate fully * * *."

Marcus Nadler: I favor increasing the powers of the Federal Reserve despite the fact that "under present conditions and in view of the huge public debt and deficit financing the policies of the Reserve authorities will be dominated by the needs of the Treasury."

Seymour E. Harris: "* * * No monetary organization and no monetary policy can fail to take into account the Government's interest in monetary policy. * * * The objective of an independent central bank is scarcely even mentioned any more. That does not mean, however, that Treasury interests should dominate policy. * * * I would not advocate an increased independence for the Federal Reserve; but I would advocate improved coordination between the Federal Reserve, the Treasury, the Federal Deposit Insurance Corpora-

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tion, the independent lending agencies (inclusive of ERP), with the best interests of the whole economy the objective. Perhaps as important as the relation of the various Government interests is that of the Federal Reserve Board and the Federal Reserve banks. If the various Government agencies and departments involved are frequently in conflict, they do at least presumably seek the best interest of the entire economy. This is not necessarily true of the Federal Reserve banks which to a substantial degree are under the influence of banks."

Karl M. Arndt: "* * * There is need of a national money and credit authority to combine the policy-making functions of the Treasury and the Federal Reserve System."

E. E. Agger: "* * * One hesitates to recommend any limitation on the Treasury, but I believe that there might well be a coordinating council that could be charged with the responsibility of bringing about thoroughgoing cooperation."

Kenyon E. Poole: "Increased independence of the Federal Reserve seems to be a correct ideal, but under our political system it is difficult to see how it could be achieved."

James B. Trant: Control powers of the Federal Reserve should be increased sufficiently to prevent domination by the Treasury. Their policy should be coordinated through the Chairman of the Board and the Secretary of the Treasury, but the Federal Reserve should have greater independence than at present.

E. Sherman Adams: "* * * The prestige and independence of the Reserve System should be strengthened in a variety of ways. The Treasury cannot be expected to have an objective approach to monetary policy."

Anonymous: " * * * The Treasury has been too reluctant to allow a rise in short-term rates on Treasury securities, especially in 1945–46. * * * The independence of the System must be restored as rapidly as possible and Federal credit should be made to stand on its own feet as against its present artificial supports. It is not a matter of legislation so much as an alteration of purposes and objectives on the part of the Treasury. The System gets little credit for stabilizing the market for Governments, but it gets much blame when it asks for additional powers to make up for those lost in its efforts to effectuate fiscal policy. The policies of the Treasury must be subordinated to System measures essential for the stability of the economy, where the two are incompatible."

Howard S. Ellis: "I would advocate 'increasing the degree of independence of the Federal Reserve'; but I do not believe that especial statutory provisions are necessary (or indeed even easily conceivable), which would contribute to this end. The desirable independence of the monetary authority already exists in law. What is necessary for its realization is (1) aggressive action by the Federal Reserve Board of Governors itself; (2) administration support of the price- and employment-stabilizing policies proposed or undertaken by the Board. It is also the natural responsibility of the administration to secure coordination of Treasury and Federal Reserve policies."

Edward S. Shaw: "The theory of the independent central bank is not acceptable. The theory of the independent Treasury is also objectionable. Monetary and fiscal authority must be coordinated, each taking a logical role in a general regulation of national income. As matters stand now, the Federal Reserve is unduly subordinate to

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the Treasury. And the Treasury does not look at its problems from the standpoint of income policy."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "While there may be room for practical improvement, at agency levels, there appears to be no necessity for statutory change in the division of monetary and credit control powers between the Federal Reserve and the Treasury, or in the methods of coordinating their policies.

"Although experience indicates that it is not possible to have a completely independent central bank, it is highly desirable that the central bank have the maximum practical independence of thought and action. The problem of maintaining the independence of the Federal Reserve while providing at the same time the desired cooperation with the objectives of the Treasury is a difficult one. The Board of Governors should not be subservient to the Treasury and its changing views. The Board should, however, find practical means of cooperating with the Treasury in the development of sound fiscal and monetary policies. It is believed that this result can be accomplished within the framework of existing law.

"By no means would I advocate decreasing the independence of the Federal Reserve. Historical experience teaches that it is always harmful and dangerous to tamper with the independence of the central bank."

Anonymous: "I would advocate increasing the independence of the Federal Reserve System."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "Increase the independence of the Federal Reserve System from the monetary policies of the Treasury Department. To do otherwise is to invite trouble, as it places all our apples in one basket."

R. C. Leffingwell, J. P. Morgan & Co., New York: No statutory changes are needed or desirable. "* * * It is a matter of personalities and of the circumstances of the case. The Federal Reserve needs no greater statutory independence. It can, however, never be wholly independent of the Treasury when the Government debt is so great. Reconciliation of fiscal and credit policies must be a matter of discretion and good will and intelligent cooperation between the Treasury and the Federal Reserve."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: " * * * I think * * * greater independence on the part of the Federal Reserve might be desirable."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: "* * * The Federal Reserve should have more power over credit controls than the Treasury Department and I believe there should be an increase of independence of the Federal Reserve."

Anonymous: "* * * In the present situation it is academic to talk about increasing the degree of independence of the Federal Reserve. This arm of the Government must be effectively coordinated with other arms of Government in one way or another. The present approach has been informal. Perhaps some more formal method of coordination should be developed. It might be well to provide that the Secretary of the Treasury be returned to membership on the Board of

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Governors ex officio as used to be the case. It might also be desirable to make the Director of the Budget a member of the Board."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "Because of the enormity of our national debt there should be close coordination in the policies of the Federal Reserve System and the Treasury but the Federal Reserve System should not be made subservient to the Treasury. It should be completely independent."

William S. Gray, Central Hanover Bank & Trust Co., New York: "A great deal depends on the individuals at the head of the Reserve Board and the Treasury. The independence of the Federal Reserve should be maintained and strengthened."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "The Federal Reserve should be independent of control, but work in harmony with the Treasury Department to such an extent that they are not working against each other."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "It would seem wise to increase the degree of independence of the Federal Reserve, giving the Board the authority to chart the course of monetary and fiscal policy—further, that the Chairman of the Board should be a Cabinet member. * * * We believe the Board could plan a long-time monetary and fiscal policy better than the Treasury Department."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "Probably not qualified to answer this, but I would not want to see any decrease in the independence of the Federal Reserve."

Fred W. Glos, the First National Bank, Elgin, Ill.: "No changes. The Federal Reserve should be independent of the Treasury Department to the extent of maintaining a somewhat balance of power."

L. M. Giannini, Bank of America, San Francisco, Calif.: "The present credit control powers of the Federal Reserve should not be disturbed. The Treasury should be primarily responsible for monetary control powers."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "Keep them separate and preeminently independent, otherwise we will have political expediency creeping in, and by no means should the Treasury dominate."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia, Pa.: "There should be a distinct division in the monetary and credit control powers of the Federal Reserve and the Treasury. Their policies should be coordinated only to the degree of their joint operations for the betterment of the country. Within the last several years the policies of the Federal Reserve have been dominated by the requirements of the Treasury; while the Federal Reserve should cooperate in the Treasury's fiscal operations, such cooperation should not lessen its powers in controlling the major fluctuations in our economy. It is believed that independence of the Federal Reserve should be increased rather than decreased."

Anonymous: "* * * I do not believe coordination on a voluntary basis and without responsibility can be permanently effective. I suggest that the Secretary of the Treasury be made an ex officio member of the Federal Reserve Board, as he once was, to the end that he would have a statutory responsibility in both Federal Reserve and Treasury policies and objectives. This is the only change I would advocate in

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the division of monetary and credit control powers between the Federal Reserve and the Treasury."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott v. *Bell, State Banking Department of New York:* "The Federal Reserve System and the Treasury must, of course, work in close harmony and the Federal Reserve at certain times, such as in a period of war, cannot avoid subordinating itself to the needs of the Treasury. In general, however, the Reserve System stands in need of greater, rather than lesser, independence. If it were given more independence, it might find cooperation with the Treasury easier. Cooperation is always easier as among equals."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: The degree of independence of the Federal Reserve System should certainly be increased and no whit decreased. There must, of course, be a coordination of Treasury and Federal Reserve policies but the Board, now that both the war and the initial postwar period are over, must assume greater independence of action in these fields in which it has the great responsibilities Congress has bestowed on it and the competence to carry those responsibilities. "* * * Apart, then, from crisis operations and debt management, there would seem to be little area for a coordination of policies of the two bodies, in peacetime, unless the Government fiscal policy is continuously bad. This does not rule out constant and highly desirable consultation * * *."

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "As a practical matter, it is impossible to divorce the Federal Reserve Board from the influence of the Treasury, since the Federal Reserve Board is responsible to the President, and, generally speaking, the Secretary of the Treasury is likely to be closer to the President than the Chairman of the Federal Reserve Board."

10. What changes, if any, should be made in our monetary policy relative to silver? What should be the principal considerations in this policy?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "* * * There is no reason for subsidizing silver production in connection with monetary policy. I should suggest that silver be abandoned as a monetary medium except possibly for subsidiary coins."

Elmer C. Bratt: "Monetization support, except as use for subsidiary coinage, should be withdrawn from silver, possibly in easy stages. Silver should, however, be one of the raw materials in a buffer stock policy."

Neil Carothers: "Immediate repeal of the Silver Purchase Act and the domestic silver purchase law of 1946 is essential to decency. Eventually the silver dollar and silver certificate should be withdrawn. The 100,000 tons of silver now held should be (1) used for subsidiary coin, (2) used in atomic energy operations, and (3) sold to the public. Present policies outrage decency and adulterate currency."

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Fred R. Fairchild: "We should immediately repeal our present laws nationalizing silver. Silver should be left completely to the free market, the same as any other commodity. The Government should cease buying silver except as required for coining subsidiary coins, and such silver should be bought on the open market at the market price."

C. O. Fisher: "The present silver legislation should be repealed and silver should be used only as fiduciary currency as needed by the economy."

Lloyd W. Mints: "Silver should have no place whatever in our monetary system, except possibly as a metal from which some of the coins are made. For this purpose such amounts as may be needed should be purchased at the market price, without any attempt to influence that price."

Roland I. Robinson: "Quit buying silver. Quit subsidizing a few Western States."

Edward C. Simmons: "The silver subsidy legislation should be repealed, lock, stock, and barrel. The silver hoard should be sold for industrial purposes, the funds being used to retire national debt."

Philip E. Taylor: "Our behavior toward silver can hardly be said to be a monetary policy. I would prefer to see us cut ourselves loose from silver completely."

Edward F. Willett: "The price of silver should be left free to seek its normal level, just as that of lead, copper, zinc, or any other metal. Our Government should buy silver in the open market when it needs it, and should not be used to subsidize domestic production. Our silver purchase policy has been a national scandal for more than 60 years."

Roy L. Garis: "Repeal all silver legislation since 1932. Our silver legislation is inexcusable. It stinks. Sell silver in Treasury or use it to stabilize oriental countries."

Harry Gunnison Brown: "Our money has no relation to the value of silver * * *. The silver bloc has long bedeviled American politics and seems likely to continue to do so. Legislation favoring silver enables the owners of silver mines to collect larger royalties at the expense of Americans generally. If it should ever become politically possible to divorce our money from silver—except for the customary small change—and to cease purchasing it or even to sell what the Government has, this would be a real and substantial gain to the American people."

Albert G. Hart: "I see no monetary use for silver other than as an attractive material for coins. I should recommend complete cessation of silver purchases and use of present silver holdings in coinage as needed * * *."

Frederick A. Bradford: * * * The Silver Act of 1934 should be repealed in toto. The silver dollar should be abolished and silver certificates should be called in, Federal Reserve notes being substituted therefor. All existing legislation permitting a return to bimetallism and requiring the payment of a specific price for silver should be repealed. In short, silver should be returned to the status of any other metal * * * and should be used for monetary purposes only for the manufacture of subsidiary coin. Silver policies since 1873 have been the result of political pressures and have had no relation to sound monetary policy."

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Raymond P. Kent: Discontinue the purchase of newly mined domestic silver with the ultimate goal of complete withdrawal of Government support for the silver market except for such metal as may be needed for coinage. "It is high time that we get rid of the remnants of bimetallism."

Marcus Nadler: "The silver purchase program should be abolished."

Seymour E. Harris: "There is no case for support of silver other than the case for support of any special interests * * *. Removal of any support should be a gradual process, even with some compensation to the interests involved. This would be much less costly than continued support."

Karl M. Arndt: "As silver has precisely the same basic monetary role as the copper in the cent piece and of paper in Federal Reserve notes, it should receive the same treatment as these from monetary policy * * *."

E. E. Agger: "I should certainly advocate the repeal of the silver purchase law, which makes no sense from an economic point of view. Silver is a sort of fifth wheel in our whole monetary system and the sooner we get rid of it the better."

Kenyon E. Poole: "Our monetary policy relative to silver is really a subsidy policy and therefore is almost solely a political question."

James B. Trant: "* * * It seems to me that the silver policy should be recognized in the same subsidiary category as the half dollar and the quarter."

C. R. Whittlesey: "Present law should be repealed. Silver should be treated as an ordinary nonmonetary commodity. Silver policy should be basically comparable with our lead, zinc, or copper policy."

George N. Halm: "* * * I cannot see any reason whatsoever in a policy of buying silver at a fixed price."

E. Sherman Adams: "All silver legislation should be repealed. Policy should be based upon general welfare, not subsidies to special groups."

Howard S. Ellis: "The Treasury should be relieved of any statutory obligation to purchase silver, or to purchase it at any other than the free international market price. Silver should be definitely put into the position of subsidiary coinage."

L. Albert Hahn: "I consider the silver purchasing policy of the Government as purely political."

Edward S. Shaw: "Our monetary policy relative to silver is stupid on every count. There is no economic justification for the monetization of silver on the present pattern. The Treasury should be permitted to buy only as much silver as is needed for subsidiary coinage and should be forced to pay no more than a free-market price."

B. ANSWERS FROM BANKERS

Anonymous: "I see no need to change our monetary policy relative to silver."

Anonymous: "Our present monetary policy in regard to silver seems to me to be simply a subsidy for the silver miners at the expense of the rest of us, and believe it should be changed."

W. Lucal Woodall, Pitkin County Bank, Aspen, Colo.: "We rather like your silver policy, but we are in a silver-producing section."

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Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "We should stop buying it or at least let the price seek its true level. There certainly should not be a platform put under it and then force us to buy."

L. M. Giannini, Bank of America, San Francisco, Calif.: Silver policy should not be changed for purchases of silver are now moderate and any change would be in the direction of acquiring a larger supply. Trade does not call for a large volume of silver in circulation. Present moderate support tends to stabilize foreign currencies backed by silver reserves.

R. C. Leffingwell, J. P. Morgan & Co., New York: "Our policy relative to silver should be to allow it to find its natural price as a commodity; and to continue to use it in our subsidiary coinage as we do now, without valorization."

Anonymous: "Our silver policy has been indefensible."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "Buy more and keep it—so much inflation now and more coming."

Anonymous: "The present silver policy should be dropped. The only purpose it serves is to subsidize production of silver and thereby benefit those persons who have an economic stake in silver. There are no monetary considerations calling for this program. * * *"

William S. Gray, Central Hanover Bank & Trust Co., New York: "The Silver Purchase Act should be repealed. The principal consideration should be the welfare of the Nation and not subsidies to individual pressure groups."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "Think silver's position is purely political and would not increase its importance."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "The representatives from silver-producing States probably have looked after their own interests to the disadvantage of the country as a whole—relatively a minor issue."

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: "We should attempt to work away from any monetary policy relative to silver."

Fred W. Glos, the First National Bank, Elgin, Ill.: "The principal consideration should be for the good of the country without any partisan location consideration."

Anonymous: "We should repeal the Silver Purchase Act of 1934, stop all purchases of silver by the Treasury."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "Silver is primarily a political question. Our present silver policy constitutes a direct subsidy to the silver-producing States and has no economic justification. It is, however, self-financing and, although mildly inflationary, probably does no great harm. This is a sleeping dog we should let lie."

Donald A. Hemenway, commissioner of banking, State of Vermont: "I don't know of any advantage of bimetallism (except to silver producers)."

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D. ANSWERS BY OFFICERS OF LIFE INSURANCE COMPANIES

Alexander T. Maclean, Massachusetts Mutual Life Insurance Co., Springfield, Mass.: "We cannot believe that silver should be put into the monetary system as a major factor, if for no other reason than the fluctuations in price alone."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: "We should cease to treat silver and silver-producing companies and silver States as spoiled children. There is no conceivable reason other than political pressure, concentrated on the Senate, for silver to have any monetary function at all, except for purposes of subsidiary coinage. * * *"

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "The United States silver policy is merely a subsidy to domestic silver producers, and it should be evaluated in that light."

11. Should all of our money, including bank deposits, be freely redeemable in gold coin on demand for all purposes? What should be the advantages and disadvantages of such a policy? Would it lead to hoarding under some circumstances?

A. ANSWERS BY ECONOMISTS

Howard B. Bowen: "We should not return to gold convertibility. * * * The disadvantages in tying the currency rigidly to gold would outweigh any conceivable advantage. The monetary authorities should be free to manage the currency without reference to a more or less irrelevant factor such as the maintenance of gold convertibility."

Elmer C. Bratt: "I do not see that it is of great domestic importance as to whether money is redeemable in gold. Extensive gold hoarding will not occur in this country except under conditions of secondary depression. Under such conditions the measures taken will be so extreme that the problem does not have independent importance."

Neil Carothers: "Restoration of genuine gold standard would mean a circulation of gold certificates, automatically redeemable by Government. Until withdrawn, as they should be, greenbacks, silver certificates, and silver dollars should be redeemable in gold by Government. This gold standard should be restored. Under present conditions, it is not necessary that commercial bank deposits be payable in gold, if all paper money be redeemable in gold at Treasury and at Federal Reserve banks. Also under present conditions it may be desirable to have a noncoin gold standard, with perhaps $4,000 in gold bullion as the smallest unit of redemption."

Fred R. Fairchild: "We should return immediately to the gold standard, with free coinage of gold on demand, and all other forms of money freely redeemable in gold on demand, thus restoring the monetary system which prevailed before 1933."

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C. O. Fisher: "As an intermediate step of money, including bank deposits, should be redeemable in gold bars of substantial weight. I see no reason why gold should circulate as currency. Redemption in gold bars would strengthen confidence in our currency and would set an example that might be followed in other countries. Redemption in gold bars would not lead to hoarding, unless the Government went on a rampage."

Lloyd W. Mints: "It makes little difference whether our money is redeemable in gold coin rather than, as now (with possible restrictions), in bullion. The only possible consideration that I can see is that under conditions of panic there might be more likelihood of runs on banks, and hoarding of gold coin, than there now is of such runs. However, with a stable monetary policy panics themselves should be eliminated."

Roland I. Robinson: "No."

Edward C. Simmons: "Gold redeemability is not to be considered. Until we can trust our monetary managers we must retain the gold reserve feature of the monetary apparatus. Otherwise we shall have inflation every time a cold wind blows."

Philip E. Taylor: "No. I see no real advantage in it. The disadvantages are essentially those of imposing upon ourselves an unnecessary obligation to redeem in gold—the weakening of the power to control the money supply in the face of individual freedom to buy and sell gold. There would probably be gold hoarding in some circumstances."

Roy L. Garis: "Return to gold coin standard at once. We need only one coin—a $25 coin. Not over a billion dollars will be hoarded. * * * A gold-coin standard at present price of $35 an ounce can save our economy by restoration of confidence * * *."

Harry Gunnison Brown: "It seems to me unwise to restore gold coinage. Rather than that I would prefer to abolish completely all transactions in gold by the Treasury. We might then still maintain a stable price level through Federal Reserve and (possibly) Treasury techniques * * *."

Albert G. Hart: "I see no advantages in moving back toward domestic gold money. The present proper use of gold is as a center of gravity for international monetary relations. In the long run we can hope to economize productive resources by ceasing monetary gold purchases as silver purchases; but present international conditions make it unlikely such a move will be prudent in the visible future."

Frederick A. Bradford: "As a member of the Economists' National Committee on Monetary Policy, I have favored the return of the United States to a full gold standard since 1933.* * * It would probably be desirable to have redemption in gold coin, although redemption in bars or bullion would be satisfactory. With regard to domestic hoarding of gold, there would be scant danger of its occurrence so long as the Government followed sound fiscal policies. If the Government chooses not to follow such policies, gold might be hoarded which would indicate the lack of confidence in Government policy and the need for a change in it. * * * It is ridiculous (and unethical) to promise to pay dollars on demand, as stated on our paper currency other than silver certificates, when the dollar is defined as 13.71 grains of gold, and then make it impossible for people to obtain gold dollars

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(or the equivalent in bullion) except by special license from the Treasury."

Raymond P. Kent: The present system of limited redeemability should be retained. "A general promise of redeemability of all kinds of money, including bank demand deposits, is in a sense dishonest since it obviously cannot be fulfilled * * *."

B. H. Beckhart: He favors a return to gold redemption. This would have several advantages; it would give the foreigner somewhat greater assurance that the price of gold will not be increased, it would cause the disappearance of the premia on gold which exist in gray and black markets throughout the world, and it would enable the American people "to exercise some disciplinary control over the actions of their Government if they consider these too unsound or inflationary. It will place the dollar, the international currency of the world, upon a firmer basis."

Marcus Nadler: "Now is not the time to return to the gold standard. The benefits argued for the gold standard are merely an illusion. Return to the gold standard could lead to a very substantial hoarding. Moreover, if bank deposits were to be made freely convertible into gold coin, this could lead to a situation where the money market would be subject to the whim of the mob rather than under the control of the duly appointed authorities."

Seymour E. Harris: "This is a preposterous proposal still being made in some quarters. * * * Since our whole history has been one of finding enough money to finance a growing economy it would be absurd to tie our hands in the manner suggested. Besides, the value of a dollar dependents not on the gold and silver into which it is convertible but on supply and demand." It is also true that throughout the twentieth century the use of gold as a medium of exchange has consistently dwindled.

Charles C. Abbott: "* * * the country should return to this type of gold standard. It is doubtful that any significant amount of hoarding would develop except under conditions of war or extreme crisis," at which times a suspension of gold convertibility would be expected. The principal advantage of such a step would be (*a*) if the United States does not return to this type of standard it is difficult to see how the world can ever get back to any legitimate type of gold standard, and the gold standard affords the best basis for multilateral trading yet devised; (*b*) only such a move will end the black markets in gold; (*c*) there is no serious disadvantage in making our money redeemable in gold.

Karl M. Arndt: "I see no important gains and no discernible losses, if the practice of free convertibility of money in gold were adopted—if such a policy were accompanied by a grant of power to the Federal Reserve (or to a national monetary authority) to make needed adjustments in Federal Reserve bank gold reserve requirements to offset the effects of a possible run on gold. If the public wants to enjoy the primitive pleasure of the glitter and feel of gold coins it should be allowed that childish delight. But most people, I trust, realize how far our money is, and must be, removed from gold."

E. E. Agger: The redemption of money in gold coins has lost all its significance, not that it was ever very significant. If such redemption were reinstituted it might easily lead to hoarding in times of public anxiety.

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Kenyon E. Poole: "I see no reason to make all our money freely redeemable in gold coin. If there were general fear for the integrity of the dollar, the policy would probably be unsuccessful; and if not, there is no need for it. * * *"

Howard S. Ellis: "Redemption in gold or gold coin is quite unimportant. If we actually had in effect such redemption, the hoarding of gold in the United States would, however, do no more harm than the hoarding of any other kind of money or credit."

James B. Trant: All of our money and credit should be freely redeemable in gold coin. The advantages of such a policy would be to maintain a satisfactory relation between our gold reserve and our circulating medium. I doubt if much hoarding would take place, though some might occur.

Anoymous: It is doubtful that the free redemption of money in gold should be undertaken at this time. It might well lead to both international and domestic gold drains. Our own moneteary system is the most stable in the world and no steps should be taken that would lessen its stability. If the gold coin standard is ever to be restored it should be at a time when the monetary systems of the world are on a firmer foundation.

George R. Walker: "I would rather see gold demonetized and sold by the pound at auction than to make our currency and deposits redeemable in gold. Monetary gold in private hands would set private financial power above the political power of a democratic government. Also it would be the quickest way to encourage capitalism to commit suicide."

George N. Halm: "No advantage whatsoever would be connected with a policy of making our money redeemable in gold coin."

E. Sherman Adams: "I see no good reason for restoration of convertibility. If it did not lead to hoarding it would be a meaningless gesture. If it did lead to hoarding, it would be harmful."

Edward S. Shaw: "There is no point in interconvertibility between nongold money and gold coins. The result would be simply to increase the costs of maintaining our supply of pocket money without contributing to stability and growth in the national income. Gold's only useful function—and it may be temporary—is as an international means of payment."

Walter E. Spahr: "All our money, including bank deposits, should be freely redeemable in gold coin on demand for all purposes. There would be no disadvantages, from the point of view of the Nation as a whole, in such a policy. The 'disadvantages' would be suffered only by Government officials who wish a free hand in the use of the people's purse with the people unable to hold them to an accounting.

"The advantages of a redeemable currency would be these, briefly:

"(1) The promises to pay issued by the banks and Treasury would become honest, because redeemable. There is no valid defense for dishonesty in a nation's currency.

"(2) Control over the Government's use of the people's purse would be restored to the people where it belongs, since it is their purse. (People have fought through revolutions to establish that fact.)

"(3) We have built a great body of contract law designed to compel people to fulfill the promises they make. There is no defensible basis on which to authorize the Treasury and Reserve banks to issue promises to pay which they are not required to redeem, which they cannot

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redeem under our law, and which, of course, they do not intend to redeem. This is privilege without responsibility. It is not the proper answer to the problems of a fractional reserve system. Requirement for redemption would have the advantage of treating alike all issuers of promises to pay—they must all redeem or face the consequences.

"(4) We would end the discrimination against our people in favor of foreign central banks and governments. Under our system of discrimination, foreign central banks and governments have been able for 16 years to convert their dollars into gold at $35 per fine ounce. This privilege has for 16 years been denied our citizens and all other non-central-bank and nongovernment holders of dollars. There should be no discrimination; but if there is to be any, I should think it should be in favor of our citizens rather than central banks and governments.

"(5) No government or bank has a proper right to require a people to exchange their labor or goods or savings for something that does not in itself contain such characteristics that it can command goods or services over a wide area. Gold, being valuable in industry and for ornamentation, has these characteristics. A paper promise is merely a promise; and its quality is no better than the word of the promiser. In this country the word of our promisers means nothing except to central banks and governments. For all others it means merely that another irredeemable promise of the same sort will be given in exchange (silver for silver certificates, excepted). Gold is not dependent upon anyone's promises; it is the satisfactory fulfiller of promises.

"(6) We declare in law that our standard monetary unit is a dollar of $15\frac{5}{21}$ grains of gold nine-tenths fine, but we deny to our people the right to use this standard money while granting this right to central banks and governments.

"(7) Redeemability gives every individual with dollars the opportunity, to the extent of his purchasing power, to get the standard metal if he prefers that to the promises to pay it. This enables him to exercise some control over the use by his government and banks of the people's gold and over the amount of promises these agencies may issue. If either or both issue promises to an extent that invites lack of confidence, every individual, to the extent he has dollars, can express his lack of confidence. His demand for redemption is his right, if the promise means anything. It is his effort to protect his savings against men's uncertain promises. His demand for redemption is a red flag of doubt. If many red flags appear, the banks, the Treasury, and Congress receive warnings and must call a halt or exercise greater restraint in their use of the people's money. In this manner redeemability provides a people with control over the government's use of their purse.

"The gold standard with provision for redemption in effect provides a system of golden wires to every individual with dollars, over which he can send messages of approval or disapproval to the central signal board. When our Government took the people's gold and thrust irredeemable promises to pay on them, it cut all these wires to the central signal box. The people were cut off. The lights went out on the central signal system and the people were left helpless. Thus absolute control of the people's gold and public purse passed to their government. The latter had freed itself from receipt of signals of

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disapproval and from any effective check. The spending orgy is the result. Vote-buying goes on and can go on without let or hindrance. The people are helpless; the Government is the boss; irresponsibility is in the saddle and it cannot be checked. The understanding, concerned, and responsible men in Congress are in the minority and are helpless. Government spending and bureaucracy are out of control. Apparently this course cannot be brought to a halt except by restoring to our people control over their purse. That can be done only by the institution of redeemability of the promises to pay of the Treasury and banks.

"No government is a good government if it takes to itself the people's purse and frees itself from control by them. A responsible government is one that is responsible; it is not a government that is not responsible and has so arranged things that it cannot be held to an accounting. Our Government, by the use of irredeemable money, has made itself into an irresponsible government.

"(8) Redeemability should bring government spending to a halt and contract it. It should result in lower taxes. It should stimulate private enterprise, savings, investment, employment, and prosperity. It should increase the safety of savings and end the depreciation of our dollar.

"(9) It would end the multiple quotations for the dollar both abroad and at home. Multiple quotations for a nation's money are evidence of an unsound currency system.

"(10) It should set a good example for other countries and make the road easier for them as they struggle back to redeemable currencies.

"(11) Redeemability should open up foreign trade and investment since it would enable private enterprise to go where it can and will with dollars having the same value in any particular market.

"(12) It should provide the best of help in letting the forces of supply and demand correct the imbalances in foreign trade and payments. International trade gaps cannot be corrected otherwise.

"Nobody can possibly know whether provision for redemption would lead to hoarding. Ordinarily, resumptions do not result in hoarding if a people have confidence in their government's fiscal and monetary policies. It is in general irredeemable, rather than redeemable, currencies that invite hoarding. If hoarding should be heavy or unprecedented, that would be proof that we did not resume redemption soon enough. Considering our relatively large gold reserve ratio, there would be no good reason on that score to expect heavy hoarding. We fought World War I on a ratio of 8 to 11 percent of gold to nongold money and deposits. The ratio today is approximately 14 percent. The average ratio for 1915 to 1932 was approximately 8 percent and at one time a ratio was as low as 7.3 percent.

"I advocate redemption promptly regardless of whether hoarding is light or heavy. If it is heavy, we should know why—we should know that we have the conditions that invite it, and should proceed to correct them."

B. ANSWERS BY BANKERS

Anonymous: "I see no advantage of making our money, including bank deposits, redeemable in gold coin, and there are many disad-

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vantages. It would lead to hoarding and to terrific strain on the System in times of national emergencies or general uneasiness."

Anonymous: "Do not see any necessity for going back on gold. Believe certainly it would lead to hoarding as I know of cases where I strongly suspect hoarding of bills of large denominations of paper money within recent years. Such a small proportion of the total business of the world could be actually carried out in coin and such a large proportion is done on faith represented either by checks or paper money that I feel gold as a base for currency has nearly outlived its usefulness."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "We believe that gold should be reestablished freely. There might be hoarding to some extent, but when this is done it is because the people are afraid of something. To release gold should cause confidence. To allow unlimited export, we do not feel competent to pass on."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "* * * If we had returned to the gold standard after confidence was restored in the early stages of the New Deal Administration there would not have been the extravagance, waste, inefficiency, incompetency, and reckless abandon then or now, as we have and are experiencing. There should be a firm base for our money to rest upon. * * * Steps should be prepared and taken toward going back on the gold standard. And unless we do the road we are in will lead to ruin."

L. M. Giannini, Bank of America, San Francisco: Resumption of the convertibility of currency and deposits into gold should be an objective of monetary policy, but the attainment of this must await the reestablishment of a more stable peace and a more promising restoration of world trade.

R. C. Leffingwell, J. P. Morgan & Co., New York: "Our currency should be redeemable in gold only for export under license as at present. To make it freely redeemable in gold coin on demand would only serve the purposes of the hoarders and black-marketeers and profiteers. They would sell it chiefly to foreigners, who would devote to its purchase dollars which should be used for more useful purposes in these days of dollar shortage. Further, we might lose enough gold in this way, in the course of time, to restrict the freedom of our own credit and monetary policies. * * *"

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "I have always believed in the gold standard, but at the present time it would be doubtful that it is best that all money, including bank deposits, be readily redeemable in gold coin. Such a condition probably would encourage a very great amount of hoarding."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: There may be a day when it will be advisable to do this, but at present our system is all right.

H. H. Gardner, the Birmingham National, and Ferndale National, Michigan: Currency and credit should be redeemable in terms of gold because this sets fixed and known limits to monetary and credit expansion.

Anonymous: "The old gold standard * * * was a fair-weather friend. It worked fine when things were going well and broke down

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otherwise * * *. There would be no domestic advantages gained, and the problem of gold hoarding could conceivably be a source of difficulty."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "No; for gold is too bulky for general circulation and such a policy would certainly lead to hoarding."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The time is not opportune for a return to the gold coin standard. We should, however, return to that standard at the proper time."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "Can see no advantages in having our money and bank deposits freely redeemable in gold. Could see some disadvantages. Believe that gold can be used more advantageously as a symbol of value. Gold is a psychological invitation to hoarders. The hoarding of gold in countries like India and China has been very disastrous to their economy as a whole."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "Can see no reason for making all our money redeemable in gold coin on demand. So long as our banking system is kept on its present high plane, there would be no advantage to such a plan. Such a policy might easily lead to hoarding."

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: "* * * The currency of the United States should be freely redeemable in gold coin. It has always and ever will be an assurance to those using our currency of its goodness."

Fred W. Glos, the First National Bank, Elgin, Ill.: "Under our present system and present debts, no. Believe it would lead to considerable hoarding."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is felt that our money, including bank deposits, should not be redeemable in gold coin on demand for all purposes. In times of stress such a practice would lead to hoarding. This has been borne out by history."

Anonymous: "I do not see any advantages in putting gold coins into circulation. I doubt that putting gold coins into circulation would lead to a large amount of hoarding, and in principle there is no serious objection to letting people have gold if they want it."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: The gold coin standard should not be restored. There would be little demand for gold so long as conditions remained prosperous and confidence was high, and in the case of a recurrence of financial crisis, it is unthinkable that any administration, whatever its political complexion, would allow Government recovery policies to be hamstrung by the action of the public in withdrawing gold. "* * * In short, a gold coin standard, in the light of the history of the past 20 or more years, could never be anything but a fair-weather standard which would have to be abandoned in time of financial stress.

"The purpose of the gold-coin standard is to place in the hands of holders of liquid funds the power to veto Government and central-bank policies of which such persons do not approve, or of which they become frightened. No modern government can be expected to allow

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such a veto power to be exercised by individuals * * *. It is highly desirable, however, that those parts of an international gold standard providing for the redemption of currencies in gold as among governments and central banks should be made use of as widely as possible."

Donald A. Hemenway, commissioner of banking, State of Vermont: "Our experience in 1932 and 1933 should give a partial answer to the question of whether our money, including bank deposits, should be freely redeemable in gold coin on demand for all purposes. A 'run' on our central bank is not a pretty sight."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: To make all our money freely redeemable in gold coin could well have a serious effect upon other countries if it enabled the people of those countries to purchase gold in the black market, but as far as our own internal situation is concerned, there would seem to be no compelling argument against convertibility. Our own people would probably take out relatively little gold and the loss of that gold from bank reserves would be of little concern because of the flexibility of our reserve requirements and because Congress could, if necessary, reduce the reserve requirements of the Reserve banks.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "It does not seem presently practical to make all United States currency, and consequently bank deposits, redeemable in gold."

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: "* * * In general, it may be said that the adoption of a gold standard after a period of uncertainties is evidence of the fact that stability has been achieved—it is not to be regarded, however, as a primary method of achieving stability."

12. Under what conditions and for what purposes should the price of gold be changed, if at all?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "It is uneconomical for the United States to buy gold. This policy can be justified only as a relief project, a sort of Marshall plan, for gold-producing countries. The price of gold surely should not be raised. The psychological and political repercussions of lowering it would be unfortunate. Therefore, I would favor no change in the price, but a gradual discontinuance of our gold buying policy."

Elmer C. Bratt: "I do not favor changing the price of gold in the foreseeable future. If we should retain our present monetary and credit system and if monetary gold should become available too slowly or too rapidly the price of gold should be changed."

Neil Carothers: "There is no 'price of gold', and a Senate committee should not use such an unsound and improper term. We have in this country a special type of free coinage, with any holder of gold bullion permitted to 'coin' it at 13.7 grains to the dollar, but with the resultant coins confiscated by the Government. This value (13.7 grains to the dollar) is the standard of the United States. Your question should read: 'Under what conditions would it be proper to debase the present gold standard or to appreciate it?' We had one debasement in 1934

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which dishonored the Nation for all time and wrecked the currencies of the world. There is not now apparent any condition which would justify another instance of dishonor and world injury. Just incidentally, is your committee aware of the fact that the law of 1934 permits the Secretary of the Treasury to debase the standard at any time, without the approval of Congress?"

Fred R. Fairchild: "I do not think the price of gold should be changed."

C. O. Fisher: "Barring a calamity of a sort not likely to occur in the proximate future, no change should be made in the price of gold."

Lloyd W. Mints: "The price of gold should not be changed under a genuine gold standard, nor for that matter, under the peculiar form of the gold standard now in effect in the United States."

Roland I. Robinson: "Price of gold should not be changed. * * * world dollar scarcity would not be cured though we could subsidize South Africa a little more if we raised gold-buying price—but why do that?"

Edward C. Simmons: "The price of gold should never be changed."

Philip E. Taylor: "Should be changed only as a means of facilitating international payments—at present the price might be raised to provide more dollars to those nations now selling gold to us. Such action would, however, need to be carefully insulated, to prevent unwanted internal results."

Edward F. Willett: "I question that changes in the dollar price of gold in this country of a substantial amount, all at once, are ever going to be desirable. * * * in other words, we might at some time consider the adoption of some plan similar to Irving Fisher's stabilized dollar, although I am not convinced that it is either necessary or desirable."

Roy L. Garis: "None. Fix it at $35 an ounce. Take authority away from President and Secretary of the Treasury."

Harry Gunnison Brown: The price of gold might be increased as a means of stopping a general decline of prices and decreased as a means of inhibiting a general rise in prices.

Albert G. Hart: "I favor permanence of the present gold price, down to the date of eventual suspension of gold purchases. A rise would be merely an indirect subsidy to gold-producing countries, a reduction (though perhaps a natural step toward suspension of purchases) unsettling to opinion, and hard on foreign countries having gold."

Frederick A. Bradford: There is no necessity for changing the price of gold. "* * * Having already devalued our dollar in 1934, the inflation that has occurred in the United States has not been so great as to warrant any further devaluation. * * * Proper policy would be to maintain the dollar at its present weight and adjust other countries' parities to it."

Raymond P. Kent: There is no good reason for a change in the official price of gold in the foreseeable future. "* * * except, perhaps, in connection with a simultaneous change in the gold values of all member currencies as provided for in the statutes of the International Monetary Fund. Certainly, there should be no increase in the price of gold simply to give foreign countries, such as South Africa, increased purchasing power in the United States. If it is desirable to provide such aid, it should be continued undisguised as at present by way of ECA. We should be most reluctant to see further increases in

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our monetary gold stock; hence we should not encourage such expansion by raising the price of gold."

B. H. Beckhart: "It is difficult to conceive of any circumstances requiring a change in the price of gold. If the object be that of helping foreign gold-producing nations, this can be better accomplished by dollar loans and grants. If the object be that of easy money rates and stimulating credit expansion in the United States, this, too, can be better accomplished by an expansionist policy on the part of the Federal Reserve banks."

Marcus Nadler: "The price of gold should be constant * * *."

Seymour E. Harris: " * * * This Government should be wary of a proposal to raise the price of gold under current conditions: First, because the effect would be to increase relatively the purchasing power in this country of countries with much gold; * * * second, as the resulting inflow of gold cumulates, the effect would be to depress the dollar vis-à-vis foreign currencies * * * and thus strengthen the competitive position of this country further * * *."

Charles C. Abbott: "The basic argument for raising the price of gold is that it would be one of the most adroit ways of subsidizing the British Empire. In my view the price should not be raised unless as part of a very carefully considered and far-reaching plan for expanding world trade and hastening world rehabilitation. As an isolated step it would be a mistake."

Karl M. Arndt: "* * * If there are to be changes, they should be made only when the foreign-exchange value of the dollar needs adjustment." The price should not be changed to please the gold miners.

E. E. Agger: "I see no reason to change the price of gold at all * * *."

Kenyon E. Poole: "If a commodity is to be price fixed it seems likely that the period 1934–50 is too long and contains too many violent changes to justify failure to alter its price. This may be true of gold. Gold producers may reach a point under rising prices at which marginal producers must halt production. This may not be important in view of our excessive gold surplus, but, as is well known, a rise in the price of gold in terms of dollars would improve the lot of South Africa and the sterling-area dollar pool."

James B. Trant: "The price of gold should never be changed, unless disaster made revaluation or devaluation necessary."

C. R. Whittlesey: We should resist the proposal for raising the dollar price of gold which would further aggravate the disadvantages inherent in our present policy of buying and burying gold. The gold problem today involves a serious political dilemma arising out of the importance of the British Empire and Russia in the production of gold.

George N. Halm: "* * * For the United States appreciation could conceivably become a means by which to help to overcome the dollar shortage of the rest of the world."

E. Sherman Adams: "It is difficult to conceive circumstances which would justify a change in the dollar price of gold."

Howard S. Ellis: The price of gold should be changed only by international agreement to offset a world shortage of gold. However, most talk about such a shortage is pointless; and in general such changes in the price of gold have very slight significance.

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Edward S. Shaw: "I can see no imminent need for an inflationary increase in our price for gold or for a deflationary decrease in our gold price. It is rather desirable that the dollar price for gold should be held firm, and that internal policies for inflation or deflation should be enforced by other devices."

B. ANSWERS BY BANKERS

Anonymous: "Price of gold should be changed only when absolutely necessary."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "It should not be increased in value."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: The price of gold should not be changed.

L. M. Giannini, Bank of America, San Francisco, Calif.: The price of gold should not be changed under current conditions, and any change should be considered only in collaboration with other major participants in world trade at such time as they contemplate returning to the gold standard.

R. C. Leffingwell, J. P. Morgan & Co., New York: "The price of gold should not be changed ever except in a case of our own dire necessity such as existed for instance in 1933. To change it to oblige South Africa or other gold producers would not be in the world's interest nor in theirs in the end. * * *"

Anonymous: "There is no valid reason for changing the price of gold under most conditions. * * * The chief advocates of raising the price of gold are the foreign speculators and gold-mine owners."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "No change. The first change was a fraud by Roosevelt et al."

Anonymous: "* * * The price of gold in dollars should be held stable for the indefinite future. I see no good arguments for raising or lowering the price from its present level. We can do the most good by leaving things alone."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "I do not think the price of gold should be changed."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The price of gold should remain constant. Section 8 (R. S. 3700) of the Gold Reserve Act of 1939 should be repealed."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "Let it alone."

Ben Du Bois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "The price of gold should be changed only under the force of necessity but there is nothing sacrosanct in any stated price."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "Do not like to think of the price of gold being changed at all."

Fred W. Glos, the First National Bank, Elgin, Ill.: "No; under any conditions."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is believed that the price of gold should remain unchanged because in times of international financial unrest the United States dollar should remain stable and firm."

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C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "At this moment there are no presently foreseeable circumstances under which the United States should change its price for gold."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: I see no present or probable reasons why the price of gold should be changed in either direction for an indefinite time in the future.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "At the present time, the gold policy of the United States is, in effect, a subsidy to gold-producing areas such as South America, Canada, and Russia. It should be evaluated with this fact well in mind."

13. What changes, if any, should be made in the powers and policies of the Federal Deposit Insurance Corporation? In the coverage of deposit insurance? In the basis and rates for deposit insurance premiums? In the commitments of the Government itself to provide financial assistance at any time that the resources of the FDIC might prove to be inadequate?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "The coverage of FDIC could be increased to at least $20,000. This would merely take into account the change in the value of money. I believe we should not at this time lower the premiums—not at least until after the next major depression."

Elmer C. Bratt: "I would favor raising coverage of deposit insurance at present price levels. I see no reason to change the rates per dollar coverage for the time being. The Government should stand ready to provide unlimited financial assistance should the need arise."

Neil Carothers: "There are not now any conditions which call for immediate changes in the FDIC law, despite the move for a $10,000 limit."

Fred R. Fairchild: There should be "* * * reduction of the fees charged the member banks so long as the reserve remains above what experience has shown to be necessary."

C. O. Fisher: "The guaranty of bank deposits should be raised to the $10,000 level and the assessment should be modified to cover in reasonable degree the responsibility thus assumed. An actuarial study should indicate whether or not present assessments are adequate or more than adequate. At present there seems to be no need for Government assistance other than that provided by the FDIC."

Roland I. Robinson: "FDIC assessment rate could be dropped but do not feel it quite timely; wait until bank earnings become more slender."

Edward C. Simmons: "* * * Were all banks to be federally chartered, FDIC functions should be exercised by a department of the central bank. For the present, no changes in coverage or assessment should be made. * * *"

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Roy L. Garis: "* * * Raise amount to $10,000 that is protected * * *."

Harry Gunnison Brown: "If proper policies of stabilization are followed, there should be no need of Government assistance to the FDIC * * * it is appropriate that the necessary cost of the insurance should be paid for by its beneficiaries through a charge on bank deposits * * *. This insurance definitely should not be charged to taxpayers as such."

Albert G. Hart: "* * * I should favor coverage of all deposits, and a clear-cut commitment to support the fund in case of need—perhaps in the form of a guaranty of Federal Reserve rediscount facilities."

Frederick A. Bradford: "* * * coverage to $5,000 (which insures in full something like 98 percent of all accounts) is sufficient. It would appear more equitable * * * if banks were assessed on the basis of insured deposits only rather than total deposits * * *. If the Corporation's fund should become substantially depleted as a result of a mass of bank failures (a situation unlikely to occur) the Government should be ready to provide assistance * * *."

Raymond P. Kent: "* * * The Government should guarantee the obligations of the Federal Deposit Insurance Corporation in full * * *. Such a Government guaranty would further enhance the public's confidence in insured banks * * *. I favor increasing the coverage per depositor rather than reducing the premium rates * * *. The present method of computing average deposits for the imposition of the premium is unnecessarily complex and requires a great amount of clerical labor * * *."

B. H. Beckhart: "* * * A change which could and should doubtless be made immediately is to deduct the reserves which commercial banks must maintain against their deposit liabilities from total deposits in order to reach net assessable base."

Marcus Nadler: "* * * The premiums should * * * be based on the type of assets that a bank holds. Briefly, a premium should be paid on all risk assets but not on a riskless assets."

Karl M. Arndt: "* * * I think all bank deposits in 'commercial' banks should carry an unlimited guaranty by the Federal Government. If the guaranty is extended by an agency like the FDIC, that agency should be given unlimited Federal assistance."

E. E. Agger: Sees no great reason to change either powers or the policies of the FDIC. Where these policies affect the control of money and credit, it is important that they should be harmonized with the policies of the Federal Reserve. "The coverage of deposit insurance might well be expanded; indeed, I see no reason why there can't be 100 percent coverage * * *. There is, I think, a moral commitment on the part of the Federal Government to stand behind the FDIC should that be necessary. I am inclined to believe that it better be left standing in this way * * *."

James B. Trant: The coverage of deposits should be increased to $10,000 and premiums adjusted to meet the need. If we should ever return to normal prices and normal deposits it might be reduced again to $5,000 and the present premium.

Anonymous: The FDIC should be neither more or less than an insurance agency. It should not have the power to examine insured

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banks. This power should be given to the Federal Reserve, assuming that all insured banks are required to become members. At the present time there is a needless overlapping of examining authority with each agency setting up its own standards of liquidity, solvency, etc., which differ in important respects. What is held to be an undesirable asset by one may be approved by another. In many cases the only real examination is made by the FDIC yet the State examiners turn in a report of examination and the examined bank is required to pay the State a fee. Thus the FDIC virtually subsidizes State banking departments: "* * * The FDIC also carries on campaigns against the Federal Reserve more or less openly thus curtailing the growth of that System. It has in some instances induced State member banks to withdraw from the System. The FDIC seems to feel that it is essential to its well-being to undermine the Federal Reserve System, although that notion is stronger in some districts than in others * * *. It is undesirable to increase the coverage of insurance above its present level. * * * The present system is unjust in that the bulk of the assessments are paid by large banks on deposits that are above the $5,000 limit * * *. The assessment should be based on actuarial principles or an approximation of them * * *. The commitment of the Federal Government to provide financial assistance to the FDIC should be abrogated and the Corporation should be made to stand on its own feet. But most of all the insurer and the examiner should be separate in all cases."

C. R. Whittlesey: "Consolidate examination of banks by the Federal agencies. Raise limits of deposit protection. In view of the safety of banks today, reduce premium rates. Consideration should be given to the possibility of applying actuarial principles to the determination of premiums. No formal commitment should be expressed by the Government" * * *.

E. Sherman Adams: The FDIC should stand on its own feet and should not depend on Government support commitments. Premium payments by the banks should therefore be continued in order to build a larger reserve. However, in view of the size of the reserve now accumulated, premium payments should be reduced somewhat, preferably in the form of a rebate or dividend.

Edward S. Shaw: "The Federal Deposit Insurance Corporation should be continued on its present basis. If satisfactory policies were adopted regarding the organization and capitalization of commercial banks, of course, the assessments could be reduced very sharply and in time the Corporation could be dissolved. The Government can by no means escape the commitment, tacit or overt, to provide financial assistance in time of crisis. It may be added that all insured banks should be forced into Federal Reserve membership."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: Bring FDIC regulations relative to the payment of interest on demand deposits into line with those of the Federal Reserve banks. There appears to be no present need for an increase in the coverage of deposit insurance. "At the same time, however, the amount of coverage is, after all, closely related to the growth and strength of the fund, hence it

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might be consistent and proper to include in legislation proposing a general overhauling of the assessment rate and the manner of imposing the same, a provision for a change in the amount of coverage.

* * * * * * *

"There appears no real justification for any change in the existing commitments of the Government to provide financial assistance to the FDIC. The resources of the corporation augmented by its existing borrowing power should be ample to meet its obligations in most any conceivable situation."

Anonymous: "The assessments of the Federal Deposit Insurance Corporation should be stopped whenever the fund contains as much as a billion dollars. I see no need to increase the coverage."

Anonymous: "Think the rates of the Federal Deposit Insurance Corporation are ok at present. If experience has shown that they are higher than necessary would favor increasing the upper limit on insured deposits. Believe the Government has the moral obligation, and would politically find itself forced, to provide financial assistance at any time that the resources of the Federal Deposit Insurance Corporation proved to be inadequate."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "The FDIC should remain a separate department from the Federal Reserve system and the Treasury Department with over-all control by Congress, but with broad powers to set its own policies. We are inclined to believe that all deposits should be insured * * * it appears that a liberal adjustment for insurance premiums are now in order, especially if banks would use such reductions for further building their capital or surplus structure. We are rather against the Government having to guarantee anything but the four freedoms, so don't see why they should guarantee financial assistance should the FDIC need such * * *."

L. M. Giannini, Bank of America, San Francisco: No change should be made in the powers and policies of the FDIC or in the coverage of deposit insurance. When its surplus funds exceed $1,000,000,000 it should, following the close of each year, return the surplus except for the funds needed for operating for the ensuing year to the member banks in proportion to their respective total premium contributions throughout the years, and should set a new rate designed to provide only operating expenses and to absorb losses. Since the FDIC is an instrument of the Government and was established on the principle that the public must be protected against bank failures, the Government should unqualifiedly undertake to provide the necessary financial assistance in case of need.

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "* * * I see no need for changes in its policies. I would like to see the insurance coverage raised to $10,000 and the rates to be made on an actuarial basis * * *."

R. C. Leffingwell, J. P. Morgan & Co., New York: "The FDIC should stop accumulating idle funds by assessments against the banks. It seems to have sufficient funds in hand now, and no further assessment should be made unless and until the need appears. If its funds should at any future time turn out to be inadequate the Government should provide temporary financial assistance to be recouped by subsequent assessment against the banks. Meanwhile the money would be better employed in strengthening the assets of the banks."

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Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "* * * I doubt the wisdom of a greater coverage than the present $5,000. * * * When deposits are insured it has a tendency to place all banks on an even footing so far as a choice by the customer is concerned. * * * In my judgment assessments should cease * * * and only be renewed when the present guaranty fund falls below $1,000,000,000."

Anonymous: A reserve of $1,000,000,000 should be sufficient for meeting the current needs of the FDIC. Present assessment could be suspended and restored if this amount drops below $1,000,000,000. Insurance on deposits could be raised to $10,000 instead of $5,000 without much effect one way or the other.

W. R. Gott, the National Deposit Bank, Arnold, Pa.: The present assessment rate should stand until the FDIC has about $5,000,000,000. It could safely raise the guaranty to $10,000 with the assessment as it is. "* * * I think this would have a healthier effect on the smaller banks in the country and a lot of depositors would then have $10,000 in these banks in place of the $5,000. In our particular bank we note one customer that withdraws the interest * * * and just allows a flat $5,000 to remain in the account. * * * I believe the Government should provide financial assistance at any time to the FDIC only in the form of a loan to be paid back from the future assessments.* * *"

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "No change except raise coverage to $10,000. Rates remain the same until another one-half billion dollars is paid in."

J. R. Geis, the Farmers National Bank, Salina, Kans.: Insurance premium rates can be safely lowered when the FDIC surplus exceeds $1,000,000,000, for this is equal to 50 percent of all losses of all banks in this country in the past 60 years. Savings by the banks could be added to their capital structures. "I see no reason for changing the coverage for in practice all of the deposits of banks have been protected."

William S. Gray, Central Hanover Bank & Trust Co., New York: "Premium payments should be reduced. It would be more equitable to base premiums on assets less cash, due from banks, and Government securities, thus relating the premium to the risk involved."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: Present coverage is adequate but premiums should be lowered. If the FDIC examinations are adequate and action timely there should be no deficiency in resources requiring Government assistance.

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: The coverage should be increased, perhaps doubled or tripled. A hundred percent guaranty might find some banks with overly large individual balances. The present premium should be changed only after careful study.

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: Premium rates should be governed by loss experience as in the case of other insurance.

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: Would not be in favor of any change in the coverage. "The basis for * * * premiums could reasonably be adjusted so as to give banks credit for deposits in Federal Reserve banks and also for Government securities owned."

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P. R. Easterday, the First National Bank of Lincoln, Nebr.: It is not important whether the coverage should be limited to $5,000 or $10,000 but it should not exceed the latter amount. The fund need not be any larger than now exists.

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: "A realistic limit should be placed on the size of the balance in the FDIC fund with no further insurance premiums to be paid by banks until such fund declines below that determined amount."

Anonymous: In determining the basis for FDIC assessments the same computation should be used to determine the bank's assessment base as is used to determine its required reserves. No change should be made in the coverage of deposit insurance; the present coverage is in keeping with the basic concept of deposit insurance and provides fully for the protection of small depositors. The premium rate should be reduced to a nominal figure when the resources of the Corporation reach $1,200,000,000, with the provision that the rate will automatically revert to the present level in the event resources fall below $1,000,000,000. This will serve to keep the machinery for collecting assessments in working order and available for use on a larger scale if necessary at any future time.

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: A sizable reduction in the assessment rate is justified in light of the resources of the Corporation and the likely demands on it. Some advantage would probably come from reducing the assessment rate to a nominal figure for the next several years instead of eliminating it completely. The coverage should be continued at the present $5,000 maximum and it does not appear necessary to increase the Government's commitments to the Corporation at this time.

E. F. Haworth, commissioner of finance of the State of Idaho: No change should be made.

Paul A. Mitchell, superintendent of banks of the State of Ohio: No changes are necessary. It is conceivable that an increase in the coverage to $10,000 is justified but this should be considered in conjunction with a proposal to change the rates for insurance. The rates should either be decreased or the amount of coverage increased. The basis for computing the amount of insurance premium paid by the banks is complex and cumbersome and needs revision. The present commitments of the Government should be adequate to meet any future emergency.

C. A. Gough, deputy and acting commissioner of the State of New Jersey: There is no reason to change the powers and policies of the FDIC except that the coverage could be increased to $10,000 without any serious weakening of the ability of the Corporation to meet its obligations. I am inclined to agree that when the Corporation's funds have reached a billion dollars, assessments should cease until the funds have fallen below this figure at which time the present assessments should again be put into effect until the funds are restored. In the event of unexpectedly severe drains, the United States Government should underwrite the funds required in excess of the billion dollars referred to above in order to protect the public.

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A. A. Rogers, superintendent of banks of the State of Oregon: The powers of the FDIC are now adequate. The time may have arrived when the coverage could be increased to $10,000 but the premium rate should not be changed. "* * * It appears to me that while our banks are, as a general rule, enjoying good earnings that it would be well to increase the reserve as I do not believe that the present billion-dollar reserve will be sufficient in case of a serious depression. I believe that the commitment of the Government to provide additional financial assistance, if at any time the resources of the FDIC might prove to be inadequate, is sound; however, I think it would be better to have this on a 50–50 basis."

J. F. McLain, director of banking, State of Nebraska: The FDIC since its inception has functioned in a highly commendable manner. Deposit insurance coverage has in the past without doubt engendered confidence and confidence is the major element to be considered. It cannot be further stabilized by an increase in the amount. An adjustment in the insurance-premium rate is not likely to disturb the desired confidence providing there are flexible limitations of a wholesome nature instituted. Government commitments to provide financial assistance should be continued as a further measure of confidence. All States should obviously continue to examine and supervise all State banks and the examining powers and policies of the FDIC and the Comptroller's office should be maintained without involving either of them in politics.

W. Royden Watkins, chief examiner, board of bank control, South Carolina: No change should be made in the present coverage if it would increase the present premium rate. But if it should be found that the coverage could be increased without a corresponding increase in the rate, it would be well to move the coverage up to $10,000. Directors of the FDIC should be authorized to adjust the rates in relation to the reserve fund within the present fixed rate of $\frac{1}{12}$ of 1 percent.

Donald A. Hemenway, commissioner of banking, State of Vermont: If $5,000 was a reasonable insurable limit at the time of inception of deposit insurance then it would seem, with the substantial decline of purchasing power, that a $10,000 limit would now be more reasonable.

Benjamin O. Cooper, auditor of public accounts, Illinois: "The Federal Deposit Insurance Corporation was created solely as an insuring agency. The act creating that agency gave the Corporation ample power and authority to accomplish its purposes as an insuring agency.

"The actual force of deposit insurance is largely psychological and, of course, limited in the event of a national panic, consequently, the maximum deposit coverage should be reasonable and carefully calculated both as to effectiveness and to the maximum ability of available resources."

Maurice C. Sparling, superintendent of banks, California: "It appears to me that it would be unwise at this time to increase the amount of coverage for one individual in any one institution to more than $5,000, or to reduce the assessment rate.

"It is better to continue to build up the insurance reserves while times are good, with a view to reducing them later when times get tough. Some reduction may be justified after 2 or 3 years if the outlook for continued prosperity is favorable.

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"I do not believe the United States Government should commit itself in advance to assist the Federal Deposit Insurance Corporation. If it should become evident that the resources of the Corporation are inadequate, the Government can then provide such assistance as may seem desirable."

Richard Rapport, bank commissioner, Connecticut: "I have no suggestions for any changes in the powers and policies of the Federal Deposit Insurance Corporation beyond suggesting that the FDIC should make fewer supervisory examinations of State member banks, and should as the usual procedure accept State examinations of State banks as representing the supervisory examination. This is an authority the Corporation now has under Federal banking law. In doing so, the FDIC need not relinquish its right to examine State banks and its examinations should be specialized examinations for the proper purposes of the FDIC, particularly in the case of problem institutions.

"I believe the present $5,000 coverage should be retained. Deposit insurance was intended primarily to afford protection to the average citizen who maintained a modest checking or savings account in his local bank. The sponsors of the Federal insurance plan believed that the restoration and maintenance of confidence among this predominantly large class of depositors would provide necessary stability to the banking structure and at the same time insure against loss those persons least qualified to distinguish between strong and weak institutions. Surveys made by the FDIC in 1936, 1938, 1941, and 1945 indicate that, consistently, more than 95 percent of all demand and savings accounts belonging to individuals, partnerships, and corporations in the insured institutions are fully covered by the present $5,000 limitation. While it is true that the percentage of all deposits (in dollars) covered is less than 50 percent, the unprotected portion belongs to a relatively few depositors whose interests were not considered of paramount importance in the reasoning behind the establishing of deposit insurance.

"The 1940 report of the FDIC noted that its capital would be about half a billion dollars by the end of 1940, and stated, 'We believe, therefore, that it would be appropriate to give consideration to a reasonable reduction in the rate of assessment paid by banks.' Since that time the Corporation has repaid its contributed capital and has amassed a surplus of over $1,000,000,000. Although deposits in insured banks have greatly increased since 1940, the banks still maintain a high liquidity position and assets are generally sounder. The FDIC report of 1940 shows assets in insured commercial banks totaling $2,600,000,000 classed by examiners as substandard. The comparable figure in 1948 was $788,000,000. A reduction in present assessment rates seems both desirable and justifiable.

"There seems to be no reason for increasing the Government's commitment to the Corporation at this time."

Frank E. Goldy, State bank commissioner, Colorado: "The FDIC was to be an insuring agency but they have gradually taken on more of the supervisory authority and it seems they have assumed enough authority without any change being made in their powers and policies. In practice the FDIC has been protecting all deposits so I see no need for a change in coverage of deposit insurance. No change

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in basis or rate at this time as banks are in a position to pay the present rate and there may be a time later when a reduced rate would be needed as a relief to the banks. Furthermore, present reserves of FDIC are still only a fraction of deposit liability.

"Present commitments of the Government to provide financial assistance should be changed only in case of depression and strain becomes too great for the FDIC."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "Under present conditions, the premiums for deposit insurance are excessive. Whether they would prove to be so in the future, it is difficult to say."

14. What changes, if any, should be made in the division of the authority to supervise and examine banks? In the objectives and policies of the various supervisory and examining agencies?

A. ANSWERS BY ECONOMISTS

Elmer C. Bratt: "I am not sure the division of authority to supervise and examine banks is too important from the point of view of economic stability. Objectives and policies should be coordinated. This would tend to be effected if all banks were brought into the Federal Reserve System."

Neil Carothers: "All member banks should be examined by the Federal Reserve Board. I stated earlier that all banks should be forced to join the Federal Reserve."

C. O. Fisher: "The examination and supervision of all commercial banks should be subject to the jurisdiction of the Federal Reserve Board."

Lloyd W. Mints: "* * * the logical thing to do would be to centralize all examining power in a single agency, and since it is for monetary reasons that this should be done, that agency should be the chief monetary authority of the country, namely, the Board of Governors of the Federal Reserve system."

Edward C. Simmons: "All this authority should be lodged in a department of the central bank, which should have the sole chartering power. Aside from technical procedures, I see no need to concern one's self with objectives and standards of supervision. Let this be an audit procedure. No policy issues at a high level are involved."

Roy L. Garis: "Too much duplication at present."

Albert G. Hart: "* * * The main problem is to adjust examination standards so as to make bank credit less cycle-sensitive. My guess is that this might be best achieved by consolidating all examination authority either in the Federal Reserve or the FDIC."

Frederick A. Bradford: "* * * The simplest solution * * * would be to place sole responsibility for the examination of all insured banks with the FDIC. * * * In my own opinion, little can be expected from any marked alteration of supervisory standards in aiding business stability. * * *"

B. H. Beckhart: "I would favor the recommendation of the [Hoover] task force report, namely, that all Federal bank supervisory functions be delegated to the Federal Reserve banks."

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Charles C. Abbott: "* * * It is my impression that bank examination is one of the least understood and least explored areas in the whole field of banking and, consequently, one of the fields most deserving of inquiry."

Karl M. Arndt: "* * * Only one Federal office should have the power to examine all banks. * * * The Federal Reserve System, the Federal Deposit Insurance Corporation, and the office of the Comptroller of the Currency should be merged into one authority."

E. E. Agger: "As an old State commissioner of banking, I have a feeling that on the whole it is a good thing to have the States assume some responsibility for the banking institutions that they create. Duplication should, of course, be avoided but I believe that cooperation between the Federal Reserve, the Comptroller, the FDIC, and the various State commissioners is possible and can be made fruitful."

James B. Trant: Either the FDIC or the Comptroller should have the principal examining power.

Anonymous: If all insured banks were required to become members of the Federal Reserve the office of the Comptroller should be absorbed by the Federal Reserve and the supervision of all insured banks should be handled by the System. Even if all insured banks are not required to become members the office of the Comptroller should still be absorbed by the System and all member banks should be examined by it. There should be only one set of standards of supervision. There is too much disparity and it is injurious to the banking system. "* * * Thus the FDIC held that charging exchange did not constitute an indirect payment of interest on demand deposits. The Board of Governors held the contrary view and the actual logic was with the latter. Did the FDIC have a political motive? * * * It was certainly one contrary to sound banking. There seems to be something of a situation in which an agency once set up seeks to extend its powers and entrench itself by devious methods if necessary to gain its ends. At the present time examination standards are so divergent as to make examination itself more or less of a joke."

E. Sherman Adams: It would probably be desirable to reduce the overlapping authority but this is not a vital problem so long as the policies with respect to bank chartering and supervision remain conservative. There is urgent need, however, for stricter regulation of savings and loan associations.

Edward S. Shaw: "A central supervisory agency should be established, under the direction of the Federal Reserve. Duplicating authority should be eliminated. Supervisory and examining policy should be continuous and uniform, never used variably as an instrument of policy."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "There is no need for change in the division of authority to supervise and examine banks. Certainly the functions of bank supervision and examination should not be combined with the objectives of fiscal and monetary policy. Bankers are in the best position to determine the practical wisdom of monetary policies. They may, on occasion, feel impelled to criticize such policies, which they would be reluctant to do if bank supervision and examinations are under the control of the policy-making agency.

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To restrict in any way the desire to speak freely would be unfortunate, both for the banking system and the American economy."

Anonymous: "Although this question does not suggest a consolidation of the supervising and examining authorities which now consist of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve bank, and the State banking departments, proposals that these be consolidated in whole or in part have been made. It is believed that the independence of these various examining authorities is of significance in the maintenance of our present economic system. While it is felt to be proper for the authorities to cooperate in their methods of examination and in the enforcements of the law, the different organizations provide checks and balances which are valuable and should be preserved. Together with the dual system of banking, this independence of examining authorities is a safeguard to free enterprise and a protction against the monopolistic tendencies which are inherent to a single or a central banking system."

Anonymous: "The Federal Reserve and the Federal Deposit Insurance Corporation should accept the examination made by the State banking department and the Comptroller of the Currency."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "As a State bank, it appears to us that our State department try and keep in line with national examiners' requirements, and through the FDIC they are able to bring this about without additional laws."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "No change whatever, but build all present supervisory agencies stronger and stronger and more independent. By no means should the fatal error be made to put them under a single bureau or head, and they certainly should not be put under the domination of the Treasury."

R. C. Leffingwell, J. P. Morgan & Co., New York: "There are too many supervising and examining agencies. One Federal agency, and one State agency, should be sufficient. Probably the best method would be for the Federal Reserve to supervise and examine all member banks and the State superintendent of banks examine all State banks."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: No changes should be made.

Anonymous: "Sound banking conditions should be the primary objective. * * * Bank supervision and examination should not be used to enforce governmental or monetary policies. In practice, the several Federal supervisory agencies, as well as State agencies, have cooperated reasonably well. * * * What is needed is a high grade personnel and adequate compensations to attract competent men."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: "* * * One group of bank examiners would be all that would be necessary * * * but * * * bank examiners do not have enough authority at the present time."

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "None."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "None."

William S. Gray, Central Hanover Bank & Trust Co., New York: "No change is necessary except to better coordinate the policies of the supervising authorities."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "Further simplification."

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Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "Bank examinations are all right as they are now."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "It might be well to eliminate duplication of examinations by FDIC and State authorities in the case of State banks. The objectives and policies seem to be satisfactory."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "It would seem that one organization to supervise and examine banks should be fully sufficient."

Fred W. Glos, the First National Bank, Elgin, Ill.: "Should be examined by one agency for the various agencies."

Anonymous: "In principle I am in agreement with the task force report on regulatory agencies of the Hoover Commission, which suggested that consideration be given to the possibility of combining all Federal bank supervisory activities in one agency.

"The objectives and policies of the various supervisory and examining agencies should be basically related to appraising the quality of bank assets. The examination should not be used as a means of expressing or effecting credit policies."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: The Federal Reserve and the FDIC are not primarily supervisory agencies. The preservation of the dual banking system requires that neither agency should have direct responsibility for chartering, examining, and authorizing branches for National or State banks. "* * * * The best interests of our dual banking system demand, therefore, that the office of Comptroller of the Currency be continued as the supervisory agency for national banks and supervision over State banks be left as the proper responsibility of the State banking authorities. Examinations conducted by the Federal Reserve and the FDIC should be confined far more closely than is now the case to problem institutions. The power to withhold the privileges of membership or insurance of deposits from State-chartered banks places in the hands of the Federal Reserve and the FDIC an effective instrument for bringing about any corrective actions they may consider necessary. The aim of the Federal Reserve and the FDIC should be cooperation with the State banking departments rather than duplication of all of their functions, if not actual replacement of them."

Paul A. Mitchell, superintendent of banks of the State of Ohio: "It does not appear advisable to make any changes in the division of authority to supervise and examine banks. The idea that there is a duplication of duties by Federal agencies in the supervision and examination of banks is erroneous. The Comptroller of the Currency supervises and examines national banks and these banks are not examined by any other agency. The Federal Reserve, in conjunction with the respective State supervisor, supervises and examines State member banks and these banks are not examined by any other agency. The Federal Deposit Insurance Corporation, in conjunction with the respective State authority, supervises and examines State nonmember banks and these banks are not examined by any other agency. The respective State supervisors supervise and examine the noninsured banks. The duplication of effort between the State authority and the

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Federal Reserve or Federal Deposit Insurance Corporation is explainable since the objectives of the examinations of both the Federal Reserve and the Federal Deposit Insurance Corporation are limited with the authority resting in the State supervisor. Theoretically, at least, the purpose of the Federal Reserve examiner is to determine the amount of paper in a bank that is eligible for rediscount with the System and the purpose of the Federal Deposit Insurance Corporation examination is to determine the degree of risk on the insurance of deposits. Changes in the objectives and policies are unnecessary since the responsibility for obtaining compliance with the statutes rests with the Comptroller of the Currency and the State supervisor."

C. A. Gough, deputy and acting commissioner of the State of New Jersey: There is no reason for making any change whatever in existing methods of supervising and examining banks for present practices do not appear to overlap to any serious extent. In no event should the FDIC be superseded as a participating agency in view of the proven soundness of its examinations. Through the close cooperation which presently exists between the States and the Federal examining agencies, objectives and policies are adapted to meet the demands of changing conditions.

A. A. Rogers, superintendent of banks of the State of Oregon: "It is my opinion that the Comptroller of the Currency should supervise national banks and that State-chartered banks should be supervised by State authorities. If the Federal Reserve wish to examine State-member banks and if the Federal Deposit Insurance Corporation wish to examine State-chartered banks they should have the privilege of doing so, but I do not feel that either the Federal Reserve or the Federal Deposit Insurance Corporation should supervise banks. It is my opinion that the Federal Deposit Insurance Corporation may be encroaching upon management when they talk about capital ratio and surety bond coverage. I think the determination of the adequacy of capital funds and the surety coverage is a problem of management. The same might hold true as to the amount of the reserves held by our banks since the management, as a general rule, is interested in maintaining their bank in a safe and liquid position."

J. F. McLain, Director of Banking, State of Nebraska: The FDIC contributed more constructively to the fundamentals of examining and supervising banks during its first 5 years than was contributed during the previous 25 years by any other agency. It should be assigned the responsibility of examining all State banks that are members of the Federal Reserve, in addition to other insured State banks. The Federal Reserve should be dehorned of its power to make examinations, except in most unusual cases and then only with reservations. "* * * * Their policy of examining is to make a good audit, check for infractions of promulgated regulations and be ambassadors of good will. None of the reports of examination in this State offer suggestions for increases in the capital structure, especially none for increasing the basic capital stock or the conservation of earnings. The analysis and appraisal of loans is such that in the event of difficulty this Department would be obliged to disregard examinations of the Federal Reserve. We do not make joint examinations. They make one independent examination and the Department makes an independent examination. Our examiners are imbued with the policy of appraising risk assets upon a constructive basis.

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"Any plan, policy, or formula that is designed to sway or control the economy through the procedure of examining the banks of our Nation is without merit. The policy of this department is to exercise as much discretion and as little restriction as is compatible with the business of sound banking."

W. Royden Watkins, chief examiner, State of South Carolina: The dual banking system should be maintained and the extent to which Federal agencies examine State institutions should be regulated to the degree of that agency's specific interest—for example, the FDIC as insurer, the Federal Reserve for credit information and compliance with conditions for membership. The objectives and policies should be governed by the interest, responsibilities, or duties of the examining agency.

Donald A. Hemenway, commissioner of banking, State of Vermont: "I don't know of any desirable change to be made in the division of the authority to supervise and examine banks. While considerable division exists, the various agencies have managed pretty well to adapt themselves to existing conditions."

Benjamin O. Cooper, auditor of public accounts, Illinois: "As it becomes more fully realized and understood that independent banking, as accomplished under the ideals of the dual system, is the most logical and expedient approach to the continued development and progress of this country, greater insistence should be given to confining the various supervisory and examining agencies to the field of their own peculiar purposes and functions.

"The originating, supervisory, and terminating powers as given to the Comptroller of Currency under the National Banking Act are his and his exclusively. They should not be shared nor encroached upon by any other agency or authority.

"Similarly, as relates to State-chartered banks, the like powers and authority delegated by the statutes of the various States are exclusive, and neither should be shared nor be subject to encroachment.

"Neither the purposes nor the functions of either the Federal Reserve or the Federal Deposit Insurance Corporation were meant to supplant those of the designated statutory supervisor nor to superimpose additional authority in supervisory matters.

"Examiners from the Federal Reserve confine their examinations primarily to matters bearing upon the conditions incident to membership.

"Similarly, examinations by the Federal Deposit Insurance Corporation should be confined to an inspection of its risks and of compliance with the terms of insured status."

Maurice C. Sparling, superintendent of banks, California: "Asks what changes, if any, should be made in the present division of authority to supervise and examine banks, and the objectives and policies of the various supervising and examining agencies.

"It would appear preferable for the three Federal agencies to continue to perform separately the functions for which each is best fitted, rather than to attempt to combine the examining functions of all of them under any one head. The purpose and functions of the three Government agencies are quite different in many respects. The Comptroller of the Currency licenses, examines, and actually supervises all national banks. While all national banks are members of the Federal Reserve System and are insured by the Federal Deposit Insurance

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Corporation, neither the Federal Reserve or the FDIC has authority to examine them or to supervise them.

"Membership of national banks in the Federal Reserve System is mandatory. Since membership of State banks in the System is voluntary, the Federal Reserve System should have authority to determine the conditions under which State banks should be admitted to membership, and State member banks should be subject to Federal Reserve requirements insofar as they do not conflict with the laws of the State under which said banks are chartered. Actual supervision over State banks should rest with the State supervisors, just as supervision over national banks is left to the Comptroller of the Currency.

"The Federal Deposit Insurance Corporation has, to a large extent, the viewpoint of an insurance agency in its approach to bank examinations. It is naturally interested in the sufficiency of the capital structure of insured banks, the integrity and capacity of bank management, and of management policies insofar as they might affect the solvency of the insured banks and increase the potentiality of losses which the FDIC might have to assume. Perhaps it is natural that these interests should lead the Federal Deposit Insurance Corporation to assume supervisory authority with which it is not vested by law, and which should be left to the respective State supervisors."

Richard Rapport, bank commissioner, Connecticut: "This question contains implications of the often-raised suggestion that bank supervisory and examining functions performed by various agencies of the Federal Government should be concentrated in a single agency.

"There is at present no material overlapping of such functions in the operations of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Board of Governors of the Federal Reserve System. Each examines different classes of banks. Nor is the work of any one of those agencies supported by taxes on our citizens.

"There is, however, some duplication in the supervisory and examining activities of the States and those of the FDIC and the Federal Reserve. Neither of these two Federal agencies are supervisory bodies as such. Their fundamental purposes are different and such examinations as they may make should be specialized examinations for their proper purposes, particularly in the case of problem institutions. Each should accept State examinations of State banks and the comptroller's examinations of national banks as the supervisory examination. Any other course would inevitably result in the weakening, if not the actual destruction, of the dual banking system. Leo T. Crowley, the former Chairman of the FDIC, said publicly in 1940: 'I hope the time will never come when in any Federal agency there will be a centralization of bank examinations. Personally, I am opposed to that because I know of no living human being who could handle and coordinate the examination of State and National banks without, in effect at least, unifying the banking system. When you unify it by supervision, it is only a step to unification by law.'

"The undermining of the dual system is reason enough for avoiding concentration of supervision, but, in addition, should such a change be made, there might well be fundamental conflicts arising from such unification since the different agencies have different purposes. The Federal Reserve might, for example, in exercising its functions as a monetary and credit policy agency, actively encourage the making of

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loans by banks without proper supervisory regard to the essential soundness of such loans. The FDIC, as an insurer, for example, might be reluctant to allow a bank to close when supervisory findings indicate that the bank should not continue to operate.

"National banks should be supervised by a separate Federal agency such as the Comptroller's office and State banks by the respective State authorities. The Federal Reserve and the FDIC need not and should not supervise banks."

Frank E. Goldy, State bank commissioner, Colorado: "National banks should continue to be supervised by the Comptroller of the Currency and State banks by their respective State departments. The aim of the Federal Reserve and the FDIC should be to cooperate with State banking departments and not take over a part of their supervision. There seems to be an inclination on the part of the FDIC to take over a part of the functions of the State departments by encouraging such departments to turn one examination of the two required over to the FDIC examiners. Some States have done this and it is apparently the desire of the FDIC to see all States adopt this plan."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "Perhaps technical changes could be made. Present methods seem to be operating rather soundly."

> 15. Under what conditions and for what purposes should the Government or its agencies lend to private borrowers or guarantee loans to private borrowers? What are the advantages and disadvantages of these activities? What are the relative advantages and disadvantages of Government loans to private borrowers as compared with the Government guaranty of private loans?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "I believe that no general answer should be made. The lending policy of the Government should be determined according to the objectives that are being sought and through an intelligent choice of the best means to attain these objectives. Factors to be considered are the reactions of bankers and borrowers to various plans, and the kind of programs the Government is attempting to promote. I should oppose any principle that the Government ought not to lend or ought not to guarantee loans. On the other hand, I feel that the Federal Government in the past has perhaps relied excessively on loans and guaranteed loans to achieve its objectives. Often the easy thing to do in searching for the solution to a problem is to lend money. Sometimes more direct or more comprehensive methods would be more successful; for example, in the field of housing."

Elmer C. Bratt: "The problem of Government loans or guaranty is an extremely complex subject. On the whole, guaranty of a percentage is the preferable system, but direct loans may be desirable in some areas where desirable secular credit is not forthcoming."

Neil Carothers: "The Government should retire from the lending business and the surety business."

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Fred R. Fairchild: "I do not think it should ever be the function of the Government to lend, either to private or to public borrowers, nor to guarantee loans. This should be a function of private enterprise. The disadvantages of these Government activities are summed up in their weakening of private enterprise, involving the Government in waste and loss of the people's money, and encouraging unwise industrial ventures. All of these difficulties are eliminated or greatly reduced when lending is in private hands."

C. O. Fisher: "Excepting in dire emergency, such as a housing shortage or an impending collapse of the economy, the Government should not make loans to private borrowers. With the proper organization and regulation of lending agencies, such intervention by the Government would be necessary."

Lloyd W. Mints: "I have the feeling that we in the United States are drifting, without any definite notions of where we are in fact going or where we want to go. If we really desire to preserve a system of private enterprise we should restrict governmental activities to those things that are not suitable for private endeavor. Lending money is one of the things that can be most readily done on a private basis. I would eliminate all governmental lending and all governmental guaranties of private loans. These activities were mostly born of the depression, and that was so serious because we failed to maintain stable monetary conditions."

Edward C. Simmons: "There is no genuine need for any Government lending agencies. Neither is there any need for Government guaranty, which after all is risk protection to lenders not to borrowers. I can't see that money lenders should be spared the risk of doing business any more than other enterprises."

Philip E. Taylor: "In conditions similar to those in which it has been done in the recent past—to encourage spending in certain fields when desired, and to promote liquidity when necessary. The guaranty seems much more congenial to our type of system than the direct loan, though in extreme situations the latter should be available."

Edward F. Willett: "I am firmly opposed to Government lending to private borrowers except in the event of an extreme emergency. * * * I see little fundamental difference in the long run between direct Government lending, and Government guaranty of private loans."

Roy L. Garis: "Stop it. If Federal Reserve System worked properly no need for this. I do not want Government in banking business."

Harry Gunnison Brown: "I disapprove of both Government lending and Government guaranty of loans because of political forces, the strengthening of pressure blocs, etc. * * * With an appropriate monetary and bank credit policy, there can be no excuse for such favoritism on the ground of its necessity to stabilize business."

Albert G. Hart: "I have mixed feeling about these operations. Largely because such agencies as RFC seem to operate with such vague standards that I suspect loans are apt to get involved with political favoritism."

"I prefer Government guaranty to Government direct lending."

Frederick A. Bradford: "I am skeptical of the desirability either of direct Government lending or guaranties of loans for there are ample credit agencies to take care of sound loans for all purposes. If,

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however, the Government sees fit to try to keep alive uneconomic enterprise, I think direct lending by a Government agency should be the method employed. Guaranty of private loans tends to relax the selective judgment of the lender and is not to be advocated * * *."

B. H. Beckhart: "Except in case of war or acute emergency the Government should neither extend nor guarantee loans to private borrowers. Both * * * make the Government all too vulnerable to various political pressure groups."

Marcus Nadler: "The Government should neither lend to private borrowers nor guarantee loans of private borrowers. The Federal Reserve banks should be given the authority to handle loans which cannot otherwise be handled by the commercial banks."

Seymour E. Harris: When general activity is too high or more than adequate, the Government's task is not to contribute further to demand, but it should intervene directly when private lending agencies do not supply sufficient credit. In general I favor guaranties rather than direct lending, but only if the cost is not greater than that of direct loans.

Charles C. Abbott: In general such operations are justified when (*a*) public policy calls for the making of loans which have little chance of repayment, as in the case of disaster or national defense, and (*b*) when there is a gap in the private financial structure so that legitimate requests for credit cannot be met by private institutions. "By and large the device of the Government guaranty is preferable to the direct loan, for at least three reasons: (*a*) The guaranty device utilizes the existing financial structure and does not create a new, duplicate structure; (*b*) the guaranty device is not so likely to create a bureaucratic organization that seeks to perpetuate its existence by making new jobs for itself; (*c*) our experience with a variety of Government lending agencies since 1930 shows that it is far easier to liquidate a guaranteeing organization when the need has passed. * * *."

Karl M. Arndt: "I favor such operations when production needs encouragement, and especially favor guaranties because private business demands some degree of private management of credit."

E. E. Agger: "I feel that the Government should be the umpire and enforce the rules of the game without participating more than necessary in the actual playing of the game. However, at times, as in the case of disaster, Government guaranties or even direct loans may be justified. I prefer Government guaranties to direct lending."

Kenyon E. Poole: "* * * I would prefer to see the Government restrict its participation in production to (1) direct investment in projects having an undoubted public interest, or (2) those which private industry is not competent to undertake."

James B. Trant: Normally the Government should neither loan to nor guarantee loans to private borrowers, though this might be done in the case of great emergency.

Anonymous: "* * * The chief question before the country today is, What are the limits of Government invasion of the field of private enterprise and within what limits is private enterprise assured of some freedom from Government intervention? Private banks are taxed and thus help to provide the cheap money obtainable from Federal agencies. That, it seems to me, is not in accordance with the principles of equity. * * * Why are bank shares so undervalued today? Why is it so difficult for them to raise equity capital? The peo-

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ple set up private lending agencies such as banks and then Congress sets up Federal agencies to compete with them. That does not make sense."

C. R. Whittlesey: "The presumption is in favor of leaving credit in the hands of private enterprise, subject always to the provision of a suitable legal framework. In emergencies such as war or depression, private credit may be inadequate, or incapable of functioning effectively, so that governmental participation is necessary. Also there may be cases where Government action is called for to improve the credit mechanism. Guaranties have the advantage of preserving in large measure the forms and organization of private enterprise."

E. Sherman Adams: There should be a clearer demarcation between the proper spheres of private and public credit activities. In general, public credit agencies should function only in areas where the broad social benefits of their activities are substantial and where the risk is greater than should be assumed by private credit agencies. Authority to make nonbankable loans to business should be vested with the Reserve System rather than with the RFC except under emergency conditions.

Howard S. Ellis: The Government should lend to private borrowers if existing private enterprises do not adequately care for the potential borrowers. If the matter is pressed too far, it can of course expose banks and other private ventures to loss of patronage. But I doubt whether the various lending agencies of the United States Government have seriously impaired the profitability of private loan agencies, as a matter of historical record.

Edward S. Shaw: "I am not in sympathy with Government lending. Government guaranties may be desirable in such limited fields as international investment. The objection to Government participation is that it typically runs contrary to the objectives of monetary policy. And it is subject to raids by special interest."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "The use of public funds or credit for private purposes is inconsistent with a sound economy. It follows, therefore, that only in case of a national emergency, and then only for purposes directly related to the national effort in combating such emergency, should the Government, or its agencies, lend to private borrowers or guarantee private loans. * * *

* * * * * * *

"There is no intention to convey the thought that neither Government funds nor credit should ever be used for private purposes. The idea is that they should only be used in periods of emergency, and the emergency should be real and not political or imaginary."

Anonymous: "The Government should not lend to private borrowers during ordinary times such as the present one. Agencies such as the RFC should be maintained on a stand-by basis only."

Anonymous: "Do not feel the Government should loan to private borrowers except in time of war or major depression when speed is essential. Think guaranties by the Government of loans to private borrowers have been very useful to the small borrower who is a good moral risk but has little or no capital. I would not approve of Government loans or guaranties to large corporations, believing that if such organizations cannot obtain private credit it is because the loans

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are unsound, and except in unusual cases such as those caused by war or major depression it would be better to let nature take its course."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "We do not believe the Government should guarantee private loans, or make such loans. Exceptions might be on certain type of huge national undertakings. * * * Private funds are not influenced by political reasons, and it is unwise and unfair to place the man in politics in this position. * * *"

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: "In times of emergency and depressions."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "There is no sound reason why the Federal Government should use the taxpayers' money to compete directly with established private financial institutions, unless and until private financial institutions fail to meet all credit needs for the maintenance of a sound national economy. A tremendous political asset would accrue to the party in power if direct Government loans were authorized. * * * I do believe that it is the Government's duty to support the private credit system, but this support should be available only in periods of seriously disturbed conditions."

R. C. Leffingwell, J. P. Morgan & Co., New York: "The Government should abolish all its private lending agencies and discontinue lending or guaranteeing private loans. It is an unhealthy thing * * * for private persons to deal directly with the Government and obtain favors in the form of loans and guaranties from the Government. * * *"

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: Under normal conditions it is not in the province of the Government or its agencies to lend or guarantee loans to private borrowers. But if such loans are made it is best that they be made only under emergencies and on the basis of guaranty rather than direct from a Federal agency.

W. R. Gott, the National Deposit Bank, Arnold, Pa.: Government should not make direct loans. The RFC has some good points and some bad, but there is a place in our system for the RFC if properly supervised.

Otis E. Fuller, Security State Bank & Trust Co., Beaumont, Tex.: "No Government loan and no guaranties, FHA or otherwise."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The Government should neither make nor guarantee private loans. In times of distress only, an exception might be advisable."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "Government should get out of the loan business and certainly not create any new agencies. These Government agencies should not support uneconomic or weak business and thus make it tougher on others which might operate successfully."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "The making of loans or the guaranteeing of loans by the Government is contrary to what we call the free enterprise system. * * * Believe it better for the Government to guarantee than to loan direct. It isn't as competing with private business; it is sounder, I believe, and secures better results. If banking becomes more closely held and less competitive, there might be an added reason for Government loaning. If banks stay independent, if they are not absorbed by holding companies or large branch bank systems, the

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natural competition will produce a service that will make unnecessary much Federal loaning."

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: "Under no conditions, except extreme emergency. * * * Present sources of credit are adequate."

R. J. Hoffmann, American National Bank of Cheyenne, Wyo.: "The Government should stay out of the lending business. Generally speaking, anyone who is entitled to credit can get it from private sources. To loan to a person who is not entitled to credit is harmful both to the borrower and persons with whom he competes * * *. I do not favor Government guaranties of private loans as this practice leads to poor credit management. Guaranty of private loans is probably less dangerous than direct Government loans."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: "Very much opposed to Government lending or guaranteeing, except in case of emergencies. In my judgment, Government agencies do not exercise as good credit judgment as private institutions or individuals. * * * Many years of banking experience have convinced me that much more damage has been caused to borrowers by too much credit than by too little. It is doubtful whether some of those who advocate freer loaning policies recognize this fact."

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: "In a peacetime competitive economy we should work toward the elimination of any direct lending or guaranteeing of loans by the Government to private borrowers. Sound loans need not have the guaranty of the taxpayers."

Fred W. Glos, the First National Bank, Elgin, Ill.: "Under no conditions * * *."

L. M. Giannini, Bank of America, San Francisco: Such loans and guaranties of loans should be used in a war emergency or other national emergencies for the purpose of producing goods that are absolutely essential to the economy and in short supply, helping to restore devastated areas, and providing shelter for those who move to new areas to assist the war effort or to escape devastated areas. One of the disadvantages, particularly in peacetime, is the tendency of the citizen to lean too heavily upon the Government for assistance in normal undertakings, rather than upon his own resources. Government guaranty of private loans, where warranted, has the following advantages over direct Government loans: (1) Minimizes the expense to the Government for personnel and administration; (2) minimizes the possible effect of political or other improper influences in such credits; (3) utilizes the experience, facilities, and knowledge of local conditions of existing credit agencies; (4) utilizes loanable funds of existing credit agencies and to that extent avoids further expansion of national debt.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is felt that the Government or its agencies should lend to private borrowers or guarantee loans to private borrowers only in cases where such loans cannot be made by the banking industry. Such activities are often contrary to moves being made by the monetary authorities in the control of our economy. The principal disadvantage of Government loans to private borrowers as compared with the Government guaranty of private loans seems to be in the disposition of the funds when the loans are repaid, for example: (*a*) Loans made

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by the banking system and guaranteed by the Government—When repaid to the banking system the funds disappear from the money supply, thereby contracting the supply of money; (*b*) Loans made directly by the Government—These are repaid to the Treasury and, as a consequence, the money supply does not contract with the contraction of credit."

Anonymous: The Government or its agencies should lend or guarantee loans to meet emergencies or disasters or to deal with some aspect of national security. The advantage of such activities is that some projects can be financed that contribute to economic progress even though the loan would not qualify as to safety or maturity as a suitable bank asset.

A Government guaranty of private loans has many advantages over a direct Government loan: (*a*) The normal relationship between the borrower and lender is not disturbed and the Government receives the benefit of the close supervision which banks give to their assets; (*b*) the loan transaction is reflected in the commercial banking system as a commercial transaction, which it is, and plays its part on the over-all credit picture with which the credit authorities are dealing. Also, there have been many instances in which a commercial bank, because of its intimate knowledge of the borrower, has prevented substantial losses.

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "Government or its agencies should lend to private borrowers, or guarantee loans to private borrowers, only where private credit cannot be obtained."

E. F. Haworth, commissioner of finance of the State of Idaho: "Prefer Government guaranty of private loans where necessary."

C. A. Gough, deputy and acting commissioner of the State of New Jersey: "My viewpoint is that in ordinary times the Government should stay out of the direct-loaning field, entering it, if at all, only in seriously depressed periods such as occurred in the 1930's and then only to the extent necessary to fill the gap until private banks are in a position to operate. On the other hand, I believe that Government guaranties such as are effected through instrumentalities like the Federal Housing Administration are of proven value to the country's economy. Advantages of Government guaranties were, it seems to me, demonstrated beyond any question in the case of real-estate loans, when such guaranties were responsible for providing many thousands of housing units during years when private capital was unable, or unwilling, to risk the investment of the millions of dollars which were necessary to finance the country's housing needs.

"Government guaranties of business loans to be made by banks to companies with reasonably fair prospects, but which could not meet the usual standards banks require of borrowing customers, could have done much to lessen the extent of our troubles in the 1930's, and such an arrangement should, I believe, be put into effect if we are ever again faced with similar depressed conditions."

A. A. Rogers, superintendent of banks of the State of Oregon: "I do not believe that the Government or its agencies should loan to private borrowers or guarantee loans to private borrowers, except in

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time of emergency. I feel that it was in order for the Government or its agencies to loan or guarantee loans during the war period, but that it is no longer necessary. I feel that the disadvantages of the loaning and guaranty of loans by the Government to private borrowers have resulted in too many individuals running to the Government for help and assistance and at the same time it has resulted in spoiling many bankers who found it easier to refer their customer to a governmental agency for a loan and thus have in their note pouches a loan that was guaranteed. I think that banks should take some risks and keep themselves in a position where they can supply their customers with all legitimate demands for credit. Occasionally a borrower will require amounts in excess of the ability of the bank to handle and in such case the excess amount could be handled by the governmental agency with a local bank retaining its limit. I believe that the sooner this country returns to real banking instead of having the Government brought into all business that it will do much to start us on the road to sound business."

Donald A. Hemenway, commissioner of banking, State of Vermont: As a general thing the Government or its agencies should not be required to lend to private borrowers. But in emergency conditions if lenders cannot or will not lend it may be necessary, in order to attain the objective of sound conditions and accommodation of business, for the Government to lend to private borrowers. Guaranteed loans to private borrowers in the case of the Federal Housing Administration seem to have worked out pretty well insofar as losses to the Government are concerned.

Frank E. Goldy, State bank commissioner, Colorado: "Government agencies should lend to private borrowers, or guarantee loans to private borrowers, only where private credit cannot be obtained."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "In my view, the Government should not lend money to private business except in times of national emergency. Government credit in housing and agriculture seems inevitable, but great care must be exercised to keep it on as sound a basis as possible. On the whole I believe guaranties on a portion of the risk are preferable to outright loans."

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: "* * * the whole concept of Government loans requires careful reexamination at this time. There are many areas in which Government loans are justified provided they are really loans and not subsidies. Wherever possible, Government agencies ought to use the facilities of existing lending agencies, such as banks, mortgage companies, etc., allowing these institutions to make a modest profit in consideration for passing on the credits and assuming some portion of the risk. Where it is advisable to guarantee loans, the same principle applies. When the lender takes no risk, we lose a very valuable element in our credit structure—the interested judgment of the lending agent and experienced scrutiny and supervision of the loan."

16. Have the activities of the Government agencies that lend to private borrowers or guarantee private loans been appropriately coordinated with general monetary and credit policies? If not, should the degree of coordination be increased? With respect to

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what policies? If a greater degree of coordination is desirable, how should this be accomplished?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "The activities of Government lending agencies have perhaps not been sufficiently coordinated, and the degree of coordination should be increased. However, the problem has not been serious. Moreover, it does not necessarily follow the Government lending for every purpose must expand in times of depression or contract in times of boom. For example, good public policy might require expansion of loans for housing even in a time of inflation."

Lloyd W. Mints: " 'Coordination' is a seductive word, since one can hardly object to coordination, but coordination is not the only alternative to independent action of numerous agencies. Insofar as those agencies are dealing with the same problem, they should not merely be coordinated; they should, to the fullest extent possible, be amalgamated or eliminated. The lending operations of the Government are not needed, and if they were eliminated the problem of coordination would evaporate."

Edward C. Simmons: "This is hopeless. The only sensible thing to do is to eliminate entirely the whole apparatus."

Philip E. Taylor: "On general principles, they should be closely coordinated to make monetary policy somewhat more effective. I believe they have been adequately coordinated within the limitations imposed by international affairs and veterans' policies. I suspect that the only means effective in the long run is through the machinery of the economic report and its possible influence upon legislation and upon administrative agencies."

Edward F. Willett: "There has not been appropriate coordination of Government lending and guaranties with general monetary and credit policies. If there is to be such lending, a greater degree of coordination is desirable. For some time, for example, the Government was fighting inflation with one hand and pouring money into agriculture and housing with the other hand. My choice would be to get the coordination by ending the lending, but if lending is to continue coordination is very difficult to get unless the responsibility for both functions is put into the same hands. * * *"

Roy L. Garis: "Too liberal credit to agricultural and private interests is part of our basic trouble today. It can only lead to great difficulties in time. Farmers especially have too liberal credit."

Albert G. Hart: "* * * Coordination of lending agencies with monetary and fiscal policy has been poor * * * postwar real estate loans have had a marked inflationary effect on bank credit and on real estate prices * * *. To some degree, coordination can be improved by authorizing the Federal Reserve to make parallel alterations in interest rates under all lending programs * * *. Another possibility would be to let the Budget Bureau impound part of the authorized funds, or set maximum rates of disbursement or guaranty, subject to 'legislative veto.' "

Frederick A. Bradford: Since these operations are directed to special purposes they may interfere with general credit policies, "* * * as when the Federal Reserve was given power to raise reserve requirements and control consumer credit while, at the same time, mortgage

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lending on real estate was being stimulated. The only possibility of real coordination * * * would be to place control * * * in the hands of the Federal Reserve * * *. This hardly seems feasible, but would appear to be the only way to insure successful coordination."

B. H. Beckhart: These "* * * have not been appropriately coordinated with general monetary and credit policies. The degree of coordination should be increased with respect to all policies followed. The means of achieving such coordination should be studied carefully by a National Monetary and Credit Commission."

Seymour E. Harris: There is not much evidence of conscious coordination. "A well-coordinated monetary policy requires the integration of 'spending' as well as money-creating policies. Clearly a Federal Loan Administrator should be a member of the Domestic Monetary Council."

Charles C. Abbott: Have not been well coordinated. This lack of coordination has been a far more serious hindrance to an effective central banking policy than the existence of a small volume of commercial banking resources outside the Federal Reserve System.

E. E Agger: There has been no coordination of the activities of these agencies with general monetary and credit policy. "The tendency has been to stress the needs of the particular beneficiaries of these policies * * *. General regulations might require the approval of the Board of Governors and rate levels should also be subject to this type of supervision."

James B. Trant: These have not been coordinated with general monetary and credit policies. They have operated for the special interest for which they were created without reference to general policies. They should be on a general basis and not specialized.

Anonymous: These have not been coordinated with general monetary and credit policies. The Federal agencies have become so numerous that no one can keep up with their activities and Congress itself does not know just what they are up to or why. Once an agency is set up it lives on forever by one means or another. It is clear that many of them should be terminated and the over-all situation simplified with respect to the rest. In that way one could perhaps determine whether the rest could be coordinated.

C. R. Whittlesey: Every effort should be made to improve such coordination and room for improvement definitely exists. The appearance of lack of coordination in the past, however, has been partly the result of a plurality of objectives which gave rise to seemingly contradictory policies. Some of the credit extended to provide housing for veterans, for example, was justified even in a period of inflation. Ultimately coordination depends on establishing suitable relationships between the Treasury and the Federal Reserve. Immediately, appointment of a National Monetary Commission to study and recommend is the most promising method of proceeding.

E. Sherman Adams: "The lack of coordination in this area is an obvious and serious gap in the organization of monetary management. The Reserve Board should have broad authority to regulate the general credit policies of public credit agencies."

Howard S. Ellis: "I think a coordinating agency (of a cooperative rather than mandatory character), such as suggested by Winthrop

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Aldrich and the Committee for Economic Development, would be desirable."

Edward S. Shaw: "Government lending activities have not been coordinated with fiscal and monetary policies. They have been pressed, at low rates of interest, even in inflationary periods. I can visualize no satisfactory coordination between Government lending and income policy."

B. ANSWERS BY BANKERS

J. T. Brown, First National Bank, Jackson, Miss.: "In most instances the activities of the Government agencies that lend to private borrowers or guarantee private loans, have been appropriately coordinated with general monetary and credit policies. This applies especially to the RFC, which has done a good job."

Anonymous: "The Government agencies have not been coordinated with general policy. During the past few years the Government has directed contraction of bank loans while the RFC and other lending agencies are making all the loans possible."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "Government agencies that lend to private borrowers or guarantee private loans are unsound in principle, and show undue favoritism. This leads to corrupt government, and the amassing of wealth unjustly, a misuse of money."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: The RFC and the FHA have done a good job but they are about the only ones I have come in contact with directly.

L. M. Giannini, Bank of America, San Francisco: These activities have not been appropriately coordinated with general monetary and credit policies; they expanded credit too rapidly following the close of the war, created too much purchasing power and kept the fires of wartime inflation fanned.

R. C. Leffingwell, J. P. Morgan & Co., New York: These "* * * have not been coordinated with Federal Reserve policy, and never can be; since these lending agencies are created for the purpose of lending, and are provided with the money to lend, and are inevitably subjected to pressure to lend it. They should be abolished."

J. R. Geis, the Farmers National Bank, Salina, Kans.: Federal agencies should not have the power to make direct loans to private borrowers, but if they are to have this power it should be coordinated with general monetary and credit policies.

William S. Gray, Central Hanover Bank & Trust Co., New York: They have not been coordinated.

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: "Apparently, the activities of the Government loaning agencies have not been well coordinated with general monetary and fiscal policies. It might be well to have the loaning policy in a general way directed by the Federal Reserve Board."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "I feel that there has been appropriate coordination. * * * However, I do not believe that the Government should be in the business of lending money to private borrowers or even guaranteeing private loans."

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Fred W. Glos, the First National Bank, Elgin, Ill.: "Should be more coordinated, if loans are to be made, as in my opinion there is too much confliction of the various agencies."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "The activities of Government agencies in lending to private borrowers or guaranteeing private loans has not been appropriately coordinated with general monetary and credit policies. This was demonstrated recently by activities of Government agencies in the mortgage and commodity fields, at the time when credit and monetary authorities were endeavoring to restrict credit to combat inflation. It is believed that a greater degree of coordination is desirable and could be achieved by permitting the Treasury Department and the Federal Reserve Board to pass on policies of the agencies in matters of extending credit."

Anonymous: "A notable illustration of the lack of coordination was provided during the early postwar period when various Government agencies were stimulating a high volume of mortgage lending through easy terms and guarantees. This had the effect of increasing the competition for scarce materials and labor, and of expanding credit at the very time when other governmental agencies were taking steps to restrict the expansion of credit in an effort to dampen the spirited bidding for scarce goods."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: Activities of these agencies have not been appropriately coordinated with general monetary and credit policies. "* * * The clearest case has been the liberal terms under which the Federal Government lent money and guaranteed loans in the field of housing in the midst of efforts to control the postwar inflation. Various agencies dealing with different types of agricultural credit, the whole field of credit or credit guaranty to veterans, the credit operations of the RFC—these are only the principal areas that should be properly coordinated. * * *" The necessary coordination could be achieved through the establishment of a National Monetary Council, which would be an interagency committee with or without statutory authority. An alternative but less desirable approach would be the establishment of an Economic Coordinator in the White House after the manner of the wartime Economic Stabilization Director.

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo, Ohio: "I would think that activities of Government loaning agencies have not been sufficiently coordinated with general monetary and credit policies, and it would be desirable to have this matter studied by a special temporary commission."

17. What should be the guiding principles of the Government's over-all taxing and spending policies? To achieve an annually

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balanced budget even though national income and price levels fluctuate? To achieve a surplus at all times in order to reduce its debt? To achieve a deficit at all times? To achieve a surplus at some times and a deficit at other times? If the budget should not be balanced annually, what principles should guide the authorities in determining the amounts of the surplus or deficit, and under what conditions should there be a surplus or deficit? Should tax rates be held constant throughout a business cycle or changed as business conditions change? What tax rates, if any, should be flexible? Should the rate of Government spending be varied for the purpose of promoting economic stability? If so, what should be the guiding principles? Is it feasible and desirable to develop automatic guides to fiscal policy? If so, what should they be?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "Regarding the budget, the only practicable policy is to have surpluses at some times and deficits at other times. In general, surpluses should occur during periods of full employment and deficits during periods of underemployment, and the amount of the surpluses or deficits should vary with the extent of inflationary or deflationary pressure. Although important theoretical arguments may be advanced for flexible taxes, the practical difficulties are so great under our form of government that I would hesitate to recommend such flexibility. I am inclined to favor constant tax rates set at a level to balance the budget when the economy is operating at 'near full employment.' If there is to be flexibility of taxes, the personal income tax and possibly the corporation income tax are the taxes to which the flexibility should be applied. From the above answers, it is obvious that I would recommend fluctuating levels of spending with changing business conditions. The Government should always be prepared to spend enough on socially worth-while projects to offset any deficit in the amount of aggregate spending required to maintain the economy at 'near full employment.' I define 'near full employment' as a condition in which the number of unemployed does not exceed 5 percent of the labor force. The spending should take the form of relief as little as possible. Rather, it should be made on varied projects on which going rates of wages would be paid. Often the projects would be privately contracted. I do not favor blindly automatic guides to fiscal policy. However, the level of employment would surely be an important guidepost in any program of fiscal planning."

Elmer C. Bratt: "* * * In general, I favor, under present conditions, a policy which will create a surplus of perhaps $4,000,000,000 under conditions of 'full employment.' I do not think tax rates should be changed unless (1) conditions become excessively inflationary, (2) secondary depression develops, or (3) consideration other than economic stability arise. I do not mean to imply that a better tax system, supplying the same total revenue, could not be enacted or would not be required from time to time. It should be noted that (1) this does not imply a balanced budget, (2) it makes balancing the budget subsidiary to general economic policy, (3) it gives taxation importance with relation to expenditure independent of fiscal policy for over-all economic stability. The fiscal policy I believe to be desirable is not so much positive as negative. It is to keep Government

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action from being pernicious, not to provide a central guide for control. It is not so much that certain tax rates should be flexible, but that any tax rates which have been adjusted to unusually inflationary conditions or to secondary depression conditions should be readjusted when the need has vanished. In general, the small part of the Government spending which can be effectively deferred should be so deferred when a budget surplus appears under these guiding principles and should be implemented when a deficit begins to appear."

Neil Carothers: "The debt is quite unpayable, and it is foolish to talk about paying it. It must be in some way 'sterilized' and isolated from the credit operations of the banks and then carried as an annual burden of interest. The one essential policy is economy in government. If economy could, by some miracle, be adopted as a Government policy, it is conceivable that expanded public works and a small deficit in depression would be desirable, while a surplus in boom times would be worth while. While it is thus possible to have a minor amount of deficit financing as a recovery measure it is not desirable or even possible to juggle tax rates as a policy to control ups and downs in business. Once get a low cost of Government, changes in tax rates for control purposes are undesirable. The economic system will force deficits in bad times and surpluses in good times, without change in tax rates."

C. O. Fisher: "The Government budget should be balanced over a period of years, not in every fiscal year. Tax rates should be increased in a boom period and decreased in a period of recession. Government spending, where possible, should be stepped up during a recession and decreased during a boom. This policy should be subject to the control of the monetary authorities, and they should not be limited to any mechanical formula."

Frank D. Graham: "Taxes should normally be enough, and never more than enough, to prevent inflation.[1] Deflation should always be accompanied by deficit financing (of new or old projects), on a socially costless basis, that is, through the issue of new money. There seems to me to be no good answer to the query as to why the issue of new money (which is presumptively a prerogative of the Government) should be made by the commercial banks to their own profit. This is what now occurs whenever the money supply (commercial bank demand deposits) is being expanded, no matter whether this occurs through Government or privately instigated action (it may even be done by the banks themselves in the purchase of investments). The Treasury should require the Federal Reserve banks to put to its credit the counterpart of any interest-free bonds it might turn over to them[2] and the Reserve banks should be given power, and required, to raise member bank reserve ratios in the degree necessary to prevent secondary expansion.

"The flexibility in the tax structure apparently required under the procedures just outlined could be obviated, and the tax rate could be kept constant (in line with the quondam recommendations of the CED), if the proposals made in answer to question 20 should be adopted.

[1] A more or less satisfactory temporary alternative would be to borrow from the public (not the banks).

[2] The bonds might bear a nominal rate of interest sufficient to cover the cost of administration of the Government account.

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"The rate of governmenal spending should assuredly be varied to promote economic stability and compensate the inevitable fluctuations in the outlays of a people to whom freedom of choice is still permitted."

Harold M. Groves: "The guiding principle in over-all taxing and spending policy should be to vary the budgetary balance so that it will compensate for undue and insufficient spending (consumption and investment) in the private economy. There may be checks that prevent the compensation from becoming complete but it ought at least to be in the right direction.

"For the present, at least, the most practical goal is to keep tax rate steady over the fluctuations of inflation and deflation. (One would hardly expect to do this over a war period where the changing psychology of the taxpayer will warrant an advance in tax rates beyond that which can be maintained at other times). Certainly it makes no sense to lower taxes during inflation and raise them during deflation.

"Automatic reductions in tax yields with steady rates (built-in flexibility) will help to counteract fluctuations in the private sphere. But there is no reason to suppose that they will be sufficient to compensate completely for such fluctuations. Tax policy should accordingly be supplemented with spending policy. In a severe decline this will recommend itself on other than economic grounds. A substantial amount of public construction can be saved for the period when private construction is low. If there is a desire to make this automatic, it can be done by a public works construction aid to the State that varies with an index of private construction and/or employment. The aid institution should be harnessed for fiscal policy objectives as soon as possible."

Lloyd W. Mints: "I do not subscribe to the view that the expenditures of the Federal Government should be varied cyclically. It is not that much could not be accomplished by such a procedure, but rather that better methods are available. I would stabilize to the fullest extent possible the expenditures of the Government. Variation of expenditures is among the most unwieldy means of adding to or subtracting from the stock of money that could be invested. Public works, even though planned in advance, can be instituted only very slowly. And would we want to stop work on half-completed buildings because the time had come when no more additions to the quantity of money were required? If expenditures by the Government are desirable, they should be made without waiting for the appearance of a depression.

"I would recommend the following budgetary procedure. The level of expenditures should be determined exclusively upon the basis of the merits of the projects for which funds were to be spent, that is, entirely without regard to the question of monetary policy. Then tax rates should be adjusted to balance the budget. If, as I would not anticipate, open market operations by the Reserve System and the Treasury failed to maintain the desired degree of stability in the price level, tax collections should be cyclically adjusted so as to create a surplus or deficit, as the case might be. Probably instituting, withdrawing, raising, or lowering tax credits would be preferable to changing either tax rates or exemption levels for this purpose. This procedure should be accompanied by annual purchases by the Reserve System of a sufficient amount of bonds to provide for the additional

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money necessary to maintain the price level. After the Government debt had been eliminated in this manner (and this could be done by some 20 to 30 years, depending upon what bond holdings were redeemed) I can see no way of avoiding an annual Federal deficit, to be met with new money, of a sufficient amount to prevent the price level from falling. Under these conditions again the level of expenditures would be determined independently of the requirements of monetary policy; the annual additions to the stock of money necessary to maintain the price level would be estimated; and taxes would be so adjusted as to equal the difference between these two items."

Edward C. Simmons: "The Committee for Economic Development program strikes me as the best alternative—a balanced budget at high level employment by means of a fixed fiscal formula."

Philip E. Taylor: "The guiding principles should be the same as those of monetary policy * * *. When Government expenditures (revenues) represent over 25 percent of national income, fiscal policy is willy-nilly important economic policy. Budget balance should be a secondary consideration, but secondary to economic need and not to political advantage * * *. Income-tax rates should be flexible, and in extreme cases, excise rates should change * * *. I would like to see variation in social security tax rates also, particularly unemployment compensation tax rates * * *."

Edward F. Willett: "* * * The tax policy should stimulate production and expansion, not discourage it. The tax policy necessary to do this would have to fluctuate from time to time as conditions change. Public confidence in Government fiscal policy is essential if business is to flourish. Public confidence requires a policy adapted to changing conditions. Debt retirement in prosperous times is confidence inspiring; a deficit at all times is the worst possible policy; a surplus in good times and a deficit in bad times should come closest to promoting the long-run economic welfare of the country. Most taxes should be flexible. It is probably advisable to vary the rate of Government spending to promote economic stability, but too much reliance should not be placed on this mechanism, and it will probably be only a minor factor in the direction of economic stability. * * * I question the soundness of completely automatic guides to fiscal policy, but would rely rather on the general principle of compensating to some extent by expenditures on public works for fluctuations in private spending, again stressing that human psychology is hard to predict."

Roy L. Garis: "Reduce drastically the number of Federal employees. Cut it by at least one-third and reduce all of it (100 percent) to where it has no power to determine policies and perpetuate itself in office. Otherwise our democracy is doomed and all these other problems are subsidiary."

Harry Gunnison Brown: "I am in general disagreement with those who constantly look to Treasury fiscal policy to even out fluctuations of business and employment activity. I believe that the spending of borrowed funds for various public works programs is likely to be much less effective in restoring business activity than its advocates anticipate. I believe in general that an appropriate and aggressive central bank policy would be sufficient for economic stabilization."

Albert G. Hart: "* * * Budgetary policy should be designed to yield a surplus for retirement of the public's excess liquid assets when-

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ever this is possible without generating unemployment. * * * We must expect to run into periods when a surplus or even a balanced budget will be incompatible with full employment. In such circumstances a deficit will help arrest and reverse a fall in employment.

"In view of the value of the budget-balancing principle to give a crude gage to the worth whileness of additional expenditure, I hate to see this principle dropped. I am inclined to view the proposal (linked with the name of Ruml and the CED) of balancing a hypothetical budget in which all figures are estimated on the assumption of a moderate-prosperity level of income. Additional expenditures could then be budgeted only with the provision of additional revenues. But if revenue was high because we were enjoying (say) 98 percent of full employment where the budget was balanced on an assumption of (say) 93 percent, the resulting surplus would not warrant a tax cut; nor would a deficit resulting from a drop of activity to (say) 85 percent of full employment call for deflationary tax increases.

"How well such a system would operate would depend on the degree of 'built-in flexibility' it incorporated. * * * To make such a budgetary system a good stabilizer, it should have a good many expenditures on a basis that will automatically increase in a slump * * * and it should rely on revenue sources that react sharply and quickly when activity changes. * * * My judgment is that flexible tax rates could be made serviceable as well. But only a limited list of taxes can appropriately be made flexible. Instability of corporate rates, upper bracket surtax rates on personal taxes, and death rates is not desirable. I am skeptical that much reliance can be placed on changes in Government spending except for 'automatic' changes such as that in unemployment compensation."

Frederick A. Bradford: Government spending should be kept down to a point where the tax burden is not repressive in normal times. "Ideally, taxes on income, sales, and production should be reduced sharply in depression, being increased as business recovers and stepped up sharply in the face of an inflationary boom. Given our present form of government, however, it would appear that stable tax rates year in and year out (as recommended in the CED report) would be most feasible. Rates should be fixed at such a point that they would yield a surplus in good years although a deficit might result in periods of depression. I believe that varying Government expenditure is not likely to prove highly successful as a stabilizing device but that it does seem desirable that the Government should plan its legitimate public works expenditures so as to make them in periods of depression rather than of boom."

Raymond P. Kent: "I favor great flexibility in budget policy, in tax rates, in spending, and in expansion and contraction of the national debt. As a general rule the budget should be balanced in the long run, a period of from 4 to 10 years. In periods of unemployment tax rates, especially those on corporate and individual income, should be lowered and spending stepped up; conversely, in periods of relatively full employment tax rates should be increased, spending curtailed and the resulting surplus used to retire debt.

"The annual balancing of the budget should quite definitely be discarded * * *."

B. H. Beckhart: It does not seem feasible or desirable to adopt automatic guides to fiscal policy. "In periods of prosperity every effort

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should be made to achieve the maximum possible surplus, and tax rates should, if necessary, be increased in order to achieve this goal. In periods of depression a deficit will doubtless be incurred by reason of the fact that tax revenues are so closely geared to income * * *. In depression no positive fiscal action should be taken until the index of production of the Federal Reserve Board has fallen, say, by a third * * *. The fiscal action then taken should probably assume the form of a reduction in tax rates rather than an increase in expenditures * * *. Debt reductions in periods of prosperity must exceed debt increases in periods of depression."

Marcus Nadler: These policies should be directed toward influencing favorably business activity and employment. There is no need for a balanced budget every year, but it is important that in good years a reduction of the public debt take place. The recent policy has not been appropriate. "Even during the fiscal year 1948–49, when business activity was at a high level, the Treasury had a deficit of $1,800,000,000. A constant increase in the public debt is a menace to the purchasing power of the currency."

Seymour E. Harris: The guiding principle should be to contribute to a healthy economy. An annual balancing of the budget is undesirable. Debt should be accumulated in periods of decline and retired in periods of overexpansion. So long as the debt charge remains in a reasonable proportion to national income, there is little danger in a rising debt. The tax system should have as much built-in flexibility as possible so that it will respond to changing business conditions. There is need for a better integration in Federal, State, and local taxes. Under limits set by Congress the Executive should have the prerogative of changing tax rates (particularly income and pay-roll taxes) every 3 months and also achieve greater flexibility in the timing of expenditures.

Karl M. Arndt: An annually balanced Federal budget belongs to the class of artificial and even spurious objectives of policy. It has about the same merit as a balanced-budget-at-all-costs policy for a family, or a private business. Fiscal policy must be flexible. Government spending can and should avoid competition with private production.

E. E. Agger: A balanced budget is not so important as that governmental fiscal policy should contribute as much as possible to the maintenance of full output and maximum employment. Broadly speaking, fiscal policy should aim at surpluses in periods of expansion and at deficit financing in periods of contraction. Over the whole period of a cycle, receipts should cover expenditures. There should be flexibility in tax rates, particularly of income taxes, and Government spending can also be modified to make its contribution to economic stability. It is doubtful that we can develop completely automatic guides to fiscal policy.

John H. G. Pierson: Tax and spending policies of the Government should be of a continuing long-run character and should be guided by (*a*) such obvious principles as fair distribution of the tax burden and intrinsic need for the goods and services resulting from the governmental expenditure, and (*b*) the importance of maintaining adequate purchasing power and investment incentive. This formulation rules out an annually balanced budget. Under it surpluses in some years may or may not exactly offset deficits in others. The amount of deficit

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or surplus in any year will depend on what proves necessary to realize the central purposes of the Employment Act. Certain tax rates as well as the rate of Government spending should be varied to promote stability. Government should underwrite a satisfactory level of employment and adapt its fiscal policies to this purpose.

Paul J. Strayer: A cyclically balanced budget is desirable. In general would favor the maintenance of relatively stable expenditures and secure flexibility through the revenue side, primarily through changes in the rates of personal income taxes. Automatic guides would be desirable if agreement could be reached on one that is acceptable. The guide that has the greatest appeal is the personal-income-payments figure of the Department of Commerce. Changes in tax rates and spending might be made in accordance with changes in the level of these payments.

James B. Trant: In general a balanced budget is more desirable than a stable price level, and the reduction of debt is certainly desirable in face of our present debt load. A deficit may be necessary at times to tide over difficulties but in general the policy should emphasize a balanced budget.

George R. Walker: "I am in sympathy with the program of the CED * * *."

E. Sherman Adams: "The general objective of fiscal policy should be to contribute to long-range economic progress and stability. In theory, a compensatory budget policy is unassailable but enthusiasm for such a program should be tempered by a recognition of the practical difficulties involved in reducing Government expenditures and achieving compensatory surpluses—in short, the dangers of inflation and uncontrollable Government."

Elmer D. Fagan: The principal objectives should be those of the Employment Act of 1946. Neither balanced or unbalanced budgets are desirable per se; the policy should aim at increasing economic stability. Tax rates should not be held constant throughout a business cycle but should be varied and it is essential to permit executive adjustment of basic income-tax rates within limits imposed by Congress. Also expenditures should be varied countercyclically. The proposals for "built-in flexibility" and "automatic stabilizers" are useful within limits but the executive should not be held rigorously to mandatory rules. Judgment on a wide range of indicators is necessary as in the case of monetary policy.

John F. Due: "Any attempt to obtain an annually balanced budget will aggravate business fluctuations. In depression periods an attempt to balance the budget by cutting expenditures and raising taxes will aggravate the depression and increase unemployment. * * * In depression periods taxes should be reduced (both income taxes and excises); expenditures should be increased. There are serious limitations to the ability of an unbalanced budget actually to produce recovery but it certainly should assist. * * * In periods of inflation a budget surplus, used to retire debt, is desirable both to check inflation and eliminate the debt so far as possible. * * * The maintenance of full employment is far more important than mere debt reduction as such; if there is any indication that debt retirement is producing a decline in business, it should be stopped."

Major revisions are needed in the Federal tax structure, both in the interest of equity and effect on business. Most of the excise taxes

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are highly inequitable, and particularly bad are the ones on freight, passenger service, electric power, telephone and telegraph service. These serve as direct deterrents to consumption and will make maintenance of full employment more difficult. Many others are almost as bad.

Edward S. Shaw: "The policies of perpetual budget balance, perpetual deficit, or perpetual surplus can be discarded offhand, on the grounds that they deny the use of fiscal policy for stabilizing output around a secular trend of growth at reasonably stable prices. Over such periods as the business cycle there should be a net surplus or net deficit only if that is needed to counteract serious deviations from a satisfactory trend. There is little more virtue in cyclical budget balancing than in annual budget balancing.

"Variations in Government spending should not be a major instrument of income policy. The principal reliance should be variation in tax yields. Tax rates should be allowed to vary automatically and contracyclically, changing with each given percentage change in the ratio of unemployment. The essence of the tax structure should be taxes on individual incomes, although sound argument can be made for a relatively low and stable tax on corporate net income as well."

B. ANSWERS BY BANKERS

Anonymous: "The guiding principles of the Government taxing and spending policy should be economy in Government with enough tax raise to pay 1 percent of the outstanding debt each year."

Anonymous: "Believe the Government should endeavor to have a surplus whenever possible, but allow a deficit when that seems to be better policy for the country as a whole. Very much opposed to reducing taxation when times are good or relatively good as long as we have such a large national debt. Do not believe that reduction of excise taxes or personal income taxes will stimulate business or produce equity capital to an extent that will have any appreciable effect on the economic picture. In times of depression I think it is perfectly proper and necessary for a government to use its best efforts to keep or put people at work even at the expense of a large deficit."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "The Government's over-all taxing and spending policies should be to get out of debt as rapidly as possible in good times, and in distress times through public works and sound deficit policies to stimulate the economy. * * *"

R. C. Leffingwell, J. P. Morgan & Co., New York: Under normal conditions fiscal policy should be directed toward economy in expenditure and maintenance of an ample surplus for the reduction of debt. "* * * However, in a period of depression, taxes should be reduced, not in the effort to achieve a deficit, but in spite of the fact that there may be a deficit. Increasing taxes in a depression is more likely to reduce the revenue than to increase it. * * * Increase in Government spending is not likely to relieve a depression, for Government spending is economically wasteful and burdens the taxpayers. * * * It is impossible to say in detail * * * just which taxes should be reduced in a depression. The answer is, Those rates which are most exaggerated. * * * It is not feasible or desirable to develop automatic guides to fiscal policy. * * *"

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Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "I am a firm believer in a balanced budget; however, there are times when it may be necessary to resort to deficit spending. There should be economy in Government so that debt retirement may be possible and deficit spending made unnecessary. We are firmly conviced that the tax policy should encourage the incentive reward of private enterprise."

W. R. Gott, the National Deposit Bank, Arnold, Pa.: "No individual and no government can continue to spend more than it makes. I am very much disappointed that we have made such slow headway on the reduction of our debt. It seems to me that our Government has not tried to make any appreciable reduction and again this year we have deficit financing."

J. R. Geis, the Farmers National Bank, Salina, Kans.: "* * * In general, I believe the Government should operate on a balanced budget, with a margin sufficient to maintain a continuous reduction in the Federal debt * * *. Congress should be compelled to provide adequately the revenue for every appropriation it makes and * * * deficits should only be occasioned by changes in revenue sources impossible to anticipate, or by great national emergency * * *. Taxes should be higher in prosperous times and promptly lowered in periods of falling income * * *. I do not believe in the Government rushing into ill-advised and poorly programed public works in an effort to relieve unemployment. However, it does seem sound to me that public works be so programed that they can be undertaken when private construction is lagging."

William S. Gray, Central Hanover Bank & Trust Co., New York: "* * * The budget of the Government need not be balanced annually, but should show a surplus in years of both average and high national income. The policy should be to reduce public debt, primarily through a reduction of expenditures which are presently excessively high. Taxes should fluctuate and not remain constant."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "It would be impossible to balance the budget every year. Should aim to reduce debt. Certainly we would not want a perpetual deficit. Should have a surplus most of the time. War and extreme depressions make deficit inevitable. Tax rates should change. * * * Impossible to have automatic guides to fiscal policy. Probably would not be applied if available."

Ben DuBois, secretary, Independent Bankers Association, Sauk Centre, Minn.: We naturally dislike deficit financing but at times it is justifiable. Tax rates should not be rigid but there should not be too much change. Such changes are hard on business. "* * * In other words, budget balancing should take place over the business cycle, not from year to year."

Fred W. Glos, the First National Bank, Elgin, Ill.: "No comment except that at all times the Government should operate within its budget and a reserve for the reduction of the debts."

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: "The guiding principles of Government taxing and spending policy should be: (1) Balance budget even though national income and price levels fluctuate; (2) to achieve surplus at all times to reduce debt; (3) income-tax rates should be changed to encourage business in depressed times."

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R. J. Hofmann, American National Bank of Cheyenne, Wyo.: The Government should endeavor to live within its income and retire some of its outstanding debt except in the event of war. "* * * Certainly we do not want to get back to the day of WPA and have the Government carry on a lot of useless spending in an effort to promote economic stability."

P. R. Easterday, the First National Bank of Lincoln, Nebr.: The Government's objectives should be to balance the budget and provide for debt retirement of about 2 or 3 billions annually. In some years there would be a moderate deficit and in others a moderate excess. "* * * A deficit would be justified under some unusual situations which might require a public works program to take care of excessive unemployment, but no deficit should be of a continuing nature. Tax rates should be changed as infrequently as possible. * * *"

C. H. Kleinstuck, the First National Bank & Trust Co., Kalamazoo, Mich.: "* * * The welfare of our country, of labor and capital alike, is better served when the Government in times of peace spends less instead of more. The welfare of our country in the continuance of conditions leading to full employment and production is far better served by a program of a balanced budget, reasonable debt reduction, and economies in Government which will ultimately permit of a reduction in taxes."

Leo W. Seal, Hancock Bank, Bay St. Louis, Miss.: The guiding principle should be to build a sound economy. The plight of the investor should be viewed with grave concern, and double taxation should be eliminated. A permanent part of the Revenue Code should be accelerated depreciation, modeled after wartime depreciation schedules. The cardinal principle should be taxation for revenue only. "* * * However, a new concept of the tax function has prevailed in Washington for the past 16 years. Government today considers taxation as an instrument to equalize incomes, prevent inflation, maintain full employment, and control the business cycle. These concepts are a very essential part of the social revolution which is taking place in this Nation under the false name of progress. * * *" Such a theory should not be followed, for it tends to destroy initiative, enterprise, energy, and self-reliance. The budget should always be balanced except in times of great emergencies such as war. There might be some justification for public works during a depression but the Government should not undertake vast public expenditures simply to put money into circulation during full or nearly full employment. When tax rates are fixed they should not be tampered with and a certain amount should be set aside each year to reduce the national debt.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "The guiding principle of Government over-all taxing and spending policy should be to maintain a sound monetary and banking system. Because of the size of the Government debt, our entire economy is dependent upon the credit of the Government, and, therefore, sound fiscal policies are necessary. The budget should be balanced despite fluctuations in national income and price levels. Deficit financing is the basis for inflation and hampers the Federal Reserve in its efforts to control the extension of credit. The efforts on the

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part of Government to spur business activity in the thirties by the use of deficit financing were relatively unsuccessful and tended to discourage private enterprise and private investment.

"It is highly desirable to achieve a surplus in order to reduce debt in postwar years when debt is abnormally high, as the money supply created by the issuance of such debt provides the basis for inflation.

"Tax rates should not be held constant at all times, but should be adjusted during business cycles in order not to destroy profit incentive of business. It is unfortunate that it is politically expedient to consider taxes before control of expenditures. The tax rates that should be flexible are capital-gains tax, to encourage or discourage venture capital; excise taxes, because they have an effect on price structure; corporate taxes, to encourage expansion and provide profit incentive.

"Government spending to promote economic stability appears to have been unsuccessful to date in the United States and in Great Britain.

"It would not appear to be feasible to adopt automatic guides to fiscal policy because of the changing nature of the economy of the world. This Nation's position in the economy of the world is too important to be tied to automatic guides."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: The over-all taxing and spending policies of the Government must be such as to accomplish three objectives: (1) To carry out the programs voted by Congress; (2) to preserve the fiscal integrity of the Government; (3) to contribute to the stable economic progress of the country. To achieve these purposes there will be required sometimes an overbalanced and sometimes an underbalanced budget. In boom times we should overbalance the budget enough to retire the debt at an annual rate of, say, 1 or 2 percent a year, and in times of depression we should (and automatically will, unless we try to increase tax rates) run a deficit so as to avoid increases in tax rates to maintain regular and temporarily accelerated Government spending as a stabilization measure.

"Once we get a basic revision in our tax structure with lower excise and income taxes, there is a good deal to be said on the side of leaving the tax structure relatively stable and letting the variation in national income produce the surpluses and deficits more or less automatically. This approach on net seems to have more merit than the alternative of trying to vary tax rates at various phases of the business cycle.

"It seems desirable to vary the rate of Government expenditure to help maintain economic stability. Our laws respecting unemployment insurance, agricultural price supports, and various loan-guaranty programs all contemplate this. Timing of public construction and conservation programs should be coordinated to move, as far as possible, inversely, to the business cycle * * *."

E. F. Haworth, commissioner of finance of the State of Idaho: "Government should live within its income the same as individuals."

Paul A. Mitchell, superintendent of banks of the State of Ohio: The guiding principle should be the same as applied in successful private business enterprise: to spend beyond one's income cannot but lead to disaster. The budget should be balanced annually and national

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spending should be reduced when the income falls off. The goal should be the achievement of a surplus at all times in order to reduce the debt. The only time a national deficit is warranted is in case of a national emergency, and it can be avoided even then by a proper approach to the taxation problem.

E. ANSWERS BY OFFICERS OF OTHER FINANCIAL INSTITUTIONS

Paul E. Haney, Scudder, Stevens & Clark, Washington, D. C.: At all times the Government should seek to obtain the maximum in national welfare for each dollar spent, with particular emphasis on achieving as close an approach as possible to economic stability. All other things being equal, a balanced budget is preferable to a deficit, and a surplus when debt is high is preferable to a balance, but a balanced budget need not always be the primary objective of Government taxing and spending policies. A budgetary surplus will usually tend to reduce inflationary pressures and a budgetary deficit will usually tend to reduce deflationary pressures, but it must be recognized that the budgetary position of the Government is only one of several factors creating inflation and deflation and may not always be the dominant factor. Stable tax rates are preferable to fluctuating rates and only under conditions of extreme inflation or deflation should reasonably adjusted tax rates be changed solely for the purpose of compensating other economic forces. Government spending for public improvements should if possible be concentrated in times when private spending for capital expansion is moderate. However, Government spending of a wasteful character merely for the sake of stabilization should never be necessary, for there should always be at hand a docket of highly useful expenditures.

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

E. J. Garrity, of George A. Hormel & Co., Austin, Minn.: A long-term balanced budget with some reduction of the national debt is a requisite to an expanding and prosperous economy. To achieve this goal it is necessary to formulate a long-term tax policy that will encourage citizens to contribute to the expansion of risk capital for industry. The program should carry assurance that the maximum normal and surtax rate would be lower than the now current maximum of 82 percent in order to provide risk capital and to encourage expansion and growth of the Nation's business. Steps should be taken to eliminate such items in the tax program as double taxation of dividends by perhaps allowing a credit against the tax on dividends received by individuals. Depreciation rates on new equipment purchased by industry should be left to the discretion of the taxpayer. Long-range program should also provide such devices as adequate carry-over and carry-back of losses.

Clarence Francis, General Foods Corp., New York: Government taxing-spending policies should be to spend as little as possible and to tax as little and as equitably as possible, consonant with efficient and effective Government conducted solely for the general welfare and in the interest of strong and healthy economic and social conditions, and clean and healthy political conditions. They should be fiscal policies, primarily. This is not to say that so-called compensa-

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tory fiscal policies can have no place in endeavors to secure short-term economic stability. It is only to go on record as favoring Government taxing and spending policies that are sound fiscally and not thought of primarily as an instrument of stabilization policy.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "I believe it is desirable to try to hold tax rates stable at such a level as will reduce the national debt in good times, and that, in general, one cannot expect to balance the budget during a severe depression."

Meyer Kestnbaum, Hart Schaffner & Marx, Chicago: There are no automatic guides to fiscal policy; the Government must take into account changing conditions, new social forces, and conflicting pressures. It would not be wise to insist that the budget be balanced every year, but it would be foolhardy to operate at a deficit every year.

"* * * In times of depression or severe unemployment, the Government is justified in spending freely and in undertaking deficit financing. The policy, however, is one which cannot be extended over too long a period. No Government can operate at a deficit indefinitely without doing violence in some way to either the character, the liberty, or the welfare of its people. To the degree that we achieve a surplus in good years, we provide greater assurance of our ability to handle deficit financing in bad years.

"* * * The basic objective should be a balanced budget, not necessarily year-by-year but certainly over a reasonable period. * * * We should not attempt to prevent minor declines in business activity. They represent adjustments which are both necessary and healthy. We should not undertake to guarantee prosperity to anyone. In a competitive economy there must be some failures, there will inevitably be some industrial strife and some unemployment. * * *"

18. What are the principal limitations on the effectiveness of a flexible fiscal policy as an instrument of economic stabilization? What changes in the division of authority and in procedures would increase the effectiveness of fiscal policy for this purpose?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "The greatest limitation is in the difficulty at any time of getting an integrated and consistent fiscal program through Congress. How to correlate congressional appropriations and congressional revenue measures is still an unsolved problem in American Government. It is to be hoped that the President's Council of Economic Advisers and the Joint Committee on the Economic Report will eventually provide the leadership needed for this coordination. But the outlook is not yet hopeful."

Elmer C. Bratt: "Principal limitations are (1) timing cannot be effectively achieved because of (*a*) forecasting needed and (*b*) elapsed time to get spending under way or to stop it, (2) geographical distribution of need for spending differs from that for relief, (3) political and other types of greed, (4) limited areas where Government expenditure can be effectively deferred, and (5) influence Government expenditure has on adjustment in the private economy. Authority should rest with those who will take the greatest responsibility. There is no final answer as to whether (*a*) subcontracting to private firms is most desirable, or (*b*) direction should reside with Federal, State, or local government units."

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Neil Carothers: "'Flexible fiscal policy' is not an efficient instrument of stabilization. Instead, it is a grand blunder."

Harold M. Groves: "The limitations to, and difficulties in, the above program are impressive enough but it is the best we have to control the cycle. Among the limitations are: (1) Deficits may frighten business and discourage private investment when it is most badly needed. This may be counteracted to some extent by educating businessmen to the fact that a Federal Government deficit is a monetary phenomenon, fundamentally different from a private or State and local deficit. It is also possible to reduce business fears by choosing self-liquidating (or at least highly creative) public works; (2) politics will interfere with, and perhaps stymie, the whole program. It may be taken for granted that one political group will feel that (*a*) the present level of expenditures and taxes is much too high; and (*b*) certain taxes, notably the income tax, should be reduced, whenever the votes are available to reduce it. Another political group will feel that public services need expanding whenever the votes are available to expand them and that any reduction in the income tax is always bad."

Lloyd W. Mints: "* * * As to procedure I tentatively make a suggestion upon which any Member of Congress is better qualified to pass judgment than I am. Would it be possible to organize the Reserve System and the Treasury in charge of a Secretary and two other appointed members, and then to create a congressional committee consisting of Members from both Houses, this committee to have some minor power to vary tax credits under the income tax? I suppose there may be constitutional objections to giving an administrative body, such as the three-man board in charge of the Treasury and Reserve System, any discretionary power over tax collections. Moreover, even though there were no such objections there must be some doubt about the propriety of doing so. I am not enamored in general of the idea of delegations of discretionary power by Congress. If such a congressional committee as this could be created then the three-man monetary agency could be required to obtain the approval of this committee for some variation of revenues, but even then within fairly narrow limits to be prescribed by Congress."

Edward C. Simmons: "The real barrier is the patent impossibility of reconstructing governmental machinery to accomplish the flexibility. Ideally a flexible fiscal policy could be obtained by granting broad powers to the executive, but this would be foolhardy counsel in our case. We have not the wisdom to make proper use of such powers. Granting them to the type of men who administer government would be to court disaster."

Roy L. Garis: "Stop killing the goose that lays the golden eggs—namely—free enterprise."

Albert G. Hart: The underlying limitation is the difficulty of economic forecasting. As regards public works there seems to be agreement that Congress should pass on projects but delegate the power to set them in motion. This arrangement, however, cannot be directly transferred to the more important field of tax flexibility. For this there seem to be three possibilities which would meet economic requirements and would be compatible with basic political safeguards: (*a*) Formula flexibility; under this enact a basic tax rate above the normal rate used to figure the budget. If prices rise more than a cer-

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tain amount, instruct the Treasury to apply the full basic rate, but as conditions become progressively less prosperous the Treasury should reduce the actual rate progressively below the basic rate; (*b*) administrative flexibility subject to legislative veto. Enact a set of alternative withholding taxes and authorize the Treasury to apply whichever rate seems most appropriate subject to the possibility of disapproval by congressional joint resolution; (*c*) accelerated congressional action. Congress should at its leisure frame a system of basic tax rates and a set of alternative withholding rates, then from quarter to quarter, by means of a congressional joint resolution needing a minimum of debate, decide which schedule applies.

B. H. Beckhart: The limitations are mainly political. Spending creates vested interests which demand its continuation. "It is for this reason that I suggested that spending should be held to a wasteless minimum and that countercyclical measures should take the form of tax changes * * *."

Seymour E. Harris: The principal limitations are: (1) The unwillingness of Congress to delegate powers to the Executive; (2) political pressures to increase public spending and reduce taxes irrespective of underlying conditions; (3) the time required to increase spending and reduce tax rates or vice versa; (4) difficulty of forecasting; (5) the difficulty of adapting many expenditures to the requirements of appropriate fiscal policy; (6) the clash of policies of Federal and other governmental units; (7) the almost complete ignorance of the public of the issues involved.

Karl M. Arndt: Fiscal policy has often been too uncertain and unpredictable. It should be flexible, but not erratic. Continuity of spending, with some flexibility, is desirable.

Kenyon E. Poole: The big obstacle is that Congress would be unwilling to surrender enough of its control over fiscal policy to achieve timely flexibility.

John H. G. Pierson: One of the principal difficulties is that Congress has not announced a definite policy of establishing economic floors and ceilings at which it will take compensatory action. "Hence, there is always dispute about the need to take action as well as about the kind of action to be taken, and if action is taken it usually comes too late." The Joint Committee on the Economic Report should indicate to Congress the levels of employment and consumer spending needed in the coming year to carry out the purposes of the act and Congress should underwrite and agree to support these bottom levels and to maintain ceilings reasonably above those levels.

Paul J. Strayer: "The principal limitations on the effectiveness of fiscal policy are (1) inability to forecast; (2) inability to get action soon enough to prevent cumulative forces from setting in; (3) monopoly and the danger that fiscal policy will encourage it and lead to continued inflation. The only practical method of meeting the objections cited above is to grant authority to some agency of Government, under strict control of Congress and to be used according to some formula, to take action in either direction as proved to be necessary by the evidence in the previous month or quarter * * *."

James B. Trant: The principal limitation on the effectiveness of a flexible fiscal policy is the lack of smoothness with which changes can be made.

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George R. Walker: Fiscal policy is not likely to be wholly effective in stabilizing business activity so long as individuals have the alternative of holding idle funds without any cost whatever to themselves. The remedy for this is to levy a tax upon savings which are not used for investment.

E. Sherman Adams: "The chief limitations are political. Congressional procedures could probably be improved and it might be desirable to delegate some limited discretionary authority to some semi-independent body such as the Reserve Board."

Elmer D. Fagan: Since fiscal policy is only one of several important governmental policies affecting the levels of employment and prices, its effectiveness in the promotion of economic stabilization might well be nullified unless there were adequate and proper coordination of all these policies. Congress must permit the development of adequate administrative flexibility particularly with respect to changes in income-tax rates and in the execution of long-range public-works projects.

John F. Due: The major limitations to a flexible fiscal policy are (1) the time lags in getting the adjustments made; (2) the difficulties of forecasting business trends; (3) the problem of finding suitable public-works projects; (4) the problem of overcoming fear by businessmen that the public-works program will mean increased Government competition with private business. Effectiveness would be increased either if Congress were willing to act quickly on tax and expenditure changes when it was evident that such changes were needed, or to give the administration greater power either to vary expenditures or to adjust tax rates. It is possible that some formula such as the number of unemployed might be worked out whereby the administration would be authorized to cut tax rates certain percentage points as unemployment reached certain figures, and so on.

Albert Hahn: "The principal limitation to the effectiveness of a fiscal policy as an instrument of economic stabilization lies in the fact, already mentioned above, that in a free economy the government does not control such important matters as the wage level. I cannot see how a government can stabilize the economy or guarantee full employment if it does not control the price of the most essential production factor, i. e., labor. In fact, I believe maintenance of full employment in the long run much more dependent on antimonopoly policy—whether of labor or entrepreneurs—than on monetary policy."

Edward S. Shaw: "The principal limitations are the effect of other factors than fiscal policy on national income and employment. Fiscal policy is only one determinant of many of the national income, and it competes with all of the others. They include the net foreign investment, private domestic investment, private consumption expenditure. This is a question that can be answered only by writing the entire system of equations for solution of the employment level.

"The Treasury is not the agency to apply fiscal policy. It may be charged with the routines of revenue collections and expenditure. It is not equipped to handle the decisions of policy affecting revenue and expenditure."

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B. ANSWERS BY BANKERS

Anonymous: "The principal limitations of the effectiveness of the flexible fiscal policy is that the political party in power does not bring about any deflation. An independent Federal Reserve System would increase the effectiveness of sound fiscal policy."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo.: "The principal limitations on the effectiveness of a flexible fiscal policy as an instrument of economic stabilization, is that Government spending in times of stress seems to carry on over to the good times under one pretext or another * * *."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The present limitation of the effectiveness of a flexible fiscal policy is that when such a policy is constantly inflationary it is one-sided and therefore not flexible."

James M. Kemper, Commerce Trust Co., Kansas City, Mo.: "Human beings."

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: "The principal limitation on the effectiveness of a flexible fiscal policy as an instrument of economic stabilization is the fact that eventually Government will run out of funds with which to carry on the stabilization."

Fred W. Glos, the First National Bank, Elgin, Ill.: "To much pump priming which is only another shot in the arm."

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "A flexible fiscal policy as an instrument of internal economic stabilization has the following limitations: (1) Deficit financing does not stimulate business activity to the desired degree because it does not engender capital expenditure which is the nucleus for an expanding economy; (2) repeated deficits impede private investment; (3) efforts to control economic conditions through fiscal policies ultimately lead to socialism by destroying private enterprise. The Federal Reserve should be given complete independence of the Treasury in order that its activities can be directed primarily toward economic stabilization."

E. ANSWERS BY OFFICERS OF OTHER FINANCIAL INSTITUTIONS

Paul E. Haney, Scudder, Stevens & Clark, Washington, D. C.: "The principal limitations on the effectiveness of a flexible fiscal policy are (1) an extraordinarily large deficit in times of depression might undermine confidence in the solvency of the Treasury; (2) it is difficult politically to maintain high taxes in the face of a large Government surplus; (3) economic and political groups inevitably influence expenditures in a manner not consistent with good fiscal policies; and (4) apart from political pressures, the purposes of Government spending must largely be dominated by considerations other than fiscal policy such as rearmament, pressing need for public works, necessity to pay interest on the debt, farm policy, and foreign considerations. Only a moderate area of Government expenditures are therefore responsive to fiscal policy.

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F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: The principal limitations on the effectiveness of a flexible fiscal policy are the following: (1) The art of economic diagnosis and prognosis is not an exact science; this makes it impossible to be able to prescribe exactly the right size of dose or the right kind of fiscal medicine even if there were such a thing at any time as the right anything; (2) political delays due to administrative uncertainties and legislative wrangling; (3) the higher the tax burden the more certain it is that any higher taxes levied will be more harmful than intended or harmful in different ways than expected. If taxes are to be cut, political pressures will virtually guarantee that the cuts will not be the most useful; (4) instabilities arise from sources over which there can be little control, such as crop failures or major foreign crises, and so on; (5) no formula has ever been devised or probably ever will be devised which will guarantee that notching up or letting out the tax belt by the amount X will surely have any given effect.

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "I have attempted to cover this in my previous answers."

19. What changes, if any, in the Government's debt-management policies would promote economic stability? In Treasury policies relative to interest rates? In the types and proportions of securities issued? Should these vary with changes in economic conditions? If so, according to what principles? Under what conditions should the Treasury borrow from the commercial banks? From others? Under what conditions should it seek to retire debt held by the banks? To retire debt held by others?

A. ANSWERS BY ECONOMISTS

Howard R. Bowen: "I heartily approve of the Government's debt management policy during the past 20 years. While ex post criticisms may be made, I believe the job has been well done. The amount of bank-held debt should, of course, vary inversely with business conditions."

Elmer C. Bratt: "Debt-management policies should be to prevent 'monetization' of the debt in inflationary periods and to encourage it in deflationary periods. Perhaps the best policy would be for the Treasury to leave all interest rate control to the Federal Reserve System. Outside of war conditions I would not favor Treasury borrowing from commercial banks. Borrowing from Federal Reserve banks would have to be dovetailed into an integrated stabilization policy, and the need is not independent of other parts of a desirable program. The retirement of debt held by the banks should be encouraged in inflationary periods. Retirement of debt, if any, in deflationary periods should be that held by individuals."

C. O. Fisher: "Debt policy should not be directed to the maintenance of par value of Government bonds. In the main, Government should attempt to place its bonds with other than commercial banks.

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Gradually the proceeds from the sales of bonds to investors should be used to retire the commercial bank-held securities."

Harold M. Groves: "* * * Shift from bank-held to non-bank-held debt is desirable in a period of inflation, and the reverse in a period of deflation. A rise in the interest rate might help to bring this about, but again the interest elasticity of private investment in the public debt within the practical range of fluctuation in the interest rate is doubtful.

"The Government should develop the facility of borrowing more from the Federal Reserve banks and less from commercial banks. This could be so arranged as to require the minimum outlay for debt service.

"Debt should be retired mainly not as an end in itself but as a check on inflation. Debt expansion in amounts not exceeding the rate of economic progress (secular increase in the national income) is not alarming and the public should be educated to accept this view. The retirement of bank-held debt is most deflationary and will probably not ordinarily be offset by an expansion in private bank credit beyond what would otherwise have occurred. However, to insure this result, fiscal policy to prevent inflation should be correlated with monetary policy to control bank-reserve requirements."

Lloyd W. Mints: "The chief consideration in regard to debt management is that the Treasury should be required to borrow at whatever rate it must pay to obtain the funds acquired by borrowing. There should be no rigging of the market by the Reserve System, the Treasury, or any other agency. * * * Ideally, * * * all Government borrowing should be done with either very long-term bonds or consols (perpetuities). However, the quantitative significance of this point is problematical, but I suspect that it is not so great as to make this a matter of much significance."

Edward C. Simmons: "As suggested earlier, the Government debt should be converted into nonmaturing consols, except possibly for a few billion of Treasury bills to serve as bank secondary reserves. In short, I would support the program of the late Prof. Henry C. Simons.

"Recent Treasury policy of creating more and more floating debt is to be deplored. We are floundering in a morass of mistaken thinking about national debt and monetary policy in which opportunism is the only principle."

Philip E. Taylor: "* * * The Treasury should borrow from the commercial banks only when absolutely necessary—i. e., when funds are needed too quickly or in too large amounts to permit borrowing from the public. Bank-held debt should, under most conditions, be retired first. This is particularly true of that part of bank-held debt which easily becomes monetized. Debt held by others should be retired when it is safe to make individually held assets more liquid to encourage individual spending. By and large, bank-held debt should be incurred and individually held debt retired during periods of underemployment. Individually held debt should be incurred (or debt transferred to individuals) and bank-held debt retired when inflation threatens."

Edward F. Willett: "In general, I would like to see the Government as merely one borrower among others, and let the interest rate for its securities be determined by the open, free money market rather than

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being continuously manipulated by Government action. (This would not apply in time of war.) * * *"

Roy L. Garis: Reduce Federal debt $5,000,000,000 annually and balance budget by reducing Government's costs. "It can be done if Congress will do it. Otherwise, why get excited over lesser problem?"

Harry Gunnison Brown: The Federal Reserve policy of maintaining the prices of Government securities at par, despite the low interest paid on them, kept the inflationary spiral going. This is inconsistent with a policy of stabilization. "Our long-run welfare will be much more promoted by stabilization policy than by insistence that Government bond prices must be the chief or a primary concern of Federal Reserve policy." When the price level tends to rise, pay off the Government debt.

Albert G. Hart: Debt management should become a Federal Reserve function and the bank-held part should be managed primarily by a reserve requirement rather than shifting interest rates and other contract terms.

Frederick A. Bradford: The bulk of the Federal debt should be long term with interest rates determined in a free market. The Treasury's short-term debt should be issued only in anticipation of assured revenue. The banks should purchase short-term debt and some long-term debt to be held behind savings deposits.

B. H. Beckhart: "In general, debt management should be directed toward the reduction of the floating debt and toward achieving a better ownership and maturity distribution of the outstanding marketable debt. * * * The Treasury should abandon its insistence upon low interest rates and an ascending interest-rate curve and should adjust interest rates on new and refunding obligations to market conditions. Interest rates must be permitted to fluctuate in order to perform their function in the economic system. * * *"

In periods of high-level activity the public debt should be reduced, especially that held by commercial banks. In periods of depression the Treasury doubtless would rely upon commercial banks to purchase new obligations and those being sold by other holders.

Marcus Nadler: The management of the public debt so far has been rather clumsy. Too large a floating debt has been accumulated. When business activity is decreasing and the volume of loans is declining rapidly the Treasury should offer securities which should be attractive to the commercial banks but not to ultimate investors. On the other hand, when business activity is high and the volume of loans is increasing, the Treasury should offer securities which will be attractive primarily to ultimate investors.

Seymour E. Harris: There is always a temptation for the Treasury to concentrate on its own problems and not pay sufficient heed to the requirements of the economy. Excessive concern with low rates may well bring about inflation with unfortunate effects.

Charles C. Abbott: Wider variations in the interest structure than has existed since VJ-day would be both practicable and desirable. The pegged Treasury yield curve has seriously handicapped the Reserve System in its efforts at credit control. It is also doubtful whether the postwar policy of shifting a progressively larger proportion of the debt into short-term securities is wise.

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E. E. Agger: In general the Treasury might well borrow from the commercial banks in times of contraction and from others in times of expansion.

James B. Trant: Interest rates at a more nearly normal level would tend to economic stability. Debt retirement should be applicable to the entire debt, and not to any special group.

Anonymous: Short-term rates have been too low relative to long, and banks have bought the latter for the sake of the higher yield. At the same time they have demanded support prices for all governments. The long-term issues should be purchased with capital funds and savings deposits of commercial banks and savings banks and insurance companies, and so on. As much of the debt as possible should be taken out of the hands of the commercial banks, that is, other than the short- and medium-term issues. The Federal Reserve power to fix the general level of interest rates in the interest of economic stability should not be hampered by the Treasury.

E. Sherman Adams: "* * * Policy should be formulated with a view to the national welfare, not from the standpoint of narrow fiscal expediency. Aside from interest rate policy, there is no urgent need for change in debt management policies."

Elmer D. Fagan: The Government might well consider issuing securities whose rates of interest could be changed in accordance with changes in basic credit conditions. It might also consider issuing consols or perpetuities subject to unlimited call at the convenience of the Treasury.

Howard S. Ellis: "Treasury and Federal Reserve management of the public debt should be more largely oriented toward making monetary and fiscal policy effective, and less extensively oriented toward fiscal economy and toward the price stability of Government securities. Of all types of instability, the instability of these prices is least apt to result in general instability, i. e., in employment and output. No doubt abrupt changes (a 'disorderly market') in Government bond prices ought not to be tolerated. But within wide limits these prices should find their own level on the market; indeed, if they are not allowed to do so, monetary controls are rendered completely ineffective.

"It is an exaggeration to say that the national debt is burdenless because 'we owe it to ourselves.' And yet to the very substantial degree to which this pronouncement is true, to the same degree does the fiscal burden of the debt assume a merely nominal significance. We cannot afford to sacrifice monetary-credit control to the less important 'real burden' considerations involved in the service of the debt.

"The Treasury can be certain of exercising a deflationary force by the retirement of debt only if it reduced Federal Reserve holdings, and mutatis mutandis for inflation."

Edward S. Shaw: "The Treasury view of minimizing interest charges in the public budget must be abandoned. There must be steady progress toward funding the debt into illiquid form. The policy of fixing a pattern of rates must be dropped, though not suddenly. It may be useful to make the forms of debt less liquid in boomtime and more liquid in recession, although there are more convenient ways of adjusting liquidity through monetary policy proper. The public debt is not easily managed for contra-cyclical policy on a continuing basis.

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"It is preferable that the Treasury should never borrow from commercial banks. Since it has already done so, the retirement of its debt should be apportioned between banks and other investors according to the needs of national income policy."

B. ANSWERS BY BANKERS

Anonymous: "A balanced budget and payment on the debt annually would promote economic stability. The Treasury should not borrow from commercial banks except when it is unable to borrow sufficient amounts from the general lending public."

Anonymous: "Believe the last place the Treasury should borrow from is commercial banks. Believe the obligations of the Government should be as widely diffused among the people as possible and held by individual or corporate investors who will not be as apt in times of economic stress to be forced into a position where they must liquidate their holdings rapidly. Believe long-term and medium-term obligations should be retired as rapidly as they mature. Believe endeavor should be made to continue to sell E, F, G bonds in as large amounts as is practical."

W. Lucas Woodall, Pitkin County Bank, Aspen, Colo: "We believe the Government is heading for trouble in financing so much of the public debt on a short-term basis at interest rates unattractive in normal times to a large section of the American people and business. To continue this practice is sure to bring a crisis, as at some time holders of this short-term indebtedness may be required to ask the Government to redeem, and it is sure to be at a time the Government is unable to refinance. From the banking standpoint as we see it, it would be a direct benefit to both Government and banks to have more securities on a 3-, 5-, and 10-year basis * * * the Government should abolish postal savings, a very expensive method of borrowing, and one that hurts private savings institutions unfairly. It is more reasonable to pay 2 percent on 1-year certificates, purchased in large amounts with little underwriting and selling expense, and accounting expense, than it would be to pay no interest on the type postal savings brings in * * *."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The debt management policy of the Treasury should be guided by sound financial and economic considerations and not primarily by the cost of the debt service."

E. Curtis Matthews, Piscataqua Savings Bank, Portsmouth, N. H.: Two types of action would be useful: (1) fund short-term debt into 25- to 40-year bonds even though interest cost is raised; (2) use money received from social-security payments to reduce debt.

R. C. Leffingwell, J. P. Morgan & Co., New York: "* * * Interest rates should not be so rigid, but should be permitted to fluctuate in accordance with the needs of the general welfare and the general economic situation * * *. The Treasury in such times as these should be refunding some of its short-time debt by sales of bonds to the investing public. The Treasury should borrow as much as possible from the general public in wartime and whenever inflationary conditions exist or market conditions are favorable. But when deflationary conditions exist, markets are unfavorable, or expansion is necessary or desirable, the Treasury should borrow from the commercial

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banks. The degree of borrowing from each source that is most desirable depends on the circumstances. There is no rigid rule, except that borrowing from the banks tends to be inflationary and borrowings from the public, so far as they are met from savings, do not."

W. R. Gott, the National Deposit Bank, Arnald, Pa.: "* * * Banks should be permitted * * * to buy not over $25,000 per year of a bond similar to the G and F at 2½ percent or possibly similar to the E bond at 2.9 percent. * * * This change would encourage a large proportion of the smaller banks to buy Government securities rather than speculate as a lot of them are doing, on questionable securities. I believe the Treasury * * * should borrow most of the necessary money as needed from commercial banks and from individuals but not from insurance companies. I think it should retire the debt on a 50–50 basis between the banks and individuals. The insurance companies are permitted to invest in a number of things that banks are not permitted by law to do."

J. R. Geis, the Farmers National Bank, Salina, Kans.: The debt has been handled intelligently but we are accumulating too high a percentage of the debt due in a very short period of time. There should be continued efforts to place governments in the hands of individuals, trust funds, endowment funds, and institutional funds with a lesser proportion going to banks. Treasury borrowing from commercial banks should ideally be limited to temporary borrowing in anticipation of tax receipts.

R. J. Hofmann, American National Bank of Cheyenne, Wyo.: The Government should reduce the outstanding debt. Temporary borrowings from both banks and individuals will be necessary from time to time, but the trend should be toward reduction. This may reduce the earnings of banks but is a healthy trend.

P. R. Easterday, the First National Bank of Lincoln, Nebr.: Objective should be to promote economic stability. This would include the issuance of debt securities of such types as to insure, if possible, a reasonably even market, and the public should be relieved as much as possible from taking a risk on interest rates which might change, at least moderately, from time to time. Long-term bonds place the risk of interest changes on the public and this does not make for stability nor for confidence in bonds as an investment. As much as possible the Government should assume the risk of interest-rate changes. There is no reason why the commercial banks should not continue to carry something like their present proportion of the public debt, 25 to 30 percent. If the present debt were refunded into 10-year marketable obligations with one-tenth of the total maturing each year, it would provide a great diversity of maturities from which investors could choose.

L. M. Giannini, Bank of America, San Francisco: Some of the Government debt should be retired each year in prosperous and normal times. Refund a part of the short-maturity debt by the issuance of more long-term and intermediate-term bonds. The Government should seek at all times to retire debt within its ability to do so. During inflation periods it should especially retire debt held by the banks and in times of heavy deflation it should retire debt held by others.

David Williams, Corn Exchange National Bank & Trust Co., Philadelphia: "It is felt that a departure from a fixed interest curve would be helpful in providing economic stability. Issues should be designed

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to meet requirements of investors in such a manner as to discourage switching from one type of issue to another, which action frequently increases or decreases the money supply and often works contrary to the actions of the Reserve Bank policy in controlling the money supply. A flexible short-term rate, independent of the long-term rate, provides easier control by the Reserve authorities.

"In periods when Government debt is high and issuance of debt inflates bank deposits, efforts should be made to retire bank-held debt or to transfer it to those investors outside the banking system in order to reduce bank reserves. Debt held outside the banking system should be reduced at times when funds are available and it is economically undesirable to reduce the money supply. In this manner debt can be reduced and interest charges lowered without deflationary effects.

"The composition of the debt should be such as to meet requirements of various classes of investors: Short terms for banks; medium and long terms for individuals, savings banks, and insurance companies.

"The types of securities issues should be varied to meet changes in economic conditions. In times of inflation issues should be adapted solely to those outside the banking system to prevent further expansion of money supply. If it is felt necessary to increase the money supply in times of deflation, short-term securities should be offered to commercial banks. The issues should be short term so that contraction of the debt may be easily effected at the required time."

Anonymous: "* * * In the first place, I believe that the Treasury has shown concern about minimizing the total interest cost of the public debt out of all proportion to its real significance. Sound debt management and all its implications for the economy are of far greater importance than saving relatively small amounts in interest charges. I believe that the Treasury can be fairly criticized for maintaining the wartime pattern of interest rates far too long after termination of the period of war finance. The reluctance to permit the rates on Treasury bills and certificates to find their own level served artificially to stimulate the purchase of longer-term securities by institutions for whom they were not appropriate. It is my belief that the Treasury should adhere strictly to the policy of providing types and proportions of securities suitable to the various components of demand for Treasury obligations. This policy should be emphasized even at the expense of possible small savings in interest costs.

"The types of securities offered should vary with changes in economic conditions. No hard-and-fast rules can be designed to guide debt management far into the future, but I would suggest reduced emphasis on the factor of interest cost, greater responsiveness to market conditions in the type of securities offered, and the desirability of funding a larger proportion of the debt into longer-term securities."

C. ANSWERS BY STATE BANKING COMMISSIONERS

Elliott V. Bell, State Banking Department of New York: "There is a realization now, as there was not before the war, of the impact of public debt management on the economy. Certain of the Treasury's policies do raise questions, however. The depression-born passion for extremely low long-term interest rates has not helped achieve the desirable objective of moving more of the debt into firm hands among nonbank holders. The continued emphasis on the savings-bond program

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at this late date leads to the expansion of the share of demand obligations in the debt structure. The Treasury's preoccupation with the 'budgetary approach' to debt management has led to a questionably large proportion of short-term debt with its constant refinancing problems.

"Commercial bank borrowing should be used to cover deficits in time of depression or in the early phase of war if there is slack to take up in the economic system. The Treasury should seek to retire debt from these banks in time of boom with surplus budget revenues. Borrowing from nonbank sources should be used at other times. Retirement of debt held by these groups should be carried out in times of depression with refinancing money secured from commercial banks."

D. ANSWERS BY OFFICERS OF LIFE INSURANCE COMPANIES

Alexander T. Maclean, Massachusetts Mutual Life Insurance Co., Springfield, Mass.: "We do not believe that it is good policy to issue Government loans at too low rates of interest, because of the fact that these very rates have repercussions all through the business and investment sphere, as well as on all endowment, charitable, and other funds in which a tremendous amount of money has been invested."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: "* * * Perhaps the principal point that can be made * * * is that debt management should be directed less single-mindedly than it has seemed to be, to keeping the costs down to the minimum. That can lead not only to too much short-term debt * * * but to a desire on the part of the Treasury that Federal Reserve policies * * * be pointed to the same end, whatever the consequences * * *.

"Theoretically, borrowings by the Government should be at banks in a time of recession, and from individuals in periods of inflation, and the types of securities tailored accordingly, as you are well aware. Debt retirement should be carried out inversely unless one feels—with no little justification—that Government debt holding by individuals should be sustained and encouraged at all times. Actually, since the economic nexus is so uncertain and since the matter of taxes, deficits, and surpluses enters into this picture, and not just debt management as such, and since 'changes in economic conditions' may be of many kinds and have many causes and origins, and need varied treatment and 'dosages,' it seems impossible to answer this question satisfactorily on any generalized basis, without a very great number of qualifications."

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "In periods of inflation the Treasury should retire debt held by the banks, using for this purpose the budget surplus and the proceeds of borrowing from others.

"In periods of depression the Treasury should borrow from the banks, to finance any budget deficit and to retire debt held by others."

20. What changes, if any, would you advocate in the methods and procedures for coordinating the Government's monetary, credit, and fiscal policies with each other and with other economic policies?

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A. ANSWERS BY ECONOMISTS

Neil Carothers: "Economy, simplicity, withdrawal from private business, and a rational control of credit are the answers. Above all, the abandonment of control of the interest rate is desirable."

Lloyd W. Mints: "* * * I would centralize the control of all these matters in a single agency, and then I would rigorously require that agency to operate for the sole purpose of stabilizing the general level of prices."

Edward C. Simmons: "The creation of a Government central bank is the first step. Then we must endeavor to improve the quality of top Treasury personnel and achieve some permanence of tenure there. What is needed is not more legislation, but rather more intelligence. Frankly, I don't see much hope. The Federal Government has assumed economic responsibilities far beyond its ability to discharge them. We shall drift along until chaos sets in, for political organization is not and cannot be made capable of dealing with the problems that Government has undertaken to solve."

Albert G. Hart: "I am doubtful that there is any magic formula for better coordination. I am hopeful of the long-term results of efforts to get coordinated budget policy in Congress, to set up a congressional clearinghouse for economic policy in your committee, to get better coordination on the executive side through the Council of Economic Advisers and through clearer focusing of economic policy through an 'Assistant President'. But I suspect that the basic problem is one of leadership."

B. H. Beckhart: "* * * The Hoover Commission suggested the establishment of a National Monetary and Credit Council, under the chairmanship of the Secretary of the Treasury, to coordinate and direct domestic lending and guaranties by the Government. The question is a very complex one and requires much additional detailed study."

Marcus Nadler: "It would be advisable to establish a coordinating body consisting of the Secretary of the Treasury, the Chairman of the Board of Governors of the Federal Reserve System, and the chairman of the various committees of the House and Senate dealing with economic matters. This body, assisted by an able staff, could coordinate the policies not only of the monetary authorities but also of the House and Senate. * * *"

Seymour E. Harris: "* * * More discretion for the Executive; a domestic monetary policy council with representatives of the Treasury, Federal Reserve, Federal lending policies, the International Advisory Council, the President's Economic Council; some machinery for integrating monetary and income policy—all of these would help."

Charles C. Abbott: "* * * My present thinking is that I would like to see all the lending, insuring, and guarantying of the Federal Government concentrated in a single department—either the Treasury or a new department which contained the present functions of the Treasury; an independent central bank, with functions more clear-cut than presently exist; an improved budgetary procedure, but of what character I am not wholly clear."

Karl M. Arndt: "Again, I think there should be one monetary authority, combining some functions of the Treasury with the Federal

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Reserve System and the FDIC—and with some donations of authority from other agencies; and that the authority should be within the executive family, on the Cabinet level."

Kenyon E. Poole: "I am opposed to giving unlimited economic power to a board and therefore regard this as a difficult question. Obviously a committee is required at least in an advisory capacity to coordinate fiscal and other economic policies."

E. Sherman Adams: "* * * In general, the influence of the Reserve Board should be increased and care should be taken to prevent greater domination of monetary policy by partisan politics."

Elmer D. Fagan: An Office of Economic Stabilization in the executive branch of the Federal Government might be the most effective means of securing the necessary degree of coordination. Without such coordination there is a very real danger, for example, that wages and prices might begin to soar in the face of heavy governmental loan expenditures while there were still widespread unemployment and excess capacity. There is also need for an agency which would seek to secure greater coordination of Federal, State, and local fiscal policies.

Howard S. Ellis: "The machinery for coordinating monetary, fiscal, and economic policies already exists in the Employment Act of 1946: the President's Economic Council, the President's Economic Report, and the Congressional Committee on the Economic Report. The immediately pressing need is to further the effective functioning of this machinery. This cannot be achieved by any single act, but only by sustained concern on the part of the administration and of congressional leaders, to bring economic information and analysis to bear on actual policy formation."

Edward S. Shaw: "Monetary, fiscal, wage, agricultural, trade, and other policies must be brought into a single structure of income policy. There seems to be no other satisfactory coordinating agency than the Executive Office of the President."

B. ANSWERS BY BANKERS

Anonymous: "A reduction in the number of governors of the Federal Reserve System."

R. C. Leffingwell, J. P. Morgan & Co., New York: "There are too many organizations and persons engaged in making monetary, credit, and fiscal policies. The best way to coordinate them would be to abolish all the other agencies and leave the matter to the Treasury and the Federal Reserve."

Lon C. McCrory, Citizens State Bank of Dalhart, Tex.: "* * * I believe there are too many lending agencies * * *."

William S. Gray, Central Hanover Bank & Trust Co., New York: "The setting up of a permanent committee consisting of the heads of the Treasury, the Reserve Board, and the chairmen of the committees of the House and Senate dealing with fiscal, banking, and economic problems, together with senior executives of leading financial institutions."

L. M. Giannini, Bank of America, San Francisco: Extend the authority of the National Advisory Council to the consideration of methods and procedures for coordinating the Government's entire monetary, credit, and fiscal policies with each other and with other economic policies, and the making of recommendations to Congress in these re-

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spects. To this end, the heads of all departments and principal agencies involved should be added to the membership of the council.

Anonymous: "I share the belief of the Hoover Commission that the Council of Economic Advisers should be replaced by a single economic adviser operating within the framework of the present procedures. This would improve the coordination of economic thinking within the executive branch of the Government. At present, however, the time lags in dealing with the President's messages on the economic report have resulted in a large body of legislation being passed prior to the formulation of any general economic policy by the Congress. Therefore, in order to carry out the original intentions of the congressional reorganization plan, it seems to me that further steps will be necessary as far as the Congress is concerned. The position and influence of the Joint Committee on the Economic Report should be expanded. If this committee is to perform its function of formulating and obtaining agreement to broad economic policy, it will be necessary to relieve the members of some other committee assignments and to expedite their work in other ways."

F. ANSWERS BY OTHER TYPES OF BUSINESS ORGANIZATIONS

Clarence Francis, General Foods Corp., New York: "I am not aware of any notable amount of coordination now existing between the Government's monetary, credit, and fiscal policies, or between these and other economic policies. Rather have I been aware of differences of policy between the Treasury and the Federal Reserve, between the President and Congress, between the State Department's foreign economic policies, and other departments' (such as Agriculture), between the profligates and the economizers in Congress, between the Keynesians and the non-Keynesians in the administration, and so on."

John D. Biggers, Libbey-Owens-Ford Glass Co., Toledo: "This question perhaps more than any other deserves the attention of a full-dress commission that could hear the testimony of all the agencies involved, study past experience, and obtain the opinions of authorities in the various relevant fields of policy and administration."

Resolution Adopted at Annual Convention of the American Farm Bureau Federation, Submitted to the Subcommittee on Monetary, Credit, and Fiscal Policies by Allan B. Kline, President

We reiterate our position on methods of stabilizing the general price level. We urge Congress to establish a bipartisan joint congressional monetary study commission, charged with the responsibility of making studies and submitting recommendations to the Congress on means of bringing greater stability to the value of money. The commission should have sufficient funds to employ competent technical personnel.

We will continue to solicit the cooperation of other groups in dealing with this basic problem. It is our belief that monetary and fiscal policies should be reviewed in the light of changes resulting from the war. A monetary study commission would bring about a better understanding of the problem.

In the program for bringing about a more stable general price level, consideration should be given to the following: The control of money, credit, and fiscal policies of the Federal Government should be coordinated under one authority, with members appointed by the President and confirmed by the Senate. The policies of this authority should be regulated as far as feasible by formula, based upon an established index, which would direct the authority to take action when

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the index reached certain levels, in order to stabilize the purchasing power of the dollar.

The proper agency of Government should be given responsibility for maintaining the supply of money and credit appropriate to the production needs of the Nation and for bringing about greater stability in the general price level. The proper authority should be provided for influencing more effectively the expansion and contraction of credit. More use should be made of additional selective credit controls. It should be the policy to prevent the contraction of money and bank credit during periods of depression and undue expansion during periods of prosperity.

When inflation threatens, reserve requirements for banks should be raised, with appropriate adjustments in the bank holdings eligible to be counted as reserves. Steps should be taken to prevent further shift of non-bank-held negotiable Federal bonds to the banking system because such a move makes possible an additional credit expansion.

Due to the magnitude of the national debt and the tax load, management of fiscal policies will have a greater effect on prices and production than in the past. The national debt should be so handled as to make the maximum contribution to economic and price stability, rather than to finance the debt at a minimum cost. A long-time Federal tax policy should be adopted which will contribute to a more stable general price level and to an expanding domestic economy.

Government expenditures and construction should tend to counterbalance fluctuation in private business and employment. Public expenditures for deferrable public works should be eliminated during prosperous periods. A shelf of essential public works should be maintained, to be activated during business recessions. The national debt should be reduced rapidly in periods of good business activity, while during periods of depression it may be necessary to resort to deficit financing.

The proposed monetary authority should have the power to change the gold content of the dollar within the prescribed limits of the International Monetary Organization.

This Nation should cooperate with the various international agencies to bring about international stability of prices, the orderly adjustment of exchange rates, and expanded foreign trade. Where necessary, we should adjust our domestic policies and cooperate with international organizations designed to stimulate the exchange of goods and services among the nations of the world upon a self-perpetuating and sound financial basis.

Appendix to Chapter X

MAILING LIST FOR GENERAL QUESTIONNAIRE

(Those replying are indicated by an asterisk (*))

ECONOMISTS

Name	*Affiliation*
*Abbott, C. C.	Harvard University.
*Adams, E. Sherman	New York University.
*Agger, E. E	Rutgers University.
Alyea, Paul E	University of Alabama.
Angell, J. W	Columbia University.
*Arndt, K. M	University of Nebraska.
Babson, Roger W	Babson's Reports, Inc.
Bach, G. L	Carnegie Institute of Technology.
Backman, Jules	New York University.
Baruch, Bernard M	
*Beckhart, B. H	Columbia University.
Blakey, R. G	University of Minnesota.
Blough, J. Roy	University of Chicago.
Bodfish, Morton	United States Savings and Loan League.
Bogan, J. I	New York University.
*Bowen, Howard R	University of Illinois.
*Bradford, F. A	Lehigh University.
*Bratt, E. C	Do.

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ECONOMISTS—continued

Name	Affiliation
Bratter, H. M	
*Brown, H. G	University of Missouri.
Bryan, R. F	Lionel D. Edie & Co.
Buehler, A. G	University of Pennsylvania.
Burbank, H. H	Harvard University.
Burgess, W. Randolph	National City Bank of New York.
Cable, J. R	Missouri Valley College.
Calkins, Robert D	General Education Board.
*Carothers, N	Lehigh University.
Clark, J. M	Columbia University.
Cole, Charles W	Amherst College.
Dempsey, B. W	St. Louis University.
Despres, Emile	Williams College.
de Vegh, Imrie	Pell, de Vegh & Co., Inc.
Dillard, Dudley	University of Maryland.
Domar, E. D	Johns Hopkins University.
*Due, J. F	University of Illinois.
Edmiston, Henry H	Kansas City Life Insurance Co.
Eiteman, W. J	University of Michigan.
*Ellis, Howard S	University of California.
Fabricant, S	New York University.
*Fagan, E. D	Stanford University.
*Fairchild, Fred R	Yale University.
Fellner, Wm. J	University of California.
*Fischer, C. O	Wesleyan University.
*Garis, R. L	University of Southern California.
Gayer, Arthur D	
Goldenweiser, E. A	Princeton University.
*Goodbar, Joseph E	University of Tampa.
Goode, R. B	University of Chicago.
Gordon, R. A	University of California.
*Graham, Frank D	Princeton University.
*Groves, H. M	University of Wisconsin.
*Hahn, L. A	
Haig, R. M	Columbia University.
*Halm, George N	Tufts College.
Haney, Paul E	Sheridan, Farwell & Morrison, Inc.
Hansen, Alvin H	Harvard University.
Harris, C. Lowell	Columbia University.
*Harris, Seymour E	Harvard University.
*Hart, Albert G	Columbia University
Heller, Walter W	Finance Division, OMGUS.
Holdsworth, J. T	University of Miami.
Jones, Homer	Federal Reserve Board.
Jordan, Virgil	McGraw-Hill Publishing Co.
Keezer, Dexter	do.
*Kent, Raymond P	University of Notre Dame.
Koopmans, Tjalling C	University of Chicago.
Kuznets, S. S	University of Pennsylvania.
Leland, S. E	Northwestern University.
Lindholm, Richard W	Michigan State College.
Lindow, Wesley	Irving Trust Co.
Lintner, John	Harvard University.
Lohman, Philipp H	University of Vermont.
Lutz, H. L	Princeton University and NAM.
Machlup, F	Johns Hopkins University.
*Martin, J. W	University of Kentucky.
Maxwell, James A	Clark University.
Meredith, L. D	National Life Insurance Co.
Metzger, Judith	University of Washington.
Metzler, Lloyd A	University of Chicago.
*Mints, L. W	do.
Morgan, T	University of Wisconsin.
Morton, W. A	do.
Musgrave, R. A	University of Michigan.

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ECONOMISTS—continued

Name	*Affiliation*
Myers, M. G. (Mrs. B. H. Beckhart).	Vassar College.
*Nadler, M	New York University.
Newcomer, Mabel	Vassar College.
O'Leary, James J	Life Insurance Association of America.
O'Leary, Paul	Cornell University.
Peach, W. N	Syracuse University.
*Pierson, John H. G	
*Poole, K. E	Northwestern University.
Prather, C. L	University of Texas.
Preston, H. H	University of Washington.
Ratchford, B. U	Duke University.
Reder, M. W	University of Pennsylvania.
Reierson, R. L	Bankers Trust Co.
Robey, R. W	National Association of Manufacturers.
*Robinson, R. I	Northwestern University.
Rodkey, R. G	University of Michigan.
Samuelson, Paul A	Massachusetts Institute of Technology.
Saulnier, Raymond J	
Schumpeter, Joseph A	Harvard University.
Seltzer, L. H	Wayne University.
*Shaw, Edward S	Stanford University.
Shields, D. M	Bank of Manhattan Co.
Shoup, C. S	Columbia University.
*Simmons, E. C	Duke University.
Slichter, Sumner H	Harvard University.
Smith, Bradford B	United States Steel Corp.
Smith, D. T	Harvard University.
Smithies, Arthur	do.
*Spahr, W. E	New York University.
Steiner, R. L	Grandpa Brands Corp.
Stewart, Walter W	Princeton University.
*Strayer, P. J	Do.
Sweezy, A. R	Williams College.
Tarshis, L	Stanford University.
Taus, (Mrs.) E. R	Hunter College.
*Taylor, P. E	University of Connecticut.
Terborgh, G. W	Machinery Institute.
Tippetts, C. S	Mercersburg Academy.
*Trant, J. B	Louisiana State University.
Trefftzs, K. L	University of Southern California.
*Tucker, Rufus S	General Motors Corp.
Upgren, A. R	University of Minnesota.
Villard, H. H	Hofstra College.
von Mering, O	Tufts College.
*Walker, George R	
Weissman, R. L	City College of New York.
Welfling, W. W	Simmons College.
Westerfield, R. B	Yale University.
Weyforth, W. O	Johns Hopkins University.
*Whittlesey, C. R	University of Pennsylvania.
*Willett, E. F	Smith College.
Williamson, K. M	Wesleyan University.
Wood, E	University of Missouri.
Woodworth, G. W	Dartmouth College.
Yntema, T. O	University of Chicago.
Zelomek, A. W	International Statistical Bureau.

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BANKERS

Alabama:	
The First National Bank of Birmingham	J. C. Persons.
The Bank of Columbia	Walter F. Oakley, Jr.
Union Bank & Trust Co., Montgomery	*Grover Keyton.
Arkansas:	
The City National Bank, Fort Smith	H. S. Nakdimen.
Worthen Bank & Trust Co., Little Rock	*James H. Penick.
California:	
California Bank, Los Angeles	*Frank L. King.
Bank of America	*L. M. Giannini.
Colorado:	
Pitkin County Bank, Aspen	*W. Lucas Woodall.
Mercantile Bank & Trust Co., Boulder	J. W. Valentine.
The Central Bank & Trust Co., Denver	C. M. Good.
The First National Bank, Pueblo	M. D. Thatcher.
Connecticut:	
Canaan National Bank	D. V. Smith.
The Connecticut River Banking Co., Hartford	L. M. Hubbard.
Groton Savings Bank, Mystic	John Rossie.
The American Bank & Trust Co., New Haven	F. B. Nichols.
Delaware: The Delaware Trust Co., Wilmington	William Du Pont.
District of Columbia: The Riggs National Bank	Robert V. Fleming.
Florida:	
Coconut Grove Exchange Bank, Miami	J. S. Eaton.
The Indian River Citrus Bank, Vero Beach	Merrill P. Barber.
Georgia:	
First National Bank of Atlanta	R. Clyde Williams.
The Bank of Camilla	W. W. Brooks.
Illinois:	
First National Bank & Trust Co., Alton	L. A. Schlafly.
National Bank of Canton	D. E. Houston.
The Commercial Bank, Champaign	Thomas A. Hagan.
The Continental Illinois National Bank & Trust Co. of Chicago.	Carl A. Birdsall.
The First National Bank of Chicago	Edward E. Brown.
De Kalb Trust & Savings Bank	R. F. McCormick.
The First National Bank of Elgin	*Fred W. Glos.
Elmhurst National Bank	Albert H. Glos.
First State Bank of Elmwood Park	R. J. McKay.
The First National Bank, Harrisburg	F. S. Gray.
Old Farmers and Merchants State Bank, Hillsdale.	J. M. Hanson.
First National Bank, Hinsdale	A. H. Klein.
The First Trust & Savings Bank, Kankakee	Arthur L. Geckman.
The Jefferson Trust & Savings Bank, Peoria	W. James Patton.
The First National Bank, Elkhart	G. S. Anderson.
Iowa:	
The Bankers Trust Co., Des Moines	S. C. Pidgeon.
Des Moines Bank & Trust Co	G. B. Jenson.
Kansas:	
Mission State Bank, Mission	R. R. Osborne.
First National Bank, Parsons	*L. Cortelyou, Jr.
First National Bank in Pratt	G. W. Lemon.
Farmers National Bank, Salina	*J. R. Geis.
First National Bank in Wichita	*C. J. Chandler.
Kentucky: The Louisville Trust Co	E. R. Muir.
Louisiana:	
The American Bank & Trust Co., Baton Rouge	A. R. Johnson.
The Hibernia National Bank in New Orleans	A. P. Imahorn.
Maine: Casco Bank & Trust Co., Portland	L. F. Timberlake.
Maryland: The Equitable Trust Co., Baltimore	Robert G. Merritt.

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Massachusetts:	
The First National Bank of Boston	Charles E. Spencer, Jr.
National Shawmut Bank, Boston	Roy A. Young.
The North Adams Trust Co	George H. Higgins.
The Union Trust Co., Springfield	F. W. Doty.
Michigan:	
The Deford Bank of A. Frutchey and Sons, Deford.	Irene McIntyre.
The Detroit Bank	Joseph M. Dodge.
Ferndale National Bank	*H. H. Gardner.
The Genessee County Savings Bank, Flint	H. H. Curtice.
Commercial National Bank of Iron Mountain	W. W. Thompson.
Miners' First National Bank, Ishpeming	*I. B. Moss.
First National Bank and Trust Co., Kalamazoo.	*C. H. Kleinstuck.
Manistee County Savings Bank	D. F. Lundbom.
First National Bank of Manistique	George A. Shaw.
The Pontiac State Bank	M. J. Cross.
Minnesota:	
City National Bank, Duluth	H. C. Matzke.
First National Bank of Minneapolis	Henry E. Atwood.
Marquette National Bank, Minneapolis	R. L. Stotesbury.
Northwest Bancorporation, Minneapolis	J. Cameron Thomson.
Independent Bankers Association Sauk Centre.	*Ben DuBois, Secretary.
The State Bank of Sleepy Eye	E. H. Snow.
The Empire National Bank, St. Paul	G. E. Johnson.
Mississippi:	
The Hancock Bank, Bay St. Louis	*Leo W. Seal.
The Citizens Bank of Columbia	N. H. Rankin.
The First National Bank of Jackson	*J. T. Brown.
Missouri:	
Citizens State Bank, Joplin	Stanford Leffen.
The City National Bank & Trust Co., Kansas City.	Rufus C. Kemper.
Commerce Trust Co., Kansas City	*James H. Kemper.
The Peoples Bank of Kansas City	S. M. Schultz.
First National Bank, St. Joseph	G. E. Porter.
The Boatmen's National Bank of St. Louis	Tom K. Smith.
Plaza Bank, St. Louis	F. R. von Windegger.
Montana:	
Security Trust and Savings Bank, Billings	O. M. Jorgenson.
First National Bank, Butte	Andrew J. Davis, Jr.
Nebraska:	
Beatrice National Bank	D. W. Cook.
The Crete State Bank	T. J. Aron.
First National Bank, Lincoln	*P. R. Easterday.
Stockyards National Bank of South Omaha	W. A. Sawtell.
Nevada: The Bank of Nevada, Las Vegas	J. W. Wilson.
New Hampshire:	
Loan & Trust Savings Bank, Concord	Ray W. Pert.
Piscataqua Savings Bank, Portsmouth	*E. C. Matthews.
New Jersey:	
National State Bank, Newark	W. P. Stillman.
Bank of Passaic & Trust Co	T. E. Prescott.
The Trenton Banking Co	C. S. Green.
New Mexico:	
The Farmers and Stockmen's Bank, Clayton	F. H. Chilcote.
The First National Bank of Santa Fe	Geo. M. Bloom.
New York:	
State Bank of Albany	Frederick M. McDonald.
The Industrial Bank, Binghamton	F. G. Belisle.
The Marine Trust Co., Buffalo	Charles Diefendorf.
Bankers Trust Co., New York	*S. Sloan Colt.
The Chase National Bank, New York	*Percy J. Ebbott.
Central Hanover Bank & Trust Co., New York	*William S. Gray.

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New York—Continued	
Irving Trust Co., New York	*Wesley Lindow.
J. P. Morgan & Co., New York	*Russell C. Leffingwell.
National City Bank of New York	W. Randolph Burgess.
North Carolina:	
The Durham Bank & Trust Co	George W. Hill.
The Wachovia Bank & Trust Co., Winston-Salem.	R. M. Hanes.
North Dakota:	
The First National Bank, Grand Forks	Fred R. Orth.
The First National Bank, Williston	C. M. Lund.
Ohio:	
The Central Trust Co., Cincinnati	Charles W. Dupuis.
The Cleveland Trust Co	*George Gund.
The City National Bank & Trust Co. of Columbus.	John H. McCoy.
Potters Bank & Trust Co., East Liverpool	G. E. Starkey.
Oklahoma:	
The First National Bank, Bartlesville	W. C. Smoot.
First National Bank, Chandler	E. C. Love.
First National Bank, Enid	A. F. Butts.
National Bank of Tulsa	A. E. Bradshaw.
Oregon: The United States National Bank of Portland.	E. C. Sammons.
Pennsylvania:	
The National Deposit Co. of Arnold	*W. R. Gott.
The Farmers National Bank of Beaver Falls	Ernest Richardson.
Bethlehem National Bank	F. T. Beckel.
Bristol Trust Co	Emil Metzger.
First National Bank, Carbondale	A. P. Wells.
First National Bank, Coaldale	Even Evans.
East Stroudsburg National Bank	T. J. Breitwieser.
Citizens Banking Co., Oil City	E. C. McFate.
Central Penn National Bank of Philadelphia	*C. A. Sienkiewicz.
Corn Exchange National Bank & Trust Co., Philadelphia.	*David E. Williams.
Philadelphia National Bank	Geo. B. Kneass.
The Philadelphia National Bank	Frederic A. Potts.
Colonial Trust Co., Pittsburgh	C. A. McClintock.
Rhode Island: The Industrial Trust Co., Providence.	Earnest Clayton.
South Carolina: The South Carolina National Bank, Greenville.	C. H. Marriner.
Tennessee:	
American National Bank & Trust Co., Chattanooga.	E. Y. Chapin, Jr.
Citizens Bank, Elizabethton	R. C. Turrentine.
Texas:	
The American National Bank, Austin	E. R. L. Wroe.
Security State Bank & Trust Co., Beaumont	*Otis E. Fuller.
Corpus Christi Bank & Trust Co	A. E. Dabney, Jr.
Zavala County Bank, Crystal City	A. O. Williams.
Citizens State Bank, Dalhart	*Lon C. McCrory.
Mercantile National Bank, Dallas	Milton F. Brown.
First National Bank, Eldorado	J. B. Christian.
State National Bank, El Paso	George G. Matkin.
The Fort Worth National Bank	R. E. Harding.
First State Bank, Gainesville	F. Morris, Jr.
First State Bank, Gladwater	Ernest O. Hearn.
Citizens National Bank, Hillsboro	A. L. Smith, Jr.
The Hampton Oaks State Bank, Houston	F. L. Pryor.
Temple National Bank	J. E. Woods.
Vermont:	
Barre Trust Co	Fred H. Rogers.
National Bank of Newport	R. W. H. Davis.
The Killington National Bank of Rutland	*C. A. Perkins.

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Virginia:	
Citizens Bank & Trust Co., Charlottesville	W. H. Robertson.
Peoples National Bank, Lynchburg	*Scott Nesbit.
The Seaboard Citizens National Bank, Norfolk.	Abner S. Polk.
The Bank of Virginia, Richmond	T. C. Boushall.
Washington:	
First National Bank of Renton	O. K. Moody.
National Bank of Commerce, Seattle	Maxwell Carlson.
Puget Sound National Bank of Tacoma	Reno Odlin.
Vashon State Bank	Howard A. Hansen.
West Virginia:	
Citizens National Bank, Martinsburg	B. F. Fulk.
The Wheeling Dollar Savings & Trust Co	H. E. Laupp.
Wisconsin:	
The Beloit State Bank	A. B. Adams.
American National Bank & Trust Co., Eau Claire.	Richard J. Lewis.
Bank of Green Bay	W. T. Hagen.
The City Bank & Trust Co., Milwaukee	William B. Frank.
Marine National Exchange Bank, Milwaukee	Eliot G. Fitch.
First National Bank of Oshkosh	Louis Schriber.
Wyoming:	
The Casper National Bank	Robert Grieve.
American National Bank, Cheyenne	* R. J. Hoffmann.
First National Bank, Rawlins	Robert Bible.

STATE BANKING COMMISSIONERS

Brooks Glass, superintendent of banks, Montgomery, Ala.
David O. Saunders, superintendent of banks, Phoenix, Ariz.
S. J. Dean, bank commissioner, Little Rock, Ark.
*Maurice C. Sparling, superintendent of banks, San Francisco, Calif.
*Frank E. Goldy, State bank commissioner, Denver, Colo.
*Richard Rapport, bank commissioner, Hartford, Conn.
John C. Darby, State bank commissioner, Dover, Del.
Clarence M. Gay, State comptroller, Tallahassee, Fla.
A. P. Persons, superintendent of banks, Atlanta, Ga.
*E. F. Haworth, commissioner of finance, Boise, Idaho.
*Benjamin O. Cooper, auditor of public accounts, Springfield, Ill.
Joseph McCord, director, department of financial institutions, Indianapolis, Ind.
N. P. Black, superintendent of banking, Des Moines, Iowa.
B. A. Welch, bank commissioner, Topeka, Kans.
Henry H. Carter, commissioner of banking, Frankfort, Ky.
J. S. Brock, State bank commissioner, Baton Rouge, La.
Homer E. Robinson, bank commissioner, Augusta, Maine.
J. Millard Tawes, bank commissioner, Baltimore, Md.
T. J. Donovan, commissioner of banks, Boston, Mass.
Maurice C. Eveland, commissioner of banking, Lansing, Mich.
Charles M. Wenzel, acting commissioner of banks, St. Paul, Minn.
C. T. Johnson, State comptroller, Jackson, Miss.
H. G. Shaffner, commissioner of finance, Jefferson City, Mo.
W. A. Brown, superintendent of banks, Helena, Mont.
*J. F. McLain, director of banking, Lincoln, Nebr.
Grant L. Robison, superintendent of banks, Carson City, Nev.
Clyde M. Davis, bank commissioner, Concord, N. H.
*Christopher A. Gough, acting commissioner of banking and insurance, Trenton, N. J.
Woodlan P. Saunders, State bank examiner, Sante Fe, N. Mex.
*Elliott V. Bell, superintendent of banks, New York, N. Y.
Gurney P. Hood, commissioner of banks, Raleigh, N. C.
John A. Graham, State examiner, Bismarck, N. Dak.
*Paul A. Mitchell, superintendent of banks, Columbus, Ohio.
R. B. Patton, bank commissioner, Oklahoma City, Okla.

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*Arthur A. Rogers, superintendent of banks, Salem, Oreg.
D. Emmert Brumbaugh, secretary of banking, Harrisburg, Pa.
Alexander Chmielewski, bank commissioner, Providence, R. I.
*W. Royden Watkins, chief bank examiner, Columbia, S. C.
Verne W. Abeel, superintendent of banks, Pierre, S. Dak.
H. B. Clarke, superintendent of banks, Nashville, Tenn.
J. M. Falkner, banking commissioner, Austin, Tex.
Roy W. Simmons, bank commissioner, Salt Lake City, Utah.
*Donald A. Hemenway, commissioner of banking and insurance, Montpelier, Vt.
Milton R. Morgan, commissioner of banking, Richmond, Va.
J. C. Minshell, supervisor of banking, Olympia, Wash.
John H. Hoffman, commissioner of banking, Charleston, W. Va.
*G. M. Matthews, commissioner of banks, Madison, Wis.
Norris E. Hartwell, State examiner, Cheyenne, Wyo.

LIFE INSURANCE COMPANIES

Aetna Life Insurance Co., Hartford, Conn	Morgan B. Brainard.
Connecticut General Life Insurance Co., Hartford, Conn.	*Frazar B. Wilde.
Equitable Life Insurance Co., Washington, D. C	Henry P. Blair.
The Investors Syndicate, Minneapolis, Minn	E. E. Crab.
Kansas City Life Insurance Co., Kansas City, Mo	W. E. Bixby.
Massachusetts Mutual Life Insurance Co., Springfield, Mass.	*Alexander T. Maclean.
Metropolitan Life Insurance Co., New York	Leroy A. Lincoln.
National Life Insurance Co., Montpelier, Vt	Ernest M. Hopkins.
New York Life Insurance Co., New York	George L. Harrison.
Pilot Life Insurance Co., Greensboro, N. C	O. F. Stafford.
Postal Life Insurance Co., New York	George Kolodny.
Prudential Insurance Co. of America, Newark, N. J	Carrol M. Shanks.

OTHER FINANCIAL INSTITUTIONS

Dillon, Read & Co., Inc., New York	Charles S. McCain.
Drexel & Co., Philadelphia, Pa	Edward Hopkinson, Jr.
The First Boston Corp., Boston	*James Coggeshall, Jr.
Goldman, Sachs & Co., New York	Walter E. Sachs.
Halsey, Stuart & Co., Chicago	Harold L. Stuart.
Kidder, Peabody & Co., New York	Edwin S. Webster, Jr.
Merrill Lynch, Pierce, Fenner & Beane, New York	Charles E. Merrill.
Morgan, Stanley & Co., New York	Harold Stanley.
National Savings and Loan League Washington, D. C.	Oscar R. Kreutz.
Otis & Co., Cleveland, Ohio	William R. Daley.
Scudder, Stevens & Clark, Washington, D. C	*Paul E. Haney.
Stone & Webster Securities Corp., New York	Edward K. Van Horne.
United States Savings & Loan League, Chicago	Morton Bodfish.
Universal CIT Credit Corp., Detroit	Ernest Kanzler.

OTHER TYPES OF BUSINESS ORGANIZATIONS

American Association of Small Business, New Orleans, La.	Joseph D. Henderson.
American Retail Federation, Washington, D. C	
Amsinck, Sonne & Co., New York	H. Christian Sonne.
Anderson, Clayton & Co., Houston, Tex	W. L. Clayton.
Book-of-the-Month Club, New York	Harry Scherman.
Brownlee, James F., Fairfield, Conn	
Continental, Inc., Seattle, Wash	W. Walter Williams.
Corning Glass Works, Corning, N. Y	Amory Houghton.
Des Moines Register and Tribune, Des Moines, Iowa	Gardner Cowles.

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Eastman Kodak Co., Rochester, N. Y	*Marion B. Folsom.
Encyclopaedia Britannica, Inc., and Muzak Corp., New York.	William Benton.
Federated Department Stores, Inc., Cincinnati	Fred Lazarus, Jr.
Ford Motor Co., Dearborn, Mich	Henry Ford II.
General Electric Co., New York, N. Y	Philip D. Reed.
General Foods Corp., New York	*Clarence Francis.
Hart Schaffner & Marx, Chicago	*Meyer Kestnbaum.
Geo. A. Hormel & Co., Austin, Minn	*E. J. Garrity.
Robert Heller & Associates, Inc., Cleveland	Robert Heller.
Independent Business Council, Baltimore, Md	Clarence Earle.
International Harvester Co., Chicago	Fowler McCormick.
Libbey-Owens-Ford Glass Co., Toledo, Ohio	*John D. Biggers.
Motion Picture Association of America, Inc., Washington, D. C.	Eric Johnston.
National American Wholesale Grocers Association, New York	
National Association of Manufacturers, New York.	Wallace F. Bennett.
National Association of Retail Grocers, Chicago, Ill.	
National Federation of Independent Business, Inc.	C. Wilson Harder.
National Retail Dry Goods Association, New York.	
Smaller Business Association of New England, Inc., Boston, Mass.	S. Abbot Smith.
Smaller Business of America, Inc., Cleveland, Ohio.	S. R. Christopherson.
Smaller Business Men's Association of New York, New Jersey, and Connecticut, New York, N. Y.	Henry Modell.
United Air Lines, Chicago, Ill	W. A. Patterson.
Raymond Rubicam, Scottsdale, Ariz	
Beardsley, Ruml, New York, N. Y	
United States Chamber of Commerce, Washington, D. C.	Herman Steinkraus.

OTHER ORGANIZATIONS

American Farm Bureau Federation, Chicago	*Allan B. Kline.
American Federation of Labor, Washington, D. C	Wiliam Green.
Brotherhood of Locomotive Engineers, Cleveland	A. Johnston.
Brotherhood of Locomotive Firemen and Enginemen, Cleveland, Ohio.	D. B. Robertson.
Brotherhood of Railroad Trainmen, Cleveland	W. P. Kennedy.
Congress of Industrial Organizations, Washington, D. C.	Philip Murray.
Confederated Unions of America, Washington, D. C.	Arthur Sorenson.
Peoples Lobby, Washington, D. C	*Benjamin Marsh.
National Farmers Union, Denver, Colo	James G. Patton.
National Farmers Union, Washington, D. C	Russell Smith, legislative secretary.
The National Grange, Washington, D. C	Albert S. Goss.
Order of Railway Conductors of America, Cedar Rapids, Iowa.	H. W. Fraser.
United Mine Workers, Washington, D. C	John L. Lewis.

LETTER ACCOMPANYING QUESTIONNAIRE

AUGUST 16, 1949.

By direction of Congress, the Joint Committee on the Economic Report has undertaken a comprehensive study relating to the effectiveness and coordination of monetary, credit, and fiscal policies. The general purpose of the study is to

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evaluate the guideposts, objectives, effectiveness, and coordination of these policies in the past and to discover what changes, if any, would promote the purposes of the Employment Act.

A subcommittee composed of Senators Paul H. Douglas, chairman, and Ralph E. Flanders and Representatives Wright Patman, Frank Buchanan, and Jesse P. Wolcott has been appointed to conduct the study. This subcommittee wishes to have the benefit of the best advice that it can get and to consider all points of view. As a part of its program, therefore, it is sending out a questionnaire to a number of people who can contribute to an understanding of these interrelated subjects. You have been selected as one who can make a valuable contribution to the study.

We realize that the enclosed questionnaire covers a wide range of subjects and that to answer all of its questions would be a laborious and time-consuming task and would require a detailed knowledge in many fields. We do not expect all of the recipients of the questionnaire to answer all of the questions. We would, however, appreciate your cooperation in answering as many of them as you can and in returning your answers to this office at your earliest convenience, but by the 15th of September if possible. You are assured that your answers will be fully considered and that they will be highly useful to the subcommittee in conducting hearings and in preparing its report and recommendations. We shall welcome your discussion of any other aspect of monetary, credit, and fiscal policies which you believe to require study and which is not specifically covered by the questionnaire.

It would be a public service if you would give us your best judgment on these subjects, and we would be grateful if you would reply in such detail as you may consider desirable.

The enclosed envelope, addressed to this office, is for your convenience.

Very truly yours,

PAUL H. DOUGLAS.
RALPH E. FLANDERS.

AUGUST 1949.

QUESTIONNAIRE

Your reply will be of maximum assistance to the committee if you will state the reasoning behind your answers to the following questions:

1. What should be the guideposts and objectives of monetary and credit policies. For example, in formulating these policies, what consideration should be given to the behavior of general price levels, to individual prices, to employment, to interest rates, and so on? What are your major criticisms, if any, of the guideposts and objectives of our monetary and credit policies in the past?

2. In formulating its policies, what attention should the Federal Reserve give to interest charges on the Government debt and to the prices of Government securities? What should be the guiding principles for any Federal Reserve actions relating to the yields and prices of Government securities?

3. What changes, if any, should be made in the division of authority within the Federal Reserve System and in the composition and method of selection of the System's governing bodies?

4. What changes, if any, should be made in the standards that banks must meet to qualify for membership in the Federal Reserve System? Should any banks other than national banks be required by law to become members of the System?

5. With its present powers, how effective can the Federal Reserve be in maintaining a high level of employment and relatively stable price levels? What are the principal limitations, if any, on its effectiveness for these purposes?

6. What changes, if any, should be made in the powers of the Federal Reserve in order to increase its effectiveness?

7. What changes, if any, should be made in the reserve requirements of member banks? In the authority of the Federal Reserve to alter member bank reserve requirements? Under what conditions and for what purposes should the Federal Reserve use this power? What power, if any, should the Federal Reserve have relative to the reserve requirements of nonmember banks?

8. What changes, if any, should be made in the power of the Federal Reserve to exercise selective credit controls? Has its regulation of margin requirements on security loans had any undesirable effects? Should it have the permanent power to regulate consumer credit? Should selective controls be applied to any other types of credit? If so, what should be the guiding principles?

9. What changes, if any, should be made in the division of monetary and credit

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control powers between the Federal Reserve and the Treasury? In the methods of coordinating their policies? Would you advocate increasing or decreasing the degree of independence of the Federal Reserve?

10. What changes, if any, should be made in our monetary policy relative to silver? What should be the principal considerations in this policy?

11. Should all of our money, including bank deposits, be freely redeemable in gold coin on demand for all purposes? What would be the advantages and disadvantages of such a policy? Would it lead to hoarding under some circumstances?

12. Under what conditions and for what purposes should the price of gold be changed, if at all?

13. What changes, if any, should be made in the powers and policies of the Federal Deposit Insurance Corporation? In the coverage of deposit insurance? In the basis and rates for deposit insurance premiums? In the commitments of the Government itself to provide financial assistance at any time that the resources of the FDIC might prove to be inadequate?

14. What changes, if any, should be made in the division of the authority to supervise and examine banks? In the objectives and policies of the various supervisory and examining agencies?

15. Under what conditions and for what purposes should the Government or its agencies lend to private borrowers or guarantee loans to private borrowers? What are the advantages and disadvantages of these activities? What are the relative advantages and disadvantages of Government loans to private borrowers as compared with the Government guaranty of private loans?

16. Have the activities of the Government agencies that lend to private borrowers or guarantee private loans been appropriately coordinated with general monetary and credit policies? If not, should the degree of coordination be increased? With respect to what policies? If a greater degree of coordination is desirable how should this be accomplished?

17. What should be the guiding principles of the Government's over-all taxing and spending policies? To achieve an annually balanced budget even though national income and price levels fluctuate? To achieve a surplus at all times in order to reduce its debt? To achieve a defict at all times? To achieve a surplus at some times and a deficit at other times? If the budget should not be balanced annually, what principles should guide the authorities in determining the amounts of the surplus or deficit, and under what conditions should there be a surplus or deficit? Should tax rates be held constant throughout a business cycle or changed as business conditions change? What tax rates, if any, should be flexible? Should the rate of Government spending be varied for the purpose of promoting economic stability? If so, what should be the guiding principles? Is it feasible and desirable to develop automatic guides to fiscal policy? If so, what should they be?

18. What are the principal limitations on the effectiveness of a flexible fiscal policy as an instrument of economic stabilization? What changes in the division of authority and in procedures would increase the effectiveness of fiscal policy for this purpose?

19. What changes, if any, in the Government's debt management policies would promote economic stability? In Treasury policies relative to interest rates? In the types and proportions of securities issued? Should these vary with changes in economic conditions? If so, according to what principles? Under what conditions should the Treasury borrow from the commercial banks? From others? Under what conditions should it seek to retire debt held by the banks? To retire debt held by others?

20. What changes, if any, would you advocate in the methods and procedures for coordinating the Government's monetary, credit, and fiscal policies with each other and with other economic policies?

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CHAPTER XI

ECONOMISTS' STATEMENTS ON FEDERAL EXPENDITURE AND REVENUE POLICIES

A. Federal Expenditure and Revenue Policy for Economic Stability

(A statement drafted and unanimously approved by the NPA Conference of University Economists September 16–18, 1949, Princeton, N. J.)

Introduction

Although our economic system accords a dominant role to private enterprise, Government expenditures and receipts have now reached a scale that make them crucially important factors in our national welfare. In 1949, with a gross national production of 250 billion dollars, the Federal Government is spending more than 40 billions, while Federal, State, and local governments together are spending around 60 billions.

Government programs of this size make it more than ever desirable that every dollar of Government expenditures be used as efficiently as possible. We are not rich enough to afford waste of resources by Government any more than by anyone else.

It is equally important that the expenditure and revenue programs of Government, in their formulation and execution, be consistent with the progress and stability of the private economy. The fiscal policy of the Government must make useful positive contributions to the maintenance of high levels of employment and income—the goals declared in the Employment Act of 1946 to be a national objective.

Government affects business through both sides of its budget. Payments to Government employees, bondholders, veterans, the aged, and the needy all constitute income that can be used to buy consumption goods from business; Government procurement affords a direct market for business. On the other side of the budget, taxes capture funds that consumers might have spent or that business firms might have invested in improved facilities. Taken by themselves, tax collections tend to shrink the market of private business, contract employment, and lower prices; just as, taken by themselves, Government expenditures tend to expand the market for business, increase employment, or raise prices.

It is not only the size of revenue and expenditure that counts; their composition must also be considered in any appraisal of the effects of Government policy. The economic effects of a billion dollars collected in the form of income taxes will be different from those of a billion dollars collected in excise taxes. Spending to build roads may stimulate private investment in automobiles, trucks, and garages;

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there are other forms of expenditure that may have adverse effects on private investment. Rationally or irrationally, Government spending and taxing may greatly affect the climate within which families and businesses make their decisions.

The principle of an annually balanced budget

The traditional goal of fiscal policy was to secure a balanced budget in every single year. But that objective has now proved impracticable and, besides, has serious disadvantages in principle. There is not even a clear or unique concept of "budget" to which the requirement of balance could be applied. For instance, in the regular budget, bookkeeping transfers to the social security trust account are classified as expenditures. As a result of this, that budget may show a deficit at a time when the cash budget shows an excess of receipts over outgo. But even the cash budget may not be adequate to portray the effects of fiscal policy; taxes may have their impact when tax liabilities are incurred rather than when payment is made; purchases may have their impact when contracts are entered into rather than when disbursements are made. However, where a single budget concept is used in economic analysis bearing on stabilization policy we prefer the cash budget to any available alternative.

Compared to the full span of the business cycle, a year is a short period of time. To insist upon a balance in every single year is certainly undesirable and to attain it is probably impossible. To attempt to raise tax rates every time there is a decrease in national income will only result in discouraging private consumption and investment at a time when these are most in need of expansion; on the other hand, to try to eliminate a tax surplus by cutting tax rates or expanding Government activities would serve to increase inflationary pressures at a time when they are already acute.

If the budget were balanced in good years as well as bad, there would have to be either big fluctuations in expenditure programs or severe and perverse changes in tax rates. To vary expenditures in this manner would disrupt the essential services provided by Government. Applied to military expenditures, it would mean a large defense program in boom years and a small defense program in depression years. This is both ineffective and wasteful. Government would be increasing its employment of resources when they were scarce and cutting down on their use when they were abundant. This, of course, would aggravate the fluctuations in private business.

The problem of controlling Government expenditures

Annual budget balancing is, thus, both difficult in practice and unsound in principle. But one great merit it does have: it provides a yardstick by which legislators and the people can scrutinize each activity of Government, testing it both for efficiency of operation and for its worth-whileness in terms of cost. Every Government program undertaken has to be paid for in a clear and unequivocal sense. The legislature and the executive are required to justify additional taxes equal to the cost of any new program. This is a principle every citizen can understand. If dropping the principle of annual budget balancing were to mean dropping all restraints to unwise and inefficient expenditure, grave damage would be done to our economic and political system.

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Were expenditures divorced entirely from the need for taxation, political opposition to extension of the Government's expenditure programs would largely disappear. The scale on which the public sector absorbs resources would grow beyond what was really desired by the people as a whole; sooner or later the country would find itself in a state of chronic inflation. Such inflation is a sign of weak government and comes from eagerness to spend without a willingness to tax. Accordingly, other general principles, other habits of thought and of action must be set forward to insure the standards of judgment and the self-discipline of Government's activities and to do better what the principle of annual budget policy attempted—though imperfectly—to accomplish.

Experience shows that business activity has its ups and downs. There is thus a strong case for countercyclical fiscal action—surpluses in good times and deficits in bad. If we do not adopt such a policy deliberately we are likely to be forced into an imperfect version of it through the pressure of events. One of the major questions for the future is how such a policy can be administered with the restraint and efficiency that is supposed to be achieved through the balanced-budget rule. If a flexible policy is to win acceptance, it must not be used as an excuse to introduce expenditure or tax programs that cannot be justified on their merits. Boondoggling should have no place in a rational fiscal program.

We doubt whether it would be possible, or even desirable, to rely exclusively on fiscal action to offset fluctuations in private business. That course could easily involve changes of impractical magnitudes in taxes and expenditures; it would mean placing excessive reliance on one measure for achieving economic stability and growth; it would involve problems in forecasting beyond the reach of present knowledge and techniques.

We can, however, reasonably expect that the budget be formulated in the light of economic judgment available that takes full account of the actual course of events and should contribute to economic stability rather than aggravate instability. In view of uncertainties, part of the planning process should be preparation for quick adaptation of fiscal operation to changing circumstances. Certain automatic devices for bringing remedial forces quickly into play are in a stage where they deserve consideration.

Guides to fiscal policy in normal times

When the economy is prosperous and stable and there is no clear-cut reason to expect a change in any particular direction, the objective of policy should be to adapt the budget to changes in the Government's requirements but to leave its economic impact on total employment and purchasing power unchanged. This could be approximately achieved if newly planned increases or decreases in expenditures were to be matched with corresponding changes in planned tax receipts. The net expansionary or contractionary effect of the budget would then remain roughly the same. Thus, in conditions of continued prosperity, a modified version of the balanced budget rule could be used as a guide: taxes should grow or shrink corresponding to desired changes in expenditures. Thus proposed increases in expenditures would be exposed to the traditional test of whether they are worth their cost in terms of taxes.

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However, if recent events and the outlook for the near future pointed, on balance, toward unemployment and deflation in the private sector of the economy, then budgetary changes should be made in the direction of producing a moderately expansionary effect. New Government expenditure programs should still be considered on their merits, but the additional taxation that in prosperous times would accompany them should now be deferred. Taxes that are deferred in these circumstances should be put into effect as soon as that can be done without impeding recovery. There should be no delay in making the tax reductions warranted by any reductions in Government expenditures; and if expenditure requirements are expected to decline in the future, anticipatory tax reductions could be enacted.

On the other hand, if the weight of the evidence appeared to be on the inflationary side, the opposite policy should be followed. The rule that increased expenditures should be accompanied by increased tax yields should be rigidly followed. Tax reductions that would normally be in order should be deferred; and tax increases should anticipate expected increases in expenditures.

Guiding principles in time of acute recession or boom

Where there is a definite expectation, justified by events, of serious recession or inflation, more strenuous fiscal measures would be called for, and the policies described above should be supplemented by emergency fiscal action.

In the event of severe recession, it is not only politically necessary, but economically desirable to provide additional employment projects that can be started and ended quickly. Temporary tax relief should be given in order to stimulate private spending and employment. Other incentives for private investment, such as guaranties, should be considered. There can be no social or economic justification for allowing mass unemployment to persist for extended periods at a time when there is abundant need for roads, schools, hospitals, and other useful objects of public expenditures. However, we recognize that there are difficult questions of extent and timing connected with any such program. An overambitious Government program may impede the course of recovery in the private sectors of the economy by dislocating resources and delaying needed price adjustments. On the other hand, a program that was overcautious could needlessly fail to advance recovery by not stimulating the demand for the products of private industry. Much skill and judgment are required to move from depression to stable prosperity. We must not rely on the private economy, unaided by Government action, to perform that task. The Government must not shirk the responsibility placed upon it by the Employment Act, and fiscal policy is one of the most promising instruments it possesses.

On any occasion when serious inflation is in prospect, emergency measures would be needed to curtail expenditures and increase taxation. Wartime and postwar experience provides convincing evidence that the political obstacles to a fiscal policy adequate to combat inflation are so great that there is little practical danger of going too far. The survival of a relatively free and stable price system depends heavily on our willingness to fight inflation by fiscal methods.

A policy that helps to maintain stable prosperity will be no more likely in practice to result in an upward trend in the national debt

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than one that does not. The course of events may in fact be such that stabilization requires steady reduction in the debt. Budgeting surpluses to fight inflation will provide for the reduction of the public debt in a helpful rather than a painful fashion. Surpluses are not feasible in times of depression. They are desirable where the private economy is strong enough for the Government to tax more than it spends without causing unemployment. The private economy is not likely to possess this strength if Government policies aggravate rather than offset business fluctuations.

Additional possibilities for a flexible fiscal policy

While we consider these guides for budget policy essential to a stabilization program, the annual budget cannot, in the nature of things, be based on precise forecasts; nor can it be expected to compensate for sudden and short-run fluctuations in business that occur within the period of its operation. Even though the budget can and should be amended in the light of changing circumstances, the legislative process is necessarily too cumbersome to make delicately timed adjustments in fiscal policy. Therefore, we consider whether further flexibility can be achieved by two devices which may be called "automatic flexibility" and "formula flexibility."

"Automatic flexibility" means a tax system such that revenue under a given set of tax rates will fall sharply if unemployment develops, and rise sharply in the opposite case of inflation; and expenditure programs under which increased outlays arise from increased unemployment.

"Formula flexibility" means a system under which preannounced tax cuts and upward revisions of spending programs will come into force if unemployment exceeds a certain figure or production falls below a certain level, and preannounced changes in the opposite direction if price indexes rise at more than a certain speed.

Automatic flexibility

Automatic flexibility is exemplified by the unemployment compensation system. If unemployment increases, employers' contributions at once decline, while the unemployed begin almost immediately to draw more in benefits. Thus the Government finds itself automatically taking less money out of the public's pockets and putting more in.

There are now many such flexible elements in Federal taxes and revenues; and they have greatly increased in importance with the growth of the budget. Besides the unemployment compensation system, there is, for example, substantial automatic flexibility in personal and corporate income taxes.

Automatic flexibility can slow down and perhaps halt a decline of activity or a rise of prices; it can give time for restorative forces to come into play, but it will not, by itself, pull activity back to a full-employment level or restore prices to a preinflation level.

We feel strongly that the existing automatic flexibility makes an important contribution to economic stability, which should not be frittered away, as it would be, for instance, by rigid application of the annual-balanced-budget rule. But we do not believe it prudent for policy to regard automatic flexibility as more than a first line of defense; more must be done to cope with serious economic fluctuations.

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Formula flexibility

The enactment by Congress of rules under which tax rates, and perhaps of rules under which expenditure programs, will shift in certain contingencies specified in advance is a possibility that deserves further exploration. For example, the period during which unemployed workers can drawn unemployment compensation might be extended according to a flexible schedule based on the volume of unemployment. The withholding rate under the personal income tax for any calendar quarter might rise by a stated amount above a standard rate whenever, say, the index of retail prices has increased by over a certain amount in the preceding 6 months. The withholding rate might be lowered whenever standard indices of production and employment drop below stated levels or trends.

The question of formula flexibility shades off into the question of granting to the Executive wider discretionary authority than it now possesses to initiate changes in the timing or extent of the fiscal program. This raises difficult issues of political principle and administrative responsibility. We can here do no more than call attention to them.

Conclusion

In this statement, we have confined ourselves to fiscal policy of the Federal Government. But, while essential, that is only one element in a stabilization policy. The policies of State and local governments can make useful contributions within their more limited spheres. Monetary and credit policies including debt management must play an active role in their own right and must be properly coordinated with fiscal policy. All necessary measures must be taken to preserve and stimulate competition. Supported by such measures, Federal fiscal policy offers the best prospect of achieving sustained prosperity within the framework of our existing economic system.

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B. Fiscal Policy in the Near Future

(A statement drafted and unanimously approved at the NPA Conference of University Economists September 16–18, 1949, Princeton, N. J.)

At present (September 1949) the economy exhibits no clearly discernible swing—either toward a resumption of inflation or toward increasing unemployment—which would call for a major change in tax rates or expenditures. If any substantial change were made, it might accentuate an inflationary or deflationary movement in 1950 instead of countering it.

Past decisions on taxes and commitments on expenditures have resulted in a current deficit in the cash budget. We regard those decisions as unfortunate, in particular the decision in 1948 to reduce taxes; it would have been the course of sound policy to have revenues exceeding or, at the least, equaling expenditures at the present level of business activity. The latter, if lower than levels of a year ago, is still high and a modest cash surplus at the present time would probably be consistent with stability. But it is one thing to deplore past mistakes and another to correct them on short notice. It would be unwise to increase taxes at this time. Such action might in itself be unduly deflationary. There is a possibility that the step might soon have to be reversed to counter a business downturn. While we do not doubt that there are expenditures that can and should be reduced—and we do not regard those of any agency or department as sacred—this reduction must be part of a constant and continuing effort. Economy efforts cannot be turned on and off at will.

Although no major change in fiscal program is indicated for the immediate future, the country should have positive assurance that the Government will be prepared to act promptly either if prices should display a sharp and continuous upward swing, or if unemployment should increase substantially. Congress should plan ahead and announce the actions to be taken in either contingency. It should enact preliminary legislation to be effective when needed.

Congress should act in case of a decline in activity involving a genuine increase in unemployment of more than 1½ million persons above present levels. (This would mean total unemployment of about 5 million according to present methods of computation.) The extent, combination, and sequence of its actions should depend upon the severity of the recession.

The appropriate steps include, first, the repeal of the special wartime excise taxes. These taxes were enacted for various special reasons during the war and are not appropriate to peacetime. A second step is the temporary abatement of the lower bracket rates or a temporary increase in the exemptions of the personal income tax. This should

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be done according to prearranged legislation to become effective when economic activity declines to a specific level. The revenues from other taxes would be allowed to decline, without a change in rates, as business activity fell off. If these actions were insufficient, additional measures should be taken.

The period of unemployment benefits might be temporarily lengthened, with appropriate provisions for Federal reinsurance of the emergency risks. The plan to do this should be arranged and announced in advance so that workers could count on this protection. By this measure, the system of unemployment compensation would be made adaptable to its differing role in times of prosperity and in times of depression.

Public works might be expanded. The Congress should already have arranged for a stand-by shelf of planned and ready-to-start projects, including Federal assistance for State and municipal projects. We approve the principle, expressed in pending legislation, of a shelf of public works. We recommend the prompt enactment of legislation to this end. On the shelf would be only projects that are economically desirable, and that can be started promptly when the need for additional governmental spending arises, and completed or stopped promptly when this is no longer needed. Examples of projects of this nature are road construction, residential housing, and construction and rehabilitation of public buildings.

Should there be a resumption of inflation, marked by a persistent upward surge of prices in general, Congress should be prepared to take effective counteraction. In this case increase of lower-bracket rates or lowering of exemptions in the personal income tax would be in order. Repeal of the wartime excise taxes might appropriately be postponed. If these taxes were already repealed, or their repeal were deemed necessary for reasons of equity, they should be replaced by equivalent sources of revenue. Finally, such inflation would be an occasion for strong measures to reduce public expenditures. To cite specific examples, the starts of civil public works of all categories should be held to the practical minimum. The test should be whether there is serious economic loss from delay. Military construction should also be closely measured against the urgent present needs of the armed forces. Large farm benefits, either through support prices or in the guise of soil-conservation payments, should not be tolerated at a time when, in any case, farm income is likely to be high.

Tax reform

A time like the present when no emergency exists should not be allowed to go by without consideration of fundamental tax reform. This has two sorts of relation to stabilization policy: (1) Adjustment of the tax structure so as to make private business more nearly self-stabilizing—for instance, by providing more complete averaging of losses and gains; (2) planning tax measures whose impact will be stimulating or depressing so that they can go into effect at times when short-term policy calls for additional stimulants or depressants. For example, if we are to move toward integration of corporate and individual income taxes in a way which would reduce revenue, the effective date would appropriately come in depression.

It is now, and doubtless always will be, impossible to forecast, more than a year in advance, the revenue-expenditure policies best suited to varying economic conditions. It is our final recommendation that

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Congress be prepared, both now and in the future, to make prompt alterations in the policies adopted for any fiscal year. It must be recognized that this will involve important changes in the organization and procedures of Congress for fiscal management.

SIGNERS

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